THE INDONESIAN GOVERNMENT PROCUREMENT SYSTEM: TOWARDS MULTILATERAL GOVERNMENT PROCUREMENT SYSTEM

By

Dwi Wahyuni Kartianingsih

A THESIS

Submitted to
KDI School of Public Policy and Management
In partial fulfillment of the requirements
For the degree of

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ABSTRACT

THE INDONESIAN GOVERNMENT PROCUREMENT SYSTEM: TOWARDS MULTILATERAL GOVERNMENT PROCUREMENT SYSTEM

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Dwi Wahyuni Kartianingsih

The procurement of goods and services for the government of the Republic of Indonesia is an important part of the efforts to achieve objectives and programs of development in accordance to national development planning. This paper examined the primary Indonesian Government Procurement regulation, titled "The Decree of The President of the Republic of Indonesia No. 18 Year 2000 Concerning Guidelines for The Implementation of The Procurement of Good and Services for Government Agencies". It is generally perceived that this procurement system is transparent and much in line with standards set by the international rules that are adopted in the WTO Government Procurement Agreement. However, despite the obligation under the most-favored-nation principle, the priority of the current Indonesian Government Procurement System is still to maximize the use of domestic products and services. From the multilateral perspectives, considering WTO as international rule, Indonesia has to emphasize fairness and non-

discrimination in the process of procurement of goods and services for all participants, regardless local or foreign bidders. But it seems to contradict with what are stipulated in the current regulation. The system explicitly states that one of the objectives for the government procurement policies is to "increase the use of domestic production, design and engineering with the aim of expanding domestic employment and national industries." Therefore, on the basis of the WTO rules, this regulation can be viewed as a protectionist rule to favor the domestic procedures. Therefore, Indonesia has to consider the WTO procurement system to fully incorporate the multilateral disciplines on government procurement in the future. However, the Indonesian government appears to take the position that government procurement systems should be an important instrument of national development, and therefore it should reserves its right to maintain this role.

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TABLE OF ABBREVIATIONS AND RELATED DEFINITIONS

APBD	The Regional Government Budget. The Indonesian abbreviation for Aggaran dan Pendapatan Belanja Daerah.
APBN	The Central Government Budget. The Indonesian Abbreviation for Anggaran Pendapatan dan Belanja Negara.
ASEAN	Association of South East Asian Nations, presently comprised of Brunei, Indonesia, Malaysia, Philiphines, Singapore, Thailand, Vietnam, Cambodia, Myanmar and Laos.
Contracting Parties	A country that was a party to GATT 1947.
Contracting Party	All of the countries that were members of GATT 1947 acting together.
DIP	A Project Allocation Budget. The Indonesian abbreviation for Daftar Isian Proyek.
DPR	The People's Legislative Assembly. The Indonesian abbreviation for Dewan Perwakilan Rakyat.
DSU	Dispute Settlement Understanding, i.e., the 1994 Uruguay Round Understanding on Rules and Procedures Governing the Settlement of Disputes. The DSU is one of the Multilateral Trade Agreements.
GATS	General Agreement on Trade in Services, one of the Multilateral Trade Agreements.
GATT	General Agreement on Tariffs and Trade.
GATT/WTO system	A generic term encompassing all pre and post Uruguay Round legal instruments and institutions, namely, GATT 1947, WTO Agreement, Multilateral Agreement, and GATT and WTO as institutions.

GDP	Growth Domestic Product.
GOI	Government of Indonesia.
GPA	Government Procurement Agreement.
m	The margin of price preference.
MFN	Most Favored Nation.
Multilateral Agreement	According to Article II.2 of the WTO Agreement, and Annexes 1,2 and 3 to this Agreement, The Multilateral Agreements are the Multilateral Agreements on Trade in goods, plus the GATS, TRIPs, DSU, and Trade Policy Review Mechanism.
NAFTA	North American Free Trade Trade Agrrement of 1993, the parties to which include Canada, Mexico, and the U.S.
OECD	Organization for Economic Cooperation and Development, created in 1961 pursuant to a 1960 convention and headquartered in Paris.
P	Relative Price of goods.
Pg	The price paid by the Government.
Plurilateral Agreement	The Agreements and associated legal instruments reached during the Uruguay Round that entered into force on Jan. 1, 1994, but which have been accepted only by some Members. This is plurilateral agreement, which is binding only on the Members that accept it.
Pw	The world price (plus domestic duties).
Q	Output of goods.
R & D	Research and Development.

SMEs	Small and Medium size Enterprises.
TRIPs	Uruguay Round Agreements on Trade-Related Aspects of Intellectual Property Rights.
WTO	The World Trade Organization. Located in Geneva, Switzerland, established on Jan.1. 1995.

PART I

INTRODUCTION

There is no agreed definition of "government procurement". The term is generally used to cover the activity of government or their subsidiary agencies in purchasing goods/services for their own purpose, using money allocated to them from budgetary resources or from money received under bilateral or international aid programs. Every country has a wide variety of ideas as to what is the appropriate sphere of government activity.[1] For very reason, government procurement at central and sub-central levels and state-owned enterprises usually deals with very significant amounts of goods/services; these markets represent huge opportunities for international trade.

Indonesia is the largest ASEAN country with a population of about 200 million. Like other countries in the world, governments and their subsidiary agencies are the largest purchasers in the economy. These covers the full range of defense materials, items needed for infrastructure projects, research and development programs, and several of the pure industrial needs

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[1] Jackson, John H., *The World Trading System, Law and Policy of International Economic* Relations, 2nd edition, Massachusetts Institute of Technology, 1997.

categorized under "strategic industries". These industries include steel making, shipbuilding, aircraft assembly, some electronics and communications manufacturing.

The government of Indonesia recently enacted the procurement regulation, called " The Decree of The President of the Republic of Indonesia No. 18 Year 2000 Concerning Guidelines for The Implementation of The Procurement of Good and Services for Government Agencies". This regulation is substantially revised compared with previous one that has been operated from 1994. However, it is far from perfect. Although it is nevertheless believed that this procurement system is transparent and much in line with standards set by the WTO Government Procurement Agreement.

In fact from the foreign companies' points of view, there are some problems in the implementation of the Indonesian government procurement system, such as: the system requiring local participation and content that in many situations, impedes foreign companies' abilities to compete in the market. Moreover, non-transparent government policies have also rendered competition difficulties. Concerns, in particular, have been focused on the engineering and construction industries. This condition is proved by what John H. Jackson said in his book "The World Trading System", that the

process of government procurement is, however, unlike private contracting, in that governments often use their large purchasing power as a tool to promote various domestic political, social, and economic policies. These purposes of government procurement contracting lead to the adoption of a wide range of measures that qualify the objective of obtaining the best products or services at the lowest price.[2]

From the view of points of the Indonesian Government, as stated on Presidential Decree No. 18 year 2000 that one objective of the government procurement policy is to increase the use of domestic production, design and engineering with the aim of expanding domestic employment and national industries. This is in order to ensure that the "best value" for money spent is obtained in procuring goods and services. This system requires the purchasing agencies to give preference to domestic producers of industrial policies, for example, the encouragement of small and medium-size enterprises; and social objectives, in case of purchases from firms controlled by women.[3] This is the trend of current practice of government procurement in developing countries.

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[2] Trebilcock, Michael J. and Howse, Robert, *The Regulation of International Trade,* 2nd edition, London, Routledge, 1999.

[3] Rege, Vinod, *Transparency in Government Procurement: Issues of Concern and Interest to Developing Countries*; Journal of World Trade 35 (4): 489-515, 2001.

Based on both conditions, national objectives and international restriction, both sides seem very contradictive. Moreover, in every WTO Round, issues in government procurement have always been brought in agenda. Particularly, issue of plurilateral on Government Procurement Agreement has been a big issue between developed and developing countries, where Indonesia is one of it. While issue of transparency in government practices is taken into account national policies.

Therefore this paper aims to examine the current practices of the Indonesian Government procurement regulation, which is in one side standing by as protectionist rule, but in other side, in conflict with the international restriction. This paper is divided into six sections following this introduction. First, I will present a broad overview of the Indonesian Government procurement regulation, where we can see basic principles and procurement practices in Indonesia. In second part, the focus is on the government procurement as protectionist rule. In the third part, the government procurement in the GATT / WTO system is presented. It contains broad overview of the General Agreement of Tariffs and Trade (GATT), Agreement on Government Procurement (GPA), and General Agreement on Trade in Services (GATS). While in the fourth part, some issues related to government

procurement in the WTO system will be described. In the fifth part, I try to analyze the current Indonesian government procurement system in the view of economic aspect and international rule. It is necessary to see how the implication of WTO government procurement system for Indonesian Government Procurement System is used and some problems that could arise if Indonesia would apply to international rules. Finally, conclusion and the corresponding suggestions are given in the last part.

PART II

BROAD OVERVIEW OF THE INDONESIAN GOVERNMENT PROCUREMENT REGULATION

1. General Procurement Policies

The primary objective of the Indonesian government procurement system is to acquire needed public goods and services in sufficient quantity, with accountability quality and at an accountability price. This objective can most effectively be achieved by encouraging a greater number of contractors to compete for government contracts. The Government's procurement regulations aim to foster effective, broad-based competition to maximize fairness and efficiency. Other important objectives of the system are to promote utilization of domestic products and professional services; to strengthen the capabilities of domestic contractors; and to create an environment to nurture the growth and development of economically weak contractors and cooperatives.

Indonesia primary procurement regulation is "The Decree of The President of the Republic of Indonesia No. 18 Year 2000 Concerning Guidelines for The Implementation of The Procurement of Good and Services

for Government Agencies", in short, Presidential Decree 18/2000. It has been issued on February 2000 as the new technical guidelines for government procurement of goods and services. This decree substantially was revised from the previous one issued in 1994, which is called Presidential Decree No. 16 year 1994. Key points of this regulation are emphasis on domestic sourcing, new ethics guidelines for procurement officials, set asides for small and medium size enterprises (SMEs), and special rules for consulting services.

Furthermore, the Presidential Decree 18/2000 governing all procurement of goods and services which is financed, in whole or in part, out of official government budgets, including for state-owned enterprises.[4] The decree also covers procurement of goods and services that are financed by overseas grants and loans to the extent the provisions of the relevant donor agency.

2. Basic Principles

The procurement of goods / services within Indonesian Government

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[4] Note: state-owned enterprises in Indonesia frequently finance their procurement internally without resorting to government budgetary outlays. The Presidential Decree No. 18 Year 2000 applies to state-owned enterprise procurements that are financing in whole or in part by the government budget.

Agencies must be implemented in line with the following principles: (1) Efficient, meaning that the procurement of goods / services must be conducted with the use of limited funds and resources in order to achieve the stipulated target in the shortest possible period of time and in an accountable manner; (2) Effective, meaning that the procurement of goods/services must be in accordance with the need stipulated and can provide the largest possible benefit in accordance with the goals determined by the government; (3) Competitive, meaning that the procurement of goods/services must be conducted through tender/selection and fair competition among providers of goods/services of equal standing and meeting certain requirements/criteria based on clear and transparent provisions and procedures; (4) Transparent, meaning that all provisions and information concerning the procurement of goods/services, including the required technical procurement administration, evaluation procedures, appointment of prospective providers of goods/services, shall be open to all interested participating providers of goods/services (participants of Public Tender, Direct Selection, Direct Appointment) and to the public at large; (5) Fair/Non-discriminatory, meaning the granting of equal treatment to all prospective providers of goods/services without the tendency to give advantage to certain parties, in any manner and

under any pretext what so ever; (6) Responsible, meaning that the target must be achieved physically, financially as well as benefit-wise for the sake of fluent performance of general government duties and public service in accordance with the principles prevailing in the field of procurement of good/services.[5]

3. Procurement Practices

The Indonesian Government is divided into three separate levels: the central (State) government, provincial governments, and the *kabupaten* (county) governments. The state government comprises: Departments, State Ministers, Coordinating Ministers, Non-Departmental Agencies, and other State institutions. The government procurement system is highly decentralized: line departments generally procure their own needed goods and services in accordance with the State budget coordinated by the Department of Finance and The National Development Planning Agency (Bappenas). Each year, the Ministry of Finance and the National Development Planning Agency (Bappenas) coordinate the efforts of all governmental units to prepare budgets for the central and regional levels of government. The

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[5] Cabinet Secretary of The Republic of Indonesia, *The Decree of the President of The Republic of Indonesia No. 18 Year 2000, Concerning Guidelines for the Implementation of The Implementation of The Procurement of Goods/Services for Government Procurement,* Article 3, State Gazette of The Republic of Indonesia Year 2000 number 15.

central government budget is referred to as "APBN". The regional government budget is referred to as "APBD." Each January, the President of the Republic of Indonesia presents a consolidated budget to the People's Legislative Assembly (or "DPR" the Indonesian abbreviation of Dewan Perwakilan Rakyat) for review and approval. When approved, the budget funds those activities for a one-year period commencing 1 April and ending 31 March of the following year.

A Project Allocation Budget (or "DIP" the Indonesian abbreviation of Daftar Isian Proyek) issued by the Ministry of Finance, Directorate General of Budgets authorizes Indonesian procurement agencies to commence the process to acquire needed public good or services. Each implementing agency may, within the framework of the National Development Plan and the DIP, acquire needed public goods or services.

In the departments, purchases are carried out by a Procurement Committee supported by a Project Manager appointed by the department. A Tender Committee assists the Project Manager.

The Project Manager is responsible for procurement planning, coordinating preparation of a statement of work and an owner's estimate, and determining the type of contract and whether to conduct the procurement

competitively. Line departments have considerable authority to select the contractor and manage the project.

Indonesia uses three types of tendering or selection: (1) Public Tender, must be conducted in a way open to the public with broad announcement through the printed media and notice official boards and if possible through the electronic media, enabling interested and qualifying public/ business circles to participate; (2) Direct Selection, shall be in case the tender methods being difficult to be executed or do not guarantee the achievement of the target, implemented using the method of comparing bids of a number of providers of goods / services meeting requirements (at least five qualified bidders) by requesting their quotation or competitive negotiation, conducted both from the technical as well as from the price aspect, resulting in a reasonable price and technical accountability; (3) Direct Appointment, shall be conducted for the procurement of good/service on small scale; or procurement of good/service of which after re-tender only one participant met the requirements; or procurement of urgent specific nature; or sole provider or good/service.[6]

After determining that the bid is fair and met with all requirements, the

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[6] Idle, Article 12.

procurement team may then directly award the tender to that bidder. Under all three methods, after the Tender Committee selects the proposed contractor, the implementing line agency is responsible for preparing a contract.

4. Qualifications and Responsibility of Procurement Officials

The Presidential Decree 18/2000 clearly stated the requirements and qualifications for selecting procurement officers. In doing so, it differentiates between the roles of procurement officers ([7]) with the responsibilities of procurement committees ([8]). Both of procurement officers and committees are bound by set of explicit ethics rules that are listed in the decree. They have some obligations in working professionally and honestly, neither to give nor to receive financial favors with those involved in the bidding, to maintain the secrecy of documents, to prevent unfair competition, to avoid improper influence on the process and prevent conflict of interests at the expense of the state. Nevertheless, the only sanctions in the decree for violation of these ethics guidelines are provisions that violators would be subject to

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[7] It contains: to formulate plans and schedule and determine methods of implementation, to stipulate and endorse estimated prices and to monitor and supervise the realization of the contract.

[8] It contains: to manage the bidding process by preparing tender documents, formulating lists of initial bidders, advertising the tender, evaluation incoming bids and clarifying and stipulating orders on prospective winners.

administrative, civil and criminal penalties. However, the reference in the decree to Indonesia's new Anti-corruption Law No. 28/1999 makes clear that provisions of that law would apply in cases of improper procurement activity. At last, the decree specifically mentioned to prohibit procurement officers from making contract commitments in advance of a budget authorization or making commitments that exceed budget authorization.

5. Qualifications for Suppliers

The Presidential Decree 18/2000 sets specific parameters on contractors that wish to provide goods and services to the government. Contractors are classified by size and contracts are reserved for each group according to the size of the procurement. All contractors should meet a number of general qualifications. They must have proven expertise and capacity to fulfill the contract, must not be under criminal or civil sanction by a court, must not be bankrupt or in arrears on taxes, must not lie about qualifications. Specific rules also apply to companies seeking to provide consulting services. These include being state-licensed or accredited, and having experience in the field of consultancy and able to provide appropriate references.

Moreover, the decree establishes set-asides for SMEs according to the size of the procurement. These set asides are shown in Table 1. Foreign suppliers are restricted to contracts worth over Rp 25 billion.

Table 1: Set Asides for Providers of Goods and Services under GOI Presidential Decree No. 18/2000 (values in rupiah)

Type of contractor	Contracting out services	Goods/Services	Consulting Services
Small-scale/or Cooperatives	< 1 billion	< 500 million	< 200 million
Medium	1 billion – 10 billion	500 million – 4 billion	200 million – 1 billion
Large	> 10 billion	> 4 billion	> 1 billion
Foreign Supplier	> 25 billion (*)	> 10 billion (*)	> 2 billion (*)

* Contracts over this limit require the winning contractor, foreign or domestic, to cooperate with a small or medium scale company cooperative in the implementation of the contract.

6. Domestic Preferences

In keeping with the explicit policy goal of "increasing the use of domestic production capacity, design and engineering talent" in government procurement, the decree sets out explicit requirement for the use of domestically sourced material or labor for government supply contracts. It also provides for a price preference of 15 percent for domestic goods and 7.5 percent for contract services above the lowest bid from a foreign bidder. In

addition to the price preference, the decree requires procurement contracts to specify the use of domestic production wherever possible. Procurement of foreign goods is only authorized in cases in which the goods in question are not produced domestically or the technical specifications of the domestic products fail to meet set standards or the foreign bid is lower than the domestic bid by more than the price preferences set out above. In addition, government institutions are instructed to draw up special provisions for obtaining procurement from small-scale enterprises and cooperatives in coordination with the Ministry of Cooperatives and Small and Medium Enterprises.

7. Special Provisions for Procurement of Consulting Services

Beside the general procurement rules described above, the Decree also establishes special provisions and procedures for procurement of consulting services. In those cases procurement officers are to prepare terms of reference for the consulting contract while procurement committees will be established to determine the estimated prices and prepare documentation covering the terms of reference and administrative and financial requirements and for conducting the contracting process.

Procurement of consulting services will be done in one of three methods: general selection among participants that are selected through a pre-qualification process conducted through a public notice; direct appointment; or indirect appointment. The last procedure shall only be used for contracts below Rp 50 million or cases in which the procurement process resulted in a single, eligible bidder.

8. Complaint/Appeal Procedures

In the event of conflicts, the Government encourages the agency and contractors or suppliers first to resolve their differences through mediation and conciliation techniques. Alternative dispute resolution is a viable means of keeping the problem within the control of the parties and resolving the issues reasonably and quickly. If disputes cannot be resolved in this way, parties are free to seek settlement through the Indonesian Association of Arbitrators or through the courts.

Specifically, the Indonesian Government Procurement system provides for a process of appeal if a losing bidder believes he has suffered a financial loss as a result of the procurement process. The appeals are made to the same supervisory procurement officers and must be supported by

indications of deviation from procurement rules, or conditions hampering fair competition in the bidding process, or evidence of corruption, collusion or nepotism between procurement officials and one or more participating bidders.

9. Contract System

The decree establishes a number of new contracting systems that procurement officers can use lower prices and increase efficiencies. These are: (1) a lump sum contract in which the entire job is finished in a set period and definite fixed quantity; (2) a unit price contract in which the contract is completed in a set period and a set unit price but the quantity procured may vary over the life of the contract; (3) the final-receipt contract in which the job is divided into segments but payment is not made until the entire system is functioning; (4) a long term contract in which supply are contracted for over more than one fiscal year. This requires specific approval for the Minister of Finance or, in cases involving local governments, the Governor; (5) a percentage contract, which applies only to consulting work and in which payment is based on a set percentage of the total value of the overall construction or contract job being supervised.

The decree also specifically encourages state-owned enterprise managers to "develop practices and applications of these new contracting systems to try to enhance the efficiency and effectiveness of their procurement".

PART III

THE ISSUE OF GOVERNMENT PROCUREMENT REGULATION AS PROTECTIONIST RULE

In this part, I make a focus on the issue of government procurement regulation from the perspective of domestic preference policies. Such policies have, nevertheless, become a problematic issue within international trade regulation. The various reasons that cause governments to adopt domestic preference policies also will be presented.

1. Governments as The Largest Purchaser of Goods and Services

Government is the largest consumer in the market in most countries in this world. They have need of a variety of supplies, whether goods, ranging from small and cheap goods like pencils and paper clips to the huge and expensive one like fighter planes and "doomsday" canons, or services, such as R & D, construction, professional consultancy and data management service. It's typically accounts for 10 – 15 % of GDP for developed countries, and up to as much as 20 % of GDP for developing countries.[9] Governments

[9] "Government Procurement", Harvard University, online, GTN Home Page, 2001.

will generally employ all three methods to meet these needs: by setting up state-owned factories and offices, by using the government's legislative powers to requisition from the private sector, or by purchasing in the ordinary market;[10] but the first one is used more widely in state controlled economies. Fewer interventionist governments will struggle to provide their needs by "contracting out" as much as possible to the private sector. Compulsory achievement by legislation is used only in time of war or emergency, or when it is necessary to expropriate privately owned land for public purposes.[11] Otherwise, goods and services are purchased in the open market, where mainly the government is the major actor, as same as any other private organization. Nevertheless, governments tend to use their giant purchasing power as a tool to promote political, social and economic policies.

2. Government Procurement as an Instrument of General Policy Promotion

The main objective of private firms when they undertake to procure goods and/or services is usually to get them on the best terms possible.

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[10] Reich, Arie, *International Public Procurement Law, The Evolution of International Regimes on Public Purchasing*, edited by Norbert Horn and Richard M. Buxbaum, volume 12, volumenes 1-12, London, Kluwer Law International Ltd., 1999.

[11] ibid

However, unlike private firms, governments will take into account other objectives as well, not directly connected with the actual purchase. These are usually referred to as "secondary" objectives of contracting, the primary objective being to meet the government's requirement with the best product at the lowest price.[12] Governments realize that contracts awarded to private industry not only have the effect of transferring the required item from the supplier to the government, but also often have far reaching social and economic consequences.[13] Thus, it's like "killing two birds with one stone". Due to the magnitudes of the public procurement budgets, and as long as governments are those in charge of implementing these general policies, it is obvious why most governments around the world use these budgets as a tool to promote their policies.

3. Domestic Preference Policies

The official governmental policies for the preference of domestic suppliers and products should be seen. In case of Indonesia, it's openly stated in the Presidential Decree No. 18 Year 2000 as the current Government Procurement Regulation: "to increase the use of domestic

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[12] ibid

[13] ibid

production, design and engineering with the aim of expanding domestic employment and national industries." In most countries, however, the buy national products originate from government decisions and are implemented by internal administrative directives.[14] This policy is designed to protect the domestic industry, and to create jobs for the local work force. Domestic preferences are particularly common in contracts that may support employment in declining industries or in areas for strategic reasons, in purchases of defence goods or aerospace systems.[15]

Domestic preferences are also used to support emerging high technology industries, especially in sectors that depend heavily or exclusively on government contracts. And at last but not least, government will prefer to purchase domestic products or services for more general political reasons in highly visible projects. For instance, for patriotic reasons, and to prevent protests from citizens who want to see their tax dollars spent at home, such contracts will usually be awarded to domestic suppliers.[16] Furthermore, protective procurement policies by purchasing domestic products are

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[14] ibid

[15] ibid

[16] ibid

sometimes claimed to be justified for national security reasons.[17] These will apply to certain contracts provided that governments have a high degree of "public visibility or political sensitivity".[18]

4. **Other Reasons for Domestic Preferences**

The reasons why governments have preferences for domestic products and supplier as well as discrimination against foreign suppliers and products are not always because of official government policies. More often they are do it because of psychological preferences of the procurement officers and language barriers.

Other reasons for preferring local products and supplier are: lower transport, trading and marketing costs, after sales services, shorter delivery times, the need for a local distribution service for delivery to end users such as schools, hospitals, depots, etc., products adopted to local taster, environment and methods, avoidance of complicated customs procedures, easier access to legal resource in the case of disputes, and quality assurance procedures, especially where inspection of the supplier's premises is

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[17] ibid

[18] ibid

required.[19] Some reasons above may be based on logical and economic reasons, but others are not.

[19] ibid

PART IV

THE GOVERNMENT PROCUREMENT IN THE GATT/WTO SYSTEM

Procurement of goods and services by government through their agencies for their own purposes be a symbol of an important share of total government expenditure and nevertheless has a significant role in domestic economies. While ensuring best value for money will be secured through an open and non-discriminatory procurement regime, governments sometimes seek to achieve certain other domestic policy goals through their purchasing decisions, such as promotion of local industrial sectors or business groups. Measures to this effect may be either explicitly prescribed in national legislations, for example prohibition against the purchase of foreign goods or services or from foreign suppliers, preference margins, set-asides and offsets, or in the form of less overt measures or practices which have the effect of denying foreign products, services and suppliers the opportunity to compete in domestic government procurement markets, including excessive use of single or selective tendering, non-open technical specification requirements and, in particular, lack of transparency in tendering procedures including contract awards. Such discriminatory government procurement procedures and

practices can lead to bends in international trade.

International rules leading procurement are contained in three legal instruments of the WTO. These instruments are: the General Agreement on Tariffs and Trade (GATT), the Agreement on Government Procurement (GPA) and the General Agreement on Trade in Services (GATS). The rules laid down are complex and also evolving. I will describe it one by one.

1. General Agreement of Tariffs and Trade (GATT).

It is well known that the General Agreement on Tariffs and Trade contains two major components: (1) The trade liberalization component which includes the framework for trade negotiations and tariff bindings, the unconditional most favored nation rule, and the national treatment rule; (2) the mercantilistic component, which includes national rights to raise non-bound tariffs, to impose countervailing and antidumping duties, to exclude government procurement from national treatment, and so forth.[20]

The history told us that in 1947, when GATT was being negotiated, the countries which participating in the negotiation did not want to change the

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[20] Gary C. Hufbauer, comments of paper by J.Michael Finger: Protectionist Rules and International Discretion in the Making of National Trade Policy, New Institutional Arrangements for the World Economy.

practices that they followed in procuring goods. These often involved requiring purchasing agencies to show preference on price or other considerations to domestic producers, or to buy from countries with which the country had historical ties, even though goods at lower prices were available in other countries.[21]

These requirements would have been inconsistent with the national treatment rule, which requires countries not to discriminate between a domestic product and a like product supplied by a foreign producer. The requirement to purchase goods from certain specified countries would also have been inconsistent with the MFN rule. It was therefore government procurement has been effectively omitted from the scope of the multilateral trade rules under the WTO, in the areas of both goods and services. It is important to note that this exemption does not apply to products which are purchased by governments "with a view to commercial resale or with a view to use in the production of goods for commercial resale", as stated in GATT Article III:8(a) as follow:

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[21] Rege, Vinod, *Transparency in Government Procurement,* Journal of World Trade 35(4): 489-515, 2001.

"The provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale".

and paragraph 2 of Article XVII, as follow:

State Trading Enterprises

(a) Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges, such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

(b) The provisions of sub-paragraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

(c) No contracting party shall prevent any enterprise (whether or not an enterprise described in sub-paragraph (a) of this paragraph) under its jurisdiction from acting in accordance with the principles of sub-paragraph (a) and (b) of this paragraph.

(2) The provisions of paragraph 1 of this Article shall not apply to imports of products for immediate or ultimate consumption in governmental use and not otherwise for resale or use in the production of goods for sale. With respect to such imports, each contracting party shall accord to the trade of the other contracting parties fair and equitable treatment.

2. Agreement on Government Procurement (GPA).

With objective of bringing purchases by government more within the full discipline of GATT, by requiring countries to apply its national treatment and MFN rules, efforts were renewed soon after the GATT came into existence. The main step towards this was taken in the 1960s by some of developed countries in the discussions in the OECD. Using this work as a basis, an Agreement on Government Procurement (GPA) was negotiated in GATT during the Tokyo Round of trade negotiations held between 1973 and 1979. This Agreement was extensively revised in the Uruguay Round of negotiations, which began in 1988 and were concluded in 1993. These revisions have the effect of harmonizing the GATT Code with the NAFTA Agreement on government procurement. There are four key areas of change in the revised GATT Agreement: first, the scope and coverage of the Agreement has been expanded to include service and construction contracts; second, entities covered have been extended beyond central government entities to sub national government entities and to public enterprises; third, contracting entities are no longer able to demand offsets as a condition for the awarding of contracts; and forth, the Parties are now required to establish

effective bid challenge procedures.[22]

Therefore, we can say that government Procurement Agreement is regulation relating to the procurement of goods and services by a government (through its departments and agencies) for its own use.[23]

The Agreement of Government Procurement (GPA) was signed in Marrakesh on 15 April 1994 end entered into force on 1 January 1996.[24] This is the present agreement and commitments. Unfortunately, this GPA, like its Tokyo Round predecessor, is a plurilateral, not multilateral Agreement (with 23 signatories).[25] In other words, unlike the other agreements which are treated as multilateral and whose provisions are binding on all WTO member countries, the obligation that the Agreement imposes is binding only on those

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[22] Trebilcock, Michael J. and Howse, Robert, *The Regulation of International Trade,* 2nd edition, London, Routledge, 1999.

[23] Prof, Ahn, Dukgeun, Lecture Note : *Agreement on Government Procurement*, class of Understanding of The World Trading System (2), KDI School of Public Policy and Management, Fall Term, 2001.

[24] This is the second Agreement on Government Procurement. Formally there are two Agreements on Government Procurement. The first was negotiated during the Tokyo Round (1973 – 79) and entered into force on 1 January 1981. While the second one entered into force on 1 January 1996. The signatories to the 1996 Agreement are Canada, the 15 Member States of The European Union, Israel, Japan, Korea, Norway, Switzerland and The USA. The 1979 Agreement includes Hong Kong and Singapore but does not include Korea. At a September 1996 meeting of the GPA Committee (which overseas the operation of the Agreement), Parties agreed to the terms of accession for Singapore.

[25] Trebilcock, Michael J. and Howse, Robert, *The Regulation of International Trade,* 2nd edition, London, Routledge, 1999.

countries, which become its members. Its membership is at present confined largely to developed countries. From among the developing countries, only three have so far become its members. They are Singapore, Republic of Korea and Hong Kong (China).

The cornerstone of the rules in the Agreement is non-discrimination. In respect of the procurement covered by the Agreement, governments Parties to the Agreement are required to give the product, services and suppliers of any other Party to the Agreement treatment "no less favorable" than that they give to their domestic products, services and suppliers and not to discriminate among goods, services and suppliers of other Parties (Article III:1).[26]

Furthermore, each Party is required to ensure that its entities do not treat a locally established supplier less favorably than another locally established supplier on the basis of degree of foreign affiliation or ownership and do not discriminate against a locally established supplier on the basis of country of production of the good or service being supplied (Article III:2).[27]

The Agreement lays heavy emphasis on procedures for providing transparency of laws, regulations, procedures and practices regarding

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[26] Prof, Ahn, Dukgeun, Lecture Note : *Agreement on Government Procurement*, class of Understanding of The World Trading System (2), KDI School of Public Policy and Management, Fall Term, 2001.

[27] ibid

government procurement.[28]

The Agreement allows the use of open, selective and limited-tendering procedures, provided they are consistent with the provisions laid out in Article VII to XVI.[29]

The Agreement prescribes certain minimum deadlines that must be allowed for the preparation, submission and receipt of tenders to enable responsive tendering (Article XI:2).[30] These must be set long enough to allow all suppliers, domestic and foreign, to prepare and submit tenders before the closing of the tendering procedures. In general the minimum shall be 40 days from the date of publication of an invitation to tender. The minimum time limits for receipt of tenders may be reduced to 25 or even 10 days in certain well-defined circumstances.[31]

The Agreement does not apply to all government procurement of the parties. The obligations under the Agreement apply to procurement: (1) by the procuring entities that each party has listed in its schedule in Annexes 1 to 3 of Appendix I, relating respectively to central government entities, sub-central government entities and other entities such as utilities; (2) of goods; and (3)

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[28] ibid

[29] ibid

[30] ibid

[31] ibid

all services and construction services that are specified in positive lists, found respectively, in Annexes 4 and 5 Appendix I; (4) in respect of procurement contracts above certain threshold values, each Party indicates the levels of minimum thresholds that apply to the procurement of goods and services under Annexes 1, 2 and 3 entities (Article I:4).[32] Thresholds above which the AGP is applied vary depending on the level of government, nature of the requirement and nature of the purchasing entity, but generally are in the following ranges:

Table 2: The levels of minimum thresholds that apply to the procurement of goods and services under Annexes 1,2 and 3 entities (Article I:4)

Entity Covered	Threshold Range A$	Sectors Covered
Central Government	260,000	Goods and services
Sub-central government	400,000 – 710,000	Goods and services
Utilities	710,000 – 900,000	Goods and services
All nominated entities	10 – 30 million	Construction

Source: http://www.finance.gov.au

[32] ibid

When reading the schedules in Appendix I to ascertain whether a particular procurement contracts is covered by the Agreement, it is important to check not only whether the procuring entity is covered, the threshold level, and if the contract is for a service, whether that service is covered, but also the General Notes at the end of most Parties' schedules which provide for a number of exceptions.[33] It should be noted that exceptions from the obligations of the Agreement are also allowed for developing countries in certain situations (Article V) and for non-economic reasons, for example to protect national security interests, public morals, order or safety, human, animal or plant life or health or intellectual property, etc. (Article XXIII).

2.1. Coverage of the Agreement

The Agreement applies to any law, regulation, procedure, or practice regarding any procurement by entities covered by the Agreement as specified in Appendix I (Article I:1).[34] This meant that the provisions of the GPA do not apply to all purchases made by the government but only to those made by purchasing entities specified by each member country in its list in the Appendix. Participating countries through negotiations conducting on the

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[33] ibid

[34] ibid

basis of reciprocity and mutual advantage have agreed upon the list of entities. By the large, the lists of each country include almost all the entities that are engaged in procuring goods. In the field of services, it covers construction contracts and procurement made by authorities responsible for the management of railways, ports and airports and by public utilities supplying water and electricity. It does not however include entities providing telecommunication services.

2.2. Nature of Obligations

The central government has authority to control the entities in the country lists. In case of federal governments, it is controlled by state governments and local government bodies such as municipalities and corporations. The GPA imposes a "binding obligation" on governments to require their central government bodies to abide by the rules that it lays down.[35] In the case of state government and local government bodies it only requires the governments to make their "best endeavors" to require them to follow the rules.[36] The reasons for this distinction in the nature of obligations,

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[35] Rege, Vinod, *Transparency in Government Procurement*, Journal of World Trade 35(4): 489-515, 2001.

[36] ibid

are that in most cases the governments at the center have no authority to require these bodies, many of which have a degree of autonomy, to abide by the rules and have to rely on persuasion to secure compliance.[37]

2.3. Type of Obligations

According to Vinod Rege, in Journal of World Trade 35(4): 489-515, 2001, the type of obligations the Agreement imposes can be grouped into two categories: substantial and procedural. Moreover he said that important among the substantive obligations are those requiring listed purchasing agencies to extend the GATT's national treatment and MFN rules to purchases of goods and services which are in value above the specified threshold level. The first, by imposing an obligation to extend national treatment, prohibits the covered purchasing agencies from giving price and other preferences to domestic producers. The second, by imposing an obligation on them to extend MFN treatment, requires them not to discriminate against suppliers from different countries.

In the lists of the Appendix, some countries have reserved the right to extend price and other preferences to "small business" in awarding contracts.

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[37] ibid

Furthermore, the GPA prohibits purchasing agencies from seeking or allowing for offers of offsets in the procurement process. Offsets are defined as measures to encourage local development or improvements in balance of payments accounts by means of domestic content, licensing of technology, investment requirements or counter-trade. [38] In other words, the GPA prohibited purchasing agencies to give preference for local content or job creation rather than best value of goods or services.

In the Agreement, the procedural obligations laid down in aim at ensuring: (1) openness in competition, by requiring purchasing agencies to make their purchases by inviting tenders; and (2) transparency to the procedures and decisions taken, by requiring the publication of notices inviting tenders, as well as post-award notices giving information on the name of the winning bidder and the nature and the quantity of the product covered by the contract.

These procedures, furthermore, call on members to establish an "independent review body" or challenge producers to consider complaints from any domestic or foreign suppliers relating to non-compliance with the rules of the Agreement, with a view to providing "interim rapid measures to

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[38] ibid

correct breaches" of the rules and provision of compensation for loss or damage in cases where breach is established.

2.4. Special Provision for Developing Countries

The Agreement recognized the development, financial and trade needs of developing countries, in particular least-development countries, and allows special and differential treatment in order to meet their specific development objectives. Development objectives of developing countries should be taken into account in the negotiation of coverage of procurement by entities in developed and developing countries. The Agreement also contains provision on: technical assistance; establishment of information centers giving information on procurement practices and procedures in developed countries; and special treatment for least-developed countries.[39]

3. General Agreement on Trade in Services (GATS).

The General Agreement on Trade in Services (GATS) also contains provisions on government procurement. If in previous part, the rules of GPA apply only to construction contracts and to purchases of goods and services

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[39] "Text of The Agreement on Government Procurement", Article V, online, WTO Home Page, 2001.

by service-providing entities specified in country lists, the GATS aims at the holding of comprehensive negotiations to develop rules governing the purchases of services by all governmental purchasing entities. The committee on Trade in Services has established a Working Group for this purpose.

The GATS provides that until such negotiations are complete, procurement of services by governmental entities are, as in the case of goods procured for government purposes under GATT, exempted from the purview of its rules relating to national and government purchasing entities with a view to commercial sale or for use in further production. The relevant provisions are Article XIII:1 and 2 as follow:

> Government Procurement
>
> 1. Articles II, XVI and XVII shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of services purchased for governmental purposes and not a view to commercial resale or with a view to use in the supply of services for commercial sale
>
> 2. There shall be multilateral negotiations on government procurement in services under this Agreement within two years from the date of entry into force of the WTO Agreement.

PART V

ISSUES OF GOVERNMENT PROCUREMENT IN THE WTO SYSTEM

The main idea of establishing an Agreement on Government Procurement is with objective of bringing this area of world trade more within multilateral trade disciplines. But, so far there are some issues related to this Agreement. The unwillingness of the developing countries to comply with the GPA and transparency in government practices are the major issues in every WTO Round.

1. Unwillingness of Development Countries to Comply with The GPA

The question remained is why many countries, especially developing countries - as Indonesia is one of them – have been unwilling to comply with the Agreement on Government Procurement? In considering whether to comply or not, a country has to weigh the possible benefits its export trade would derive and the efficiency gains that would result from the opening of its market to foreign competition against the administration burden and the economic costs of the changes it has to make in its rules and procedures in

order to bring them into conformity with the Agreement.[40]

Learn from the present situation of Agreement practice, the gains for exports that would flow from membership of the Agreement are therefore likely to be marginal in the case of most of the developing countries at least in the foreseeable future.[41] The share enjoyed by developing countries of the procurement market in developed countries covered by the Agreement is at present negligible.[42] Even though the purchases made include products such as office furniture and equipment, textile products required for use in hospitals, shoes, tyres and other rubber products required by defence and other establishments, the lack of availability of information on tender invitations and of the expertise required in filling the tenders has so far prevented producers from developing countries in tapping this market.[43] In the service sector, as the source agencies often require a commercial presence, it is difficult for firms from developing countries to meet the conditions.[44]

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[40] Rege, Vinod, *Transparency in Government Procurement*, Journal of World Trade 35(4): 489-515, 2001.

[41] B.Hoekman and P. Mavroidis, *Multiliasing the Agreement on Government Procurement* (1997), in Hoekman and Mavroidis (eds) Public Procurement, law and Policy (Michigan, 1999) pp.296-298.

[42] Rege, Vinod, *Transparency in Government Procurement,* Journal of World Trade 35(4): 489-515, 2001.

[43] ibid

[44] ibid

Furthermore, developing countries believed that there is much more potential for development in trading with neighboring countries in case of procurement sector. Therefore, the membership of the GPA is nevertheless not necessary.

In contrary, developed countries seem to gain benefits from the improved access to procurement markets in developing countries, in the area of industries and service suppliers. As we know that a large proportion of purchases of the entities in the developing countries include high technology and other capital goods, which are with a few notable exceptions not produced in these countries. For example, in recent years, investment in the power sector accounted for the biggest share of total public investment in developing countries. In most cases, the associated capital equipment could not be procured domestically and had to be imported from developed countries even though under the national rules purchasing agencies were required to show preference to domestic producers.[45]

In addition, apart from the question of benefits gained, another reason for the unwillingness of developing countries to comply with the Agreement is that the need would arise to modify their current practices requiring

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[45] ibid

purchasing entities to give price preference to domestic suppliers.

Considering of the provisions for special and differential treatment for developing countries in the GPA, it is possible for such an acceding country to negotiate for exclusion from the national treatment rules certain products or services for which it wishes to continue to extend price preferences. Because this provision predict that developing country could comply with the Agreement by including in its list a limited number of purchasing entities in respect of which it is prepared to accepts its discipline. Therefore, these provisions may enable a developing country to comply with the Agreement without having to change its policy of giving preferences to domestic products in sectors where continued maintenance of such preferences its vital. However, apprehensions on the part of developing countries, particularly those which have reached a relatively high stage of development, that in the negotiations for accession to GPA these recommended provisions may not always be respected in practice: once they agree to the negotiations the might be required to open up their procurement market to foreign competition to the same extent as has been done by the developed countries.[46] It is surely unacceptable for developing countries.

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[46] ibid

2. Transparency in Agreement Practice

The subject of transparency in government procurement was included in the WTO work program. This has been based on a mandate adopted by the 1996 Singapore Ministerial Conference, which subject to:

> "establish a working group to conduct a study on transparency in government procurement practices, taking into account national policies, and , based on this study, to develop elements for inclusion in an appropriate agreement".

This is a multilateral working group; meaning that all WTO members participate. There are two focus of the multilateral work. First, as indicated, this work is multilateral in nature and aimed at drawing up an agreement to which all 135 WTO Members will be parties. Second, the focus is on transparency as such, rather than on transparency as a vehicle for monitoring market-access commitments.

Actually, this is the first step towards preparing developing countries to comply with the Agreement. The manufacturing and service industries in the developed countries that would like to get a greater share of the procurement market in the developing countries are bringing increasing pressures on their governments to require these countries to join the Agreement, particularly the US and the European Union. They thought that it might not be possible for developing countries to accept the main substantive obligations relating to the extension of MFN and national treatment, therefore, it would be desirable for

them to require their purchasing agencies to follow the procedures would, by ensuring transparency and competition among suppliers invited to submit tenders, enable the government entities to buy goods and services on the basis of quality and at prices that are competitive. Moreover, it could also result in substantial savings in expenditure, since owing to lack of transparency and openness in the purchase procedures government agencies often unknowingly pay higher prices for their purchases.[47]

Then, the second step, in order to facilitate adoption of such procedures by all WTO member countries, it was suggested that it would be desirable to negotiate an interim agreement that would lay down principles and procedures that purchasing agencies would have to follow in making their purchases. The interim agreement could contain provisions that would ensure "openness", "transparency" and "due process" in government procurement practices. It would not, however, impose on countries the substantive obligation to abolish price or other preferences for domestic procedures by accepting the national treatment rules.

The discussion in the Working Group as well as the papers submitted by individual delegations and the background documentation prepared by the

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[47] ibid

WTO secretariat have resulted in some progress being made in identifying the elements that could be considered as transparency provisions and therefore included in the proposed Agreement on Transparency. There are:

- Preamble
- Objectives, definition and scope
- Procurement methods
- Publication of information on national legislation and procedures
- Information on Procurement opportunities, tendering and qualification procedures
- Transparency of bid documents, qualifications and decisions on contract awards
- Bid periods and decisions on qualification of suppliers
- Decision on contract awards
- Domestic review
- Dispute settlement
- Notification requirements
- Review and institutional provisions
- Language, maintenance of records regarding decisions

As a note that these elements are tentative and there are a lot of differences among the members of Working Group. The approach so far of developing countries has been to insist that it was necessary to limit the scope and content of the Agreement that may be negotiated to the provisions that are aimed at ensuring that practices followed by member countries remain transparent, and avoid including in it provisions which may result in improvement of access to the market. This is for ensured that the methods and procedures that could be used in procuring goods and services would be left to be determined by national legislations, regulations and practices, without any prescriptions on when and how such methods should be adopted. Meanwhile, a number of developed countries have been suggesting that the Group should agree that the phase of work on analysis and study has now been completed with the identification of elements and that consequently it should seek authorization from the General Council for commencement of the negotiations for developing an Agreement on Transparency on Government Procurement.

PART VI

ANALYSIS OF INDONESIAN GOVERNMENT PROCUREMENT SYSTEM

From the previous part I already described the broad review of current Indonesian Government Procurement practices, government procurement as protectionist rule and current practices and issues of government procurement on WTO. Therefore, the analysis of the current Indonesian government procurement system will be presented in this part. Firstly, I will analyze it in the view of economic aspect and taking WTO GPA into consideration. It is necessary to see how the implication of WTO government procurement for Indonesian Government Procurement System works and some problems that could be arise if Government of Indonesia apply the international rules. Two focuses will be made, plurilateral in WTO GPA and practice toward transparency agreement.

1. Economic Analysis

As explicitly stated in Presidential Decree No.18 Year 2000 that one objective of Government of Indonesia's procurement policy is to increase the use of domestic production. Moreover, in Article 22; 1 of Presidential Decree

No. 18 Year 2000 stated explicitly about price preference, that is used in favor of domestic suppliers or products:

> Price preference must be given for domestic products and national providers or services in the procurement documents/contracts concerned.

Therefore, by practicing this kind of domestic preference, it is very obvious that this policy is protectionist public procurement policy. Although, Indonesian government makes this decision based on the perceived benefits to their citizens, and not necessarily to the rest of the world. I will make this analysis on the costs and benefits of protectionist procurement policy.

The basic theory of protection is an old and controversial issue in the field of international trade.[48] For the detailed explanation, please see in figure 1 below. Considering this figure, the top portion of the figure shows standard domestic supply and demand curves for the industry (say, shoes), if there were no international trade that would mean that the country were in a closed economy. The equilibrium home price and quantity would be P1 and Q1. If the country then were to open its economy to world trade, its small size in relation to the world market would mean that it would face a horizontal, perfectly elastic demand curve. In other words, it could sell (or buy) all it wanted at a

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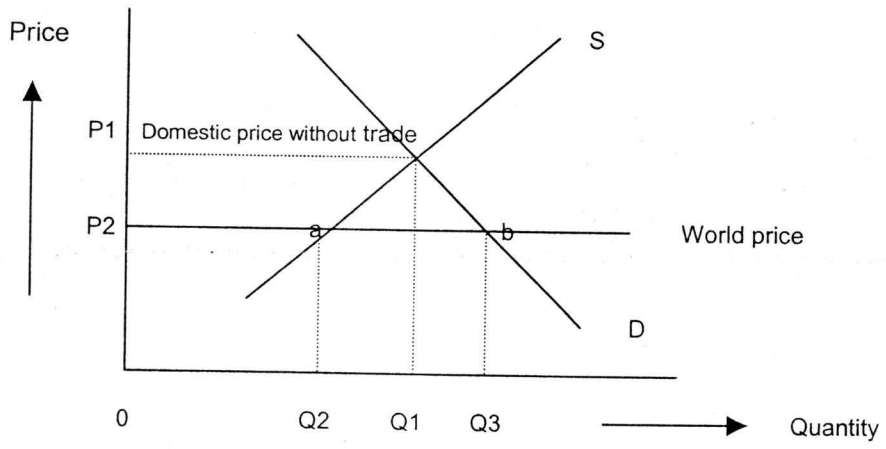
[48] Todaro, Michael P., *Economic Development*, sixth edition, Massachusetts, Addison – Wesley Reading, 1997.

lower world price, P2. Domestic consumers would benefit from the lower price of imports and the resultant greater quantity purchased, while domestic producers and their employees would clearly suffer as they lose business to lower-cost foreign suppliers. Thus at the lower world price, P2, quantity demanded rises from Q1 to Q2. The difference between what domestic producers are willing to supply at the lower P2 world price (Q2) and what consumers want to buy (Q3) is the amount that will be imported, as shown as line ab in figure 1.

Figure 1. Theory of Protection



source: Todaro, Michael P., *Economic Development*, sixth edition, Massachusetts, Addison – Wesley Reading, 1997.

Next, let see Article 22; 2 and 3 of Keppres 18 Year 2000 as follows:

2. The extent of price preference for domestic products shall be not more than 15% above the imported goods bid price, excluding the import duties.

3. The extent of price preference for contracting work services rendered by national contractors shall be 7.5% above the lowest bid price quoted by a foreign contractor.

Therefore, procurement of foreign goods is only authorized in cases in which the goods in question are not produced domestically or the technical specifications of the domestic product fail to meet set standards or the foreign bid is lower than the domestic bid by more than the price preferences set out above. Frankly speaking, some projects in Indonesia do proceed on less concessional terms. Foreign firms bidding on certain government sponsored construction or procurement projects may be asked to purchase and export the equivalent is selected Indonesian products, but this rarely occurs. This is very common area for domestic preference in government procurement, well known as overtly discriminatory tactics by selective sourcing policies and less visible forms of discrimination by using product or service standards which are only readily met by domestic producers.

Moreover, under Article 22 above, it's meant that foreign suppliers are not entirely precluded from competition. The price paid for any given product under a price preference is somewhere between the lowest foreign price

(inclusive of duties) and this price plus the margin.[49] In mathematical form:

$$P_w \leq P_g \leq P_w + m$$

Where:

P_w is the world price (plus domestic duties);

P_g is the price paid by the government;

And m is the margin of price preference.

Pg will be equal to Pw (i.e. the government is not paying any subsidies under the margin of preference scheme) in either of two situations:

(i) The lowest foreign bid has been chosen, since all existing domestic bids exceed it by more than the margin of preference. In other words, domestic producers are inefficient or suffer from a comparative disadvantage in relation to world standards to an extent that exceeds the tariff plus the margin.

(ii) A domestic bid equal to the world price has been chosen. This will occur where domestic producers are relatively efficient and strong competition among themselves has prevented them from taking

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[49] Reich, Arie, *International Public Procurement Law, The Evolution of International Regimes on Public Purchasing*, edited by Robert Horn and Richard M. Buxbaum, volume 12, volumenes 1 – 12, London, Kluwer Law International Ltd., 1999.

advantage of the margin of preference.[50]

In all other situations, Pg will tend toward Pw + m, since domestic suppliers can be expected to maximize their profits by taking full advantage of the margin of price preference.[51] Thus there is a general increase in the cost of government procurement, public funds are transferred to domestic manufactures and fewer governmental programmes can be carried out.[52] In addition, as a result of the decrease in imports, there is a loss of tariff revenues. The main difference is that the extra cost to the government is limited by the amount of the margin, and that foreign suppliers still have a chance to overcome this margin and stay in the market.[53]

2. The analysis from WTO GPA point of view: The Plurilateral Agreement.

The Indonesian Government Procurement Policies explicitly favor domestic suppliers of goods and services. It can by any means a protectionist "tool" which would in any way be contrary to the WTO Government Procurement Agreements.

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[50] ibid

[51] ibid

[52] ibid

[53] ibid

The Government of Indonesia is in the process of revising its law on government procurement. Since Indonesia has not yet signed the WTO Government Procurement, there is no obligation for implementing it. This is because of the WTO GPA is plurilateral Agreement. The provisions of this Agreement are bind to only signatories. But, it is nevertheless believed that the current Indonesian procurement system is more transparent and much in line with standards set by the WTO Government Procurement system. For instance, as WTO GPA demanded in their cornerstone, the main objectivities in Indonesia's Government Procurement system are transparency, fairness / un-discrimination, and competitiveness as explicitly state as a new ethics guidelines for government procurement in Indonesia; then in Article 12, stating "The procurement of contractor goods/services and other services shall be conducted in a way open to the public...". This is very important as a fundamental base for future procurement process.

3. Toward Transparency Agreement: Multilateral Agreement

Against the background of what has been stated so far, it would be interest to examine what are likely to be the benefits of any such agreement on transparency to Indonesia that has not yet become a member of the GPA.

According to Vinod Rege in Transparency in Government Procurement, there are 3 reasons that the transparency agreement may be in the long-term become interesting for developing countries.

Firstly, for both domestic and foreign suppliers it will provide an assurance that contracts will be awarded on the basis of criteria that are fair and equitable. Secondly, from the point of view of the governments, the adoption of such rules would ensure that goods and services are obtained at the most economic prices and thus lead to a reduction in costs and budgetary expenditure. Thirdly, according to some analysts, the most important benefit of transparent and open procedures is the impact, which their adoption may have at the level of corruption in countries where it is widespread. These three reasons seem in line with the current Indonesian Procurement System, as stated in Article 2, Article 3, and Article 5 of Presidential Decree No. 18 Year 2000. (Please see exhibit I).

In addition, the Indonesian Government Procurement regulations previously make specific reference to new Indonesian laws on combating government corruption and regional decentralization and are designed with those reforms in mind, but whether the new rules will result in less corruption into government procurement remains to be seen. It's because corruption in

Indonesia has usually been more a problem of enforcement than laws. Therefore, with transparency agreement, the obligation to invite tenders, the transparency of the procedures used in awarding contracts and the right which the agreement would give to aggrieved suppliers to challenge the decisions, would restrain both domestic and foreign suppliers from making under-the-table payments and deter public officials and political parties from receiving such payments.

However, the realization of the benefits would depend on how far the rules adopted take the following factors into account: (1) political pressures imposed by foreign governments on behalf of their firms; (2) the proportion of tied aid requiring countries to obtain goods and services from the providers of the aid; (3) the revolutionary changes taking place both in the methods for procuring goods and services and in the regulatory mechanism used; (4) the specific situation and needs of developing countries. In this case, the Indonesian Government Procurement Regulation mentioned in Article 6, 3 as follow:

> This Presidential Decree shall be valid for the following:
>
> 3. Procurement of goods/services partly or entirely financed from Offshore Loan/Grant **in accordance with or not in violation of the guidelines and provisions for the procurement of goods/services of the party providing such loan/grant**."

4. Problems that rising in Applying International Rules

Beside some advantages that could be interesting for Government of Indonesia to applying the multilateral agreement, there are some problems that could raising in applying this agreement, such as:

4.1. Bias against purchases from domestic producer

Studies on trends in procurement have shown that the size of the country influences market shares of domestic and foreign firms. They expose that "small countries do on an average procure much more on international markets than do large countries.[54] Purchasing entities in larger countries are procuring a larger proportion of goods and services domestically, while smaller countries may be obtaining a large proportion of goods and services from outside.[55] The lower the stage of development, the greater would be the dependence on foreign suppliers, as for a larger number of products and services domestic production may not exist. However, very often happen in Indonesia where domestic capacities exist purchasing entities may show bias against purchasing locally. It's because of two factors below:

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[54] Rege, Vinod, *Transparency in Government Procurement*, Journal of World Trade 35(4): 489-515, 2001.

[55] ibid

- A long tradition of buying from foreign suppliers under the tied aid programmes would be continue to buy from the same sources even after the aid is untied.
- The bias may be unintended; the purchasing entity may not simply know that products of equally good quality are available domestically.

Furthermore, as the countries start increasing the use of information technology in procuring goods, this bias against purchasers from domestic industry may increase instead of becoming less. The extent to which both foreign and domestic firms are able to derive benefits from information on tender notices in the electronic database will depend on the extent to which internet facilities are developed locally. Since in Indonesia internet facilities are at an early stage of development, resort to international bidding and the inclusion of information on tendering opportunities on the internet will, at least for a number of years to come, benefit only suppliers in developed countries, and a few developing countries where such facilities are widely available.

4.2. Bad experience of international bidding

As a purpose of implementing the GPA and transparency agreement is to assist purchasing agencies in developing countries to get the best value for

the goods and services they purchased, by encouraging them to use international bidding. Some recent studies, however, show that for products that are readily available in the domestic market, the requirement that they should be purchased only through international bidding could lead not only to delays but also to higher procurement costs and higher prices for the goods that they got.[56]

However, these studies emphasize the need for more analysis of the difficulties that developing countries encounter in complying with procedural requirements of the international bidding, and the possible impact that such difficulties and resulting delays may have on administrative and other costs relating to procurement of goods and services.

4.3. Compliance with the national rules

Another important factor that need to be kept in mind is that while the WTO rules would impose obligations on government, the responsibility for implementation would rest with thousands of different bodies, some of them local. Many of these entities have a large degree of autonomy, and persuasion is the only means that the governmental authorities have in

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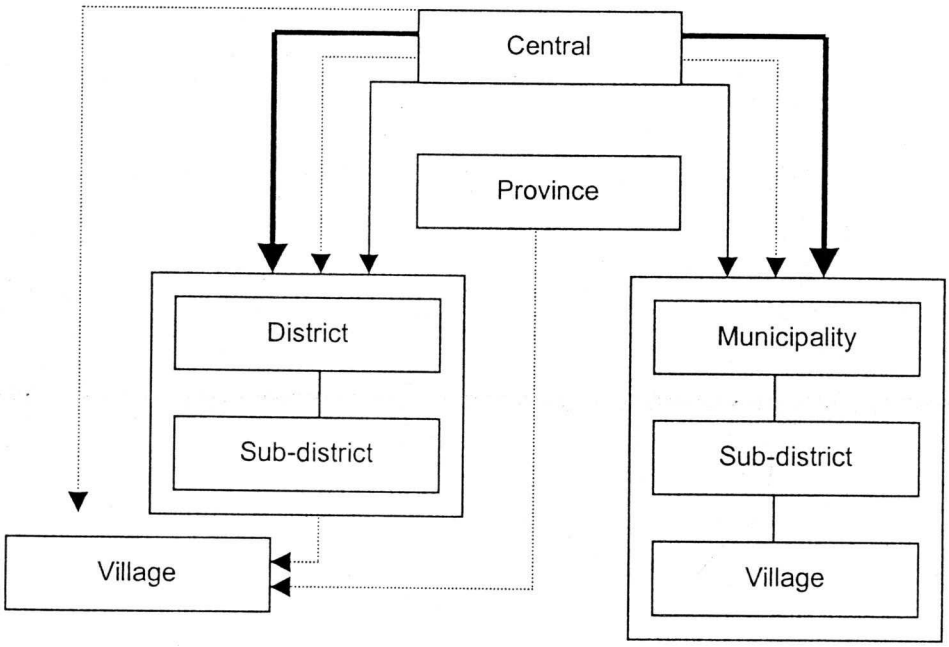
[56] ibid

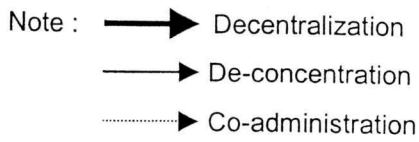
securing compliance.[57] Especially, The Government of Indonesia just established the new policy of decentralization, which is outlined in Law No. 22, 1999 concerning "Local Government" and Law No. 25, 1999 concerning "The Fiscal Balance Between the Central Government and the Region". The Law No. 22, 1999 transfers functions, personnel and assets from the central government to the provincial, as well as the district and the municipal governments.[58] The framework of Government According to Law No. 22, 1999 is as figure 2 below.

Figure 2. The Framework of Government according to Law No. 22, 1999.



[57] ibid

[58] Smeru Working Paper, *Indonesia's Decentralization Policy: Initial Experiences and Emerging Problems,* A paper prepared for The Third EOROSEAS Conference Panel on Decentralization in Southeast Asia, London, September 2001.



The difficulties that are encountered in securing compliance will occur, whether those local governments will follow the rules or not. Moreover, many uncertainties surrounding functions of the provincial government still remain. Therefore, such problems in ensuring implementation by the purchasing entities in the future, of any rules that may be adopted are likely to be difficult.

PART VII

CONCLUSION AND SUGESTIONS

The current Indonesian Government Procurement system is substantially revised compared with previous one that has been operated since 1994 and nevertheless, much in line with standards set by the WTO Government Procurement Agreement. As stated in the objectives of the regulation, the Indonesian Government wanted to emphasis fairness / un-discrimination in the process of procurement of goods/services in order to meet with the standards of international government procurement system law. But, in the meantime, Government of Indonesia cannot run from obligation to secure their domestic sourcing. This is very fundamental reason in applying the protectionist public procurement policy. The current regulation explicitly shows that one objective of the government procurement policy is to increase the use of domestic production, design and engineering with the aim of expanding domestic employment and national industries. As a result, it is very small portion of foreign goods or foreign bid flowing into government procurement bidding channel. This is a very common issue of adopting domestic preference policy in developing countries, and subsequently

becoming a problematic issue within international trade regulation. Several supportive reasons that cause government to adopt this policy are: (1) Government is the largest consumer in the market. Therefore the government tends to use their giant purchasing power as a tool to promote political, social and economic policies; (2) Due to the magnitudes of the public procurement budgets, as long as government is in charge of implementing the general policy, government will use these budgets as a tool to promote their policies; and (3) in order to protect the domestic industry, to create jobs for the local work force, to support emerging high technology industries and sometime claimed to be justified for national security reasons, the government will follow the above domestic preference rule.

In the mean time, as an international rule, the present WTO rules applicable in the area of government procurement has different practice among members and non-members of the Agreement on Government Procurement (GPA). The GPA WTO is plurilateral agreement. Therefore the GPA only binds those signatory countries. Therefore, in one hand, almost all developing countries, which are not members of the GPA, are at present not bound by the basic rules of GATT and GATS relating to the extension of national and MFN treatment in regard to the goods and services obtained by

them for governmental purposes. In the other hand, all countries, which are members of the GPA are bound by its substantive provisions which impose an obligation to extend MFN and national treatment as well as the procedural obligations which it imposes in order to ensure transparency of the procedures adopted for awarding contracts and for providing to the public information on contracts awarded. Therefore, this plurilateral issue has been a big-front-and-back-issue between developed and developed countries.

Those issues are becoming big issues in every WTO Round. One big problem is unwillingness of developing countries to comply with the GPA. It's because from developing point of view, the share enjoyed by developing countries of the procurement market in developed countries covered by the Agreement is at present negligible. Furthermore developing countries believe that there is a more potential for development in trade with neighboring countries in case of procurement sector. In this case, the membership of the GPA is nevertheless not necessary. In addition, the unwillingness of developing countries to comply with the Agreement is that the need would arise to modify their current practices requiring purchasing entities to give price preference to domestic suppliers. This is very contradictive with the objectives of the current Indonesian Government Procurement regulation.

In spite of that, in order to get developing countries to comply with the GPA, there is a multilateral working group in WTO which is subject to conduct a study on transparency in government procurement practices, taking into account national policies, and to develop elements for inclusion in an appropriate agreement. Since this is multilateral working group, therefore all WTO members should participate, not an exception for Indonesia as long as it intends to become a member of WTO. But so far, there are a lot of different views among the members of Working Group. For instant, the major countries pushing this issue have made clear their ultimate goal to fully integrate the huge worldwide government procurement market into the WTO rules and systems. While the developing countries insist that it be necessary to limit the scope and content of the future Agreement in Transparency.

From the analysis of the current Indonesian Government Procurement System, there are not only some advantages in Indonesia when implementing international rules completely, but also some difficulties which may be arising. By using theory of protection in economic analysis, it is shown that where international trade exist, procurements of products and services needed at a lower world price become possible. It, nevertheless, will benefit domestic consumers from the lower price of imports. Moreover, in case of implementing

Transparency Agreement, Indonesia will get some advantages such as: (1) for domestic and foreign suppliers it will provide an assurance that contracts will be awarded on the basis of criteria that are fair and equitable; (2) a "clean government" away from corruption can be seen due to a wide range of bidders involved, when the transparency of the procedures is applied in the process of government procurement.

Otherwise, there could be some problems that rising from applying international rules, such as bias against purchases from domestic producer; and also from bad experience of international bidding when the products or services need are found available in domestic market. The requirements covering purchasing only through international bidding could not only lead to delays but also to higher procurement costs and higher prices for the goods that the buyers got. In addition, the most important one is the responsibility for implementation the WTO rules would rest with thousand of different bodies and local government rules. Many of these entities have a large degree of autonomy, and persuasion is the only means, which the governmental authorities have in securing compliance. Therefore, it would be a problem of compliance with the national rules existed.

Since the priority of the current Indonesian Government Procurement System is still to maximize the use of domestic products and services, therefore, on the basis of the WTO rules, this regulation can be viewed as a protectionist rule to favor the domestic procedures. Therefore, Indonesia has to consider the WTO procurement system to fully incorporate the multilateral disciplines on government procurement in the future and should take the position that government procurement systems is an important instrument of national development and it should reserves its right to maintain this role.

The last but not least, in order to ensure steady implementation of these operational guidelines in the Presidential Decree No.18 Year 2000, it is necessary to establish a detailed operational enforcement. Without detailed enforcement rules, it will be difficult to see the materialization of what exactly the objective of the system supposed to be obtained.

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