

# **THE WORLD BANK PROCUREMENT REGULATIONS:**

**A CRITICAL ANALYSIS OF THE ENFORCEMENT MECHANISM AND OF THE  
APPLICATION OF SECONDARY POLICIES IN FINANCED PROJECTS**

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## **Abstract**

Many national and international instruments have been concerned with building an effective procurement system. In this context, particular procurement issues, such as the implementation of secondary policies, the review mechanism to address complaints, provisions on electronic procurement or rules governing privately financed projects, have received an in-depth examination. However, the particular analysis of those issues in the context of World Bank-funded procurement has been given almost no attention in the literature. Discussing such issues in the context of World Bank procurement involves special consideration because of the status and character of the organisation and the special nature of the relationship between the Bank, the borrower, and private parties involved in the procurement process.

This thesis proposes to offer a critical analysis of the World Bank procurement system in two specific respects, namely enforcement mechanisms and secondary policies. There are two main objectives in this study. The first one is to examine the current position in respect of those two issues, since there is no literature that offers a significant analysis of these points. Once it is determined what the current position is, this study will offer a critique of the rules and suggestions for reform, based on the particular character of the World Bank procurement system.

In terms of the first subject, several options for establishing a complaints mechanism are considered. Since none offer a wholly satisfactory answer for the particular needs of the World Bank procurement system, this study has tried to offer a conciliatory suggestion whereby the current system of suppliers' complaints would be strengthened by a more formal review mechanism. Regarding the analysis of secondary policies, it is suggested that the current provisions could be improved in three main ways; namely, through a review of the policies set in the Guidelines; through greater use of national policies, and by providing further scope for implementing international standards.

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## **CHAPTER I – THESIS OVERVIEW**

### **1 Introduction**

The World Bank has as its main objective the reduction of poverty in its client countries. Recently, the Bank has concentrated its efforts on reaching the Millennium Development Goals agreed by members of the United Nations in 2000. Those goals include among other things, the eradication of extreme poverty, promotion of gender equality, improvement of environmental sustainability and further development of an open, rule-based, predictable, non-discriminatory trading and financial system. The means to achieve its objectives is through financially assisting low and middle income member countries in building policies and infrastructure for a stable and sustainable development. The assistance is usually given by loans or grants, which are attached to a specific project. The projects financed by the Bank involve not only reforming economic, financial and social policies, but also some practical actions such as building roads, educating people, protecting the environment, etc. The major institutions within the World Bank providing financial aid to client countries are the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). Together these organisations provide low-interest loans, interest-free credit, and grants to developing countries.

Following the Bank's Articles of Agreement, the interest in procurement derives from the need to ensure that the resources will be allocated for the purpose for which the loan was granted, and also that this will be done in an efficient way (Articles of Agreement, Article III, Section 5 (b)). The procurement procedure will be carried out by the member country that is implementing the project but the Bank will have the role of closely supervising the process to ensure that the procurement goals are achieved. The aiding institution is, therefore, concerned with the effective application of the money granted and usually requires the use of its own rules on public procurement. Recently the Bank adopted a more structural approach by changing its policy and stating that “the main thrust of the Bank’s current procurement work is to move from the traditional role of reviewing contracts to building capacity of World Bank borrowers.” This statement is in line with the Bank’s policy for the 21st century, where the importance of

establishing the strengths and weaknesses of developing countries to put in place policies and structural reforms can be observed, which can provide the basis for strong growth.

The World Bank is not the only financing institution which imposes special rules on procurement for financed projects. In fact, most international financing institutions will insist on the use of their own rules, as opposed to the borrower's national rules, when procuring goods, works and services in financed projects. However, the World Bank Guidelines stands out as its rules have provided a model for many of the other institutions<sup>1</sup>. Moreover, while most of the other international institutions have a regional character, the World Bank provides funds for countries from North to South, and from East to West. In fact, the Bank has 184 member countries at the moment, most of which are eligible to receive loans or grants. Therefore, the World Bank procurement rules might face particular challenges imposed by its implementation on a wide range of political structures and legal backgrounds.

## **2 Objectives of this study**

Given the importance of the World Bank Procurement Guidelines, there is already some academic literature<sup>2</sup> and a vast number of documents published by the World Bank and by other parties interested in procurement opportunities<sup>3</sup> offering guidance on the procurement procedures followed in financed projects. Nonetheless, an in-depth examination of particular procurement issues that have received attention in the context of national systems and other international instruments - such as the implementation of social policies, the review mechanism to address complaints, provisions on electronic procurement or rules governing privately financed projects -

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<sup>1</sup> For example, the procurement rules of the OPEC and Japan's Overseas Economic Co-operation rules for aid-funded projects were heavily influenced by the World Bank Model. Westring and Jadoun, (1996).

<sup>2</sup> See for example, Tucker in Arrowsmith and Davis (eds) (1998); Arrowsmith, Linarelli and Wallace (2000); Westring (1991); Tucker (2001); Hunja (1997).

<sup>3</sup> See for example, World Bank, Guide to International Business Opportunities in Projects Funded by the World Bank, (Washington D.C., World Bank) (1997), World Bank, Bank-Financed Procurement Manual, July 2001, World Bank, List of Currents Standard Biding Documents, Procurement Technical Notes, Standard Forms of Contract, and other procurement documents, are available at the World Bank web site at [www.worldbank.org](http://www.worldbank.org). Also see Department of Foreign Affairs and International Trade – Canada, Comparison of AfDB and World Bank Procurement Procedures, <http://www.infoexport.gc.ca/docs/view-e.asp?did=5974&gid=119> as in 22/02/02, OECD, Strengthening Procurement Capacities in Developing Countries OECD/DAC - World Bank Roundtable International Benchmarks and Standards for Public Procurement System, Paris January 2003 at <http://www.OECD.org> (c).

has not been previously undertaken. This thesis proposes to offer a critical analysis of the World Bank procurement system in two respects, namely enforcement mechanism and secondary policies. There are two main objectives in this study. The first one is to examine the current position in respect of those two issues, since there is almost no literature that offers an analysis of the state of law regarding the World Bank procurement system. Once it is determined what the current position is, this study will offer a critique of those rules, using the methodology elaborated further below.

Enforcement has been chosen from various areas needing further analysis for various reasons. Firstly, as will be argued in Chapter V, for any procurement regulation to be effective and to inspire confidence, an enforcement system is needed. All interested persons need to know that the rules will be followed in practice and that any breach will either be corrected or will trigger the accountability of the people involved. However, it seems that the World Bank's procurement regulations do not provide for a clear form of complaint mechanism which requires accountability for conduct during the procurement process. The Bank's policy, which – as explained in Chapter IV – is to leave complaints to be addressed under the enforcement mechanism available in the borrower's national system, seems inadequate to guarantee that the Bank's objectives of economy, efficiency, transparency and development will be achieved. Moreover, the application of external procurement rules might bring additional practical constraints to the contracting agency, since besides dealing with unfamiliar rules, it might also need to take into account the interaction of the external procurement rules and other national regulations influencing the procurement process. For a legal researcher this subject is particularly challenging because of the special considerations that will need to be given to the particular character and status of the World Bank procurement rules. The particular framework in which the relationship between the Bank, borrowers and bidders develops means that the design of the enforcement system presents special difficulties and that it is not possible simply to adapt model rules designed for national systems, but there is a need to take special account of the presence and interaction of the national and international actors involved.

The choice of considering the possibility of using secondary policies under the World Bank system results from some additional factors. The first and most important drive for this choice is that despite the widespread use of secondary policies within national systems and the relevance of the debate over their use under different international procurement agreements, this issue has not been examined in the literature within the World Bank procurement context. The analysis of the application of secondary objectives in projects financed by the World Bank is particularly interesting given the number of client countries and the special relationship that is established with the loan agreement. There are two main issues that arise in this context. The first is the possibility for borrowing countries to use their procurement as a means of promoting their social or other secondary objectives at their own discretion, either based on purely domestic policies or on international agreements to which the borrower is party. Borrowing countries might, for example, be part of international agreements on environmental protection or be compelled by local laws to provide some guarantees that minimal labour standards will be kept in government contracts. In those cases is there scope in the guidelines to accommodate such requirements? The World Bank procurement regulation does not have clear rules addressing those issues. Even when there is a specific rule, such as applies in the case on national preferences (as explained in Chapter VII), there is a margin of discretion that might bring inconsistency and a lack of transparency to the application of the rule in different borrowing countries. A second issue is the question of whether the World Bank should seek to leverage the procurement powers of borrowing countries to support or promote policies of the Bank itself, through secondary uses of that procurement power. Given the amount of resources involved in financed projects, and since some of the issued pursued by secondary policies, such as protection of the environment, development of infant industries or protection of labour rights, are recognised by the Bank as important development targets, there is a question of whether the Bank should use procurement as a means to adopt some standard practices in all its financed projects.

The choice of concentrating the work of the thesis in these two particular aspects derives from the doubt as to whether in these areas the system that has developed has given sufficient attention or adopted adequate solutions to take into account the particular character of the people

involved in this peculiar procurement system. The relationship between the Bank, borrowers and bidders/contractors is not ordinarily drafted by the national law of the borrowing country, but there are national and international rules that will interact to define a specific procurement environment. The additional dimension of this relationship poses a challenge for this study.

It is expected that this work will provide a contribution to the legal literature in the procurement field and guide governments, lawyers, private entities and all the agents involved in the World Bank procurement area, both by its examination of the current provisions that apply in this area and by identifying problems and options for reform. It is hoped that in this way this study will contribute to the enhancement of the World Bank's recent strategy and will help developing countries to build (or to restructure) solid legal frameworks in procurement as one of the bases of their effective development.

### **3 Method**

The method adopted for achieving the proposed objectives was mainly a comprehensive library-based study involving the analysis of primary and secondary literature. In order to complete the first objective, namely, the examination of the current rules, the researcher looked at the procurement regulations and other internal rules of the Bank relevant to each of the issues examined. This included the World Bank's operational policies and procedures, country procurement reports, and also other literature drafted by the Bank or by other organisations on business opportunities in World Bank financed projects. The analysis of the secondary literature at this point was seen as an interesting vehicle to practical constraints that could not be easily identified by the analysis of the primary material.

In order to elucidate the legal framework in which the procurement rules apply, the research will also have to take into account international law rules. This would involve the examination of primary and secondary material applicable to international organisations and to their relationship with states and private parties. Treaties defining the scope and powers of the Bank, the agreement between the borrower and the Bank and the rights and duties of third parties that are involved in the procurement process are some of the things that will have to be examined.

Although no qualitative or quantitative work was undertaken, there was, however, the opportunity to interact with some of the people involved in World Bank operations. During those meetings no formal interviews or questionnaires were used, but rather, people were encouraged to talk freely about practical constraints experienced in enforcing the rules or in accommodating secondary objectives. Those meetings have also contributed to a better understanding of the practical context in which the rules are applied. Moreover, the discussion has also contributed to the second objective by helping to identify and understand the possible advantages and disadvantages of adopting some of the different approaches and models discussed in this thesis.

The critique proposed as the second objective of the thesis aims at two main things: firstly, to identify deficiencies in the current rules and, secondly, to consider the arguments for and against various possible alternative approaches that might be adopted. The critique was drafted based on the primary materials and on the academic literature on regulating public procurement. This critique will also refer to existing experiences in national and international systems which can illustrate the problems involved in the issues analysed in each Chapter. Solutions adopted in different procurement systems, and the reasons behind them, were also considered when these could be regarded as embodying solutions that might provide a useful approach. The value of those possible solutions was considered, taking into account the particular context of the World Bank rules and the justification behind the Bank's regulation.

The methodological approach adopted in the critique does not use a predefined set of standards. In other words, it is not the aim of the critique to establish a predefined framework and assess the World Bank procurement rules against it. Instead, the author examines several models found in the procurement literature which could provide for different solutions. In this context concepts adopted in national and international systems are used as examples rather than accepted standards.

The choice of the material used as examples of the literature in regulating public procurement has been a careful one. Three main procurement regulations provided a significant contribution to the analysis undertaken in this work; namely, the United Nations Commission for International Trade Law (UNCITRAL) Model Law on Procurement of Goods, Construction and

Services; the Word Trade Organisation - Government Procurement Agreement (GPA), and the Procurement Directives of the European Community (EC).

The UNCITRAL Model Law has been one of the major contributions for several reasons. Firstly, one of the major factors that make the procurement rules stated in the Model Law relevant worldwide is the fact that it reflects the wide representation of the United Nations<sup>4</sup>. The Model Law was formulated to assist all states, including developing countries and countries with economies in transition<sup>5</sup>. Unlike other international agreements liberalising procurement trade, the UNCITRAL Model Law is not only concerned with the opening procurement for foreign competition, but it also provides a rather comprehensive framework for the establishment of procurement legislation<sup>6</sup>. In practice this agreement has helped mainly transition and developing economies to set national procurement legislation or to reform their existing laws according to a liberal approach<sup>7</sup>.

The Model Law is a framework agreement and states can depart from its guidance when setting their procurement regulations. Moreover, the Model Law provides for alternative choices in drafting a procurement system. This flexibility of the Model Law means that it is able to reflect differences in regulatory policies deriving from a wide range of legal cultures, and even to take into account some political constraints that other international agreements try to avoid. Although this pragmatic approach might mean that in some instances the optimal choice will not be achieved, the Model Law can in those cases ensure that such policies can be implemented in the least damaging way. In other words, the Model Law provisions and guidelines to enactment will try to balance the tension between the “pragmatic” and the “ideal” procurement solutions.

The discussion in achieving this balance on the enforcement provisions and the scope of the use of secondary policies illustrates the sensitivity of those issues, especially for developing

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<sup>4</sup> The UNCITRAL is a subsidiary body of the General Assembly of the United Nations with the general mandate to further the harmonization and unification of the law of international trade. UNCITRAL texts are adopted by the United Nations Commission on International Trade Law, a body with 60 elected member States representing a wide range of geographic regions. Developing countries play an active role in both drafting and adoption UNCITRAL texts.

<sup>5</sup> See Report of UNCITRAL on the work of its 26th session (A/41/17), para 217.

<sup>6</sup> See comparison made by Arrowsmith, (2004) (a).

<sup>7</sup> See for example, Lemke and; Piselli, both in Arrowsmith and Trybus (eds) (2003). Also see further examples in Arrowsmith (2004) (a).

countries. However, for the analysis undertaken in this work, the special characteristics of the relationship between the Bank and borrowers should be kept in mind. The economic power of the Bank might be enough to overcome some of the constraints despite the sensitivity of the issues when defining national procurement policies. Therefore, although the Model Law options could provide some interesting tools to address the issues dealt with in this thesis, in the specific context of the World Bank there might be other forces influencing the choice of the model.

Another factor that influenced the choice of the Model Law as one of the main systems used in this thesis is the support given by the World Bank to its provisions. In fact, when helping to finance the reform of the procurement system of borrowing countries, the Bank has insisted on the use of the Model Law as a guide for reform. The adoption of practices stated in the Model Law by client countries might influence the adequacy of the World Bank procurement regulation. For example, if most client countries have strong national enforcement systems, the World Bank could rely on them for procurement in financed projects. On the other hand, if weak systems prevail, the Bank might have to adopt other forms to address complaints in financed projects. The advantages and disadvantages of both approaches will be further assessed in Chapter V.

The GPA and the EC Directives have also been chosen as important examples throughout this work. In fact, those are major international agreements that have much stricter rules in regulating public procurement<sup>8</sup> and which have a wide membership. The EC Directives now regulates public procurement in 25 states while the GPA has a membership of 37 states – a quarter of the WTO members. Although it is correct to say that membership of the GPA includes EC states and mainly developed countries, it accounts for a significant portion of the world trade. In this sense, the rules adopted in those agreements could be regarded as relatively widely accepted. Moreover, despite the fact that most World Bank borrowers are not members of those agreements, the resistance to adopting the GPA provisions and the arguments of developed and developing countries, especially regarding the provision on enforcement and on secondary

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<sup>8</sup> The procurement provisions in the NAFTA also have the same character but since they were inspired in the GPA and that membership is mainly composed by members of the GPA, the NAFTA will not be considered separately.

policies, could also provide significant contributions for this work. Another aspect arising from the wide applicability of those agreements is that consideration has been given to the suitability of the rules by a variety of different states. Such states may have had different traditions and regulations regarding public procurement and their processes in adopting them might provide a rich source of information.

Since the EC Directives and the GPA are agreements reached with the mediation of multilateral institutions, it could be argued that their provisions would reflect what could be regarded as a good procurement system since political pressure from individual groups tends to be minimised. This argument follows from the fact that political difficulties make ideal solutions difficult in individual states or in the early stages of integration, but effective multinational institutions are designed to get round these vested political interests to bring about solutions that are effective to promote a state's overall well-being. Although such organisations might not bring the ideal solutions for all instances, in general they tend to draft how a procurement system would look, in the absence of certain domestic vested interests. Whether those agreements will work in practice will depend on several factors, including the proper implementation of their provisions. Thus the benefits and constraints perceived when implementing those agreements, especially regarding the provisions on remedies and secondary policies, might help to identify the benefits and problems of having such provisions in the World Bank Guidelines.

One further reason lies in the fact that those agreements have been implemented over some considerable time. The EC system in particular is a very longstanding system which has been developed over a long period, and therefore could provide wider sources of interpretations of its provisions, including case law material. The GPA, on the other hand, despite being a newer system, by being part of the WTO system, might demonstrate the pros and cons of different aspects, not only through the interpretation of its own provision but also in the interpretation of other agreements. It is important to emphasise that this research does not make any judgment on the efficiency of those systems or imply that they set lessons to be learned. All that is done is to use their practice, the abundant literature and critiques, and the alternative solutions presented,

for both systems to illustrate achievements and problems that might be experienced during the implementation of some aspects of the procurement regulation.

The procurement regulations under other international agreements have also been sources for this work, although to a more limited extent. This would include the procurement provisions of the North America Free Trade Agreement (NAFTA), which were inspired by the GPA provisions and whose members are mainly from the GPA<sup>9</sup>; the Asia Pacific Economic Cooperation (APEC), which is a non-binding agreement that intends to provide a first step toward procurement integration in the region, and therefore does not have significant institutions that can overcome political vested interests<sup>10</sup>; the Common Market for Eastern and Southern Africa (COMESA) Principles on Government Procurement, which involves a non-binding agreement that in order to promote trade tries to harmonise procurement rules in the regions (pursuing the same rationale as the UNCITRAL Model Law)<sup>11</sup>; and the Common Market of the Southern Cone (MERCOSUR) Protocol of Public Contracting, which is an agreement reached in 2003 establishing general rules on public procurement, although so far it has not been clear how member countries have incorporated those rules into their national procurement regulation<sup>12</sup>.

#### **4 Outline**

This work will be divided into eight major Chapters, which will be outlined in the following paragraphs. This introduction is the first Chapter of the thesis and its aim is to clarify the objectives of the work, the methodology used to achieve those objectives, and to give an overview of the Chapters that will follow.

Before addressing the main objectives of this thesis, the following two Chapters will provide background information which needs to be known and understood in order to appreciate

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<sup>9</sup> For further general information see Greenwold, (1994); Bovis, (1993). See specific Chapters for further information on the issues treated in the thesis.

<sup>10</sup> For example, given the sensitivity of the issue the APEC provisions do not provide any form of enforcement system. For full details see Asia Pacific Co-operation Forum, Government Procurement Experts Group, Non-binding Principles on Government Procurement: Transparency at [http://www.apecsec.org.sg/committee/gov\\_non\\_binding.html](http://www.apecsec.org.sg/committee/gov_non_binding.html); Brown (1999); Arrowsmith (1998) (a)

<sup>11</sup> For more information see Karangizi (2005).

<sup>12</sup> For further information on public procurement in the MERCOSUR see Bizai and Gruskin (2004); Bizai (2000); and Guimarães (1997).

the context in which the relationship between the World Bank, borrowers, and private parties involved in the procurement process develops. Such information will set the foundation for developing some of the arguments presented in later Chapters of the thesis. Following this line of reasoning, the second Chapter starts with an analysis of the World Bank as an international organisation, its constitutional rules, powers and functions. In order to determine the legal basis in which the procurement relationship develops, the legal background between the Bank and other actors involved in the Bank's operation is established. Principles, treaties and rules of public international law applicable to international institutions, the legal status of the Loan Agreement between the Bank and the borrower, and the responsibility of the institution towards third parties are dealt with in this Chapter.

The Bank's concern with procurement will be the main subject of Chapter III. The objective of this Chapter is to determine what the Bank's policies regarding procurement are and how they frame the legal relationship between the institution, borrowers and bidders. The general procurement policy under project lending will be explained. However, a detailed explanation of the rules and procedures will not be carried out in this work since there are studies and World Bank documents that already do that. Moreover, development policy operations will not be considered since the procurement guidelines usually do not apply.

After defining the context in which the procurement relationship develops, the following Chapters will directly address the main research issues of this thesis, namely the enforcement system and the use of secondary policy in procurement for financed projects.

Chapter IV will aim to examine the enforcement provision under the current procurement system. Not only are the provisions of the Guidelines on enforcement analysed, but also indirect forms of review mechanism, such as the provisions on fraud and corruption and procurement audits. Moreover, the accountability of the Bank towards bidders is examined.

In Chapter V, the research will critically analyse the enforcement system currently in place. Some consideration will be given to issues that are seen as relevant when setting a review mechanism, such as the role of private parties, burden of proof, stands to sue, speed of the procedure and remedies. Finally, several models of review mechanism are mentioned, namely a

formal complaint mechanism within the Bank; access of private parties to national review mechanisms; international arbitration, and the creation of an “ombudsman” like mechanism, and their advantages and disadvantages are assessed. It is tentatively suggested that that the Bank’s procurement guidelines would improve if a more formal review mechanism were to be in place, and that it could submit complaints not to one, but to several review mechanisms, maximising the advantages that each of them could bring.

Chapter VI will introduce the subject of secondary policies on public procurement. In this Chapter the controversies underlying some of those policies will be examined, as well as some models commonly used to pursue those policies under procurement procedures. It is important to note that although a wide range of policies could be implemented through procurement regulations, this study will concentrate its discussion on policies under four major headings, namely, economic development of sectors or regions, development of social groups, environmental policies, and labour standards, since those are major issues for concern. The analysis, which will be based on the secondary literature on public procurement, will point out some of the strengths and weaknesses of each of the models mentioned in implementing policies in each of the chosen sectors.

The following Chapter, Chapter VII, will aim to examine the possibility of using secondary policies under the World Bank’s current procurement system. Not only will the contents of the rules be assessed, but also the models used in national and international procurement regulations will be used to provide examples of how other systems have tried to strike a balance between the various procurement objectives. This will lead to an overview of the current state of the rules and the identification of the areas that could be improved. It will be determined that although there are significant limitations on the use of national secondary policies, the Guidelines have some provisions which could be used to implement secondary procurement concerns.

Finally, Chapter VIII will provide a critique on the current provisions and will offer some proposals for the reform of the system. The proposed reform will consider the three different facets of the use of secondary policies in financed projects, namely, improvements to the current

policies; the scope for further use of established national policies of the borrowing country; and the possibility of the using the Bank's procurement power to promote other policies. It will be argued that there is some scope for improving the provisions in the Guidelines and that guidance should be given on the precise limits of the provisions so that transparency could be improved and discrepancies avoided. The possibility of using national policies should be carefully taken into account and, if the Bank decides to allow them, their implementation should be limited to what is required by national law. As to the Bank's role in promoting secondary policies, significant limitations will be found in the Bank's charter. However, those limitations may not preclude the use of international standards in procurement contracts. In this context, it is tentatively suggested that the Bank could use its power to promote standards provided they reflect policies pursued by the borrower in international agreements. The ultimate choice will depend on the choices the Bank is prepared to make.

## **CHAPTER II – THE WORLD BANK: SCOPE, POWER AND FUNCTION**

### **1 Introduction**

This Chapter defines the context in which the World Bank operates<sup>13</sup>. The study will start with an analysis of the Bank as an international organisation, and of its constitutional characteristics, powers and functions. As it develops the Bank's distinctive features will be identified, and the rules that could influence the legal relationship between the organisation and the outside world will be pointed out. Within the field of public international law there will be treaties and customary international law that helps to shape how the Bank operates, and determines the extent to which it enjoys immunity from suit. This analysis is relevant since there are principles and rules that might interfere with Bank-financed procurement<sup>14</sup>. Furthermore, as the Bank carries out its purpose primarily through loan operations, the next step will be an analysis of the legal aspect of the Loan and Guarantee Agreements. Here will be defined the specific framework of the relationship between the Bank and the borrower and, where applicable, the guarantor. Moreover, the accountability of the institution towards third parties affected during the designing, appraisal and implementation stages of the project will be assessed. This is important in considering the liability of the Bank for acts carried out by borrower states in the procurement process that have been required or authorised by the Bank. Thus, this Chapter will aim to set out the legal foundations for the discussion regarding the procurement provisions in financed projects. In particular, the Chapter will provide a framework for determining the attribution and responsibility of the Bank in the context of procurement.

### **2 The World Bank Group – Financial Structure**

The World Bank is a specialised agency of the United Nations created in 1944 as a result of the United Nations Monetary and Financial Conference held in Bretton Woods (USA). At that

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<sup>13</sup> For the purpose of this work the expression ‘the Bank’ will refer to the IBRD and the IDA only, because those agencies are the ones that are involved with providing funds for projects that require procurement of goods and services by their borrowers through the Bank’s Guidelines.

<sup>14</sup> For further discussion on the relation between the World Bank rules and national rules see Chapter III.

conference its charter – the Articles of Agreement- were drafted by the forty five governments present, and came into force on 27<sup>th</sup> December 1945. At that time the World Bank was the popular name of the International Bank for Reconstruction and Development, which was formed with the purpose of providing loans to finance post-war reconstruction and economic development. Today, the World Bank Group consists of five associated institutions: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the International Centre for the Settlement of Investment Disputes (ICSID) and the Multilateral Investment Guarantee Agency (MIGA).

The World Bank is an institution created by an intergovernmental agreement, which has, at present, 184 member states<sup>15</sup>. For a new member state to be admitted, it first has to join the International Monetary Fund<sup>16</sup> and then be admitted by decision of the Bank's Board of Governors<sup>17</sup>. Also membership of the International Development Association (IDA), the International Finance Corporation (IFC), the International Centre for the Settlement of Investment Disputes (ICSID) and the Multilateral Investment Guarantee Agency (MIGA) are conditional on membership of the International Bank for Reconstruction and Development (IBRD). In general terms, the membership procedure requires subscriptions based on 'quotas' which are determined based on the country's Gross National Product, its current reserves and its foreign trade prospects. In practice this will mean that the size of the 'quota' will be proportionate to the economic size of each member, so that the wealthier countries pay more than the poorer ones<sup>18</sup>. All member countries are shareholders of the Bank<sup>19</sup>. Describing its procedures for subscription, the Bank states that the capital subscription of a new member consists of two

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<sup>15</sup> The IBRD has 184 members, IDA has 165members, the IFC has 177 members, MIGA has 164 members and ICSID has 140 members.

<sup>16</sup> For more information on the IMF and its relationship with the World Bank Group see Sir Walters, (1994); Horn, and Schmitthoff, (1982) page. 310; Efraim, (2000) Chapter IV and Driscoll, (1994). For a recent analysis of the World Bank and IMF origins and contemporary functions see Mac Darrow, (2003).

<sup>17</sup> Article II, Section 1 of the IBRD Articles of Agreement.

<sup>18</sup> The 'quota' in the IMF is determined according to the country's financial standing in the world. (IMF Articles of Agreement, Article II Sections 1 and 2). It is important to note that the quota subscriptions are systematically adjusted to the economic reality of members.

<sup>19</sup> For deeper explanation of the subscription procedures see World Bank group at <http://www.worldbank.org/html/extdr/about/members/generalinfo.htm>

components. The first is an obligatory subscription that the new member must subscribe to at the time it joins the Bank. However, with respect to each share of this subscription, the member must pay 0.60% of the price in US dollars in cash and 5.40% in the member's currency or in US dollars. The balance of the price of the shares consists of callable capital<sup>20</sup>. The second component, subscription to which is also optional, consists of 250 shares with respect to which no payment is due at the time of subscription. The total price of these shares is made up of callable capital. All members of the Bank were offered to subscribe 250 'membership' shares on these terms in 1979 to avoid dilution of the voting power of the smaller members of the Bank as a result of the 1979 general capital increase. New members are also authorised to subscribe 250 shares on the same terms and conditions.<sup>21</sup>.

According to the Bank's charter<sup>22</sup>, only 20% of the shares subscribed by member states are in fact paid. The residual amount of the capital is not available for lending but remains as a guarantee fund for the Bank's own borrowing. In fact the Bank does not rely on contributions made by its members but raises most of its funds from non-governmental sources. There are two main ways in which funds are raised: the Bank borrows money from the international capital market<sup>23</sup> or it sells portions of its loan to private investors. Under the Bank's Loan Agreement the borrower will issue bonds that relate to their debts, and those are sold in the market in order to raise funds for further loans. Although out of the scope of this research, it can be foreseen that there might be important legal issues related to the transference of rights and liabilities of the Loan Agreement to private investors<sup>24</sup>.

The way in which the Bank's financial and capital structure is drafted is crucial for the understanding of the great autonomy enjoyed by this institution<sup>25</sup>. The special position of the

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<sup>20</sup> All the shares of the Bank's capital stock are valued at \$120,635 per share.

<sup>21</sup> World Bank group at <http://www.worldbank.org/html/extdr/about/members/generalinfo.htm>

<sup>22</sup> Article 2, Section 5 of the IBRD Articles of Agreement.

<sup>23</sup> See Driscoll (1994).

<sup>24</sup> See Broches, (1995), page 8.

<sup>25</sup> The position of the IMF and the World Bank and the International Finance Corporation are very similar but it differs from other institutions such as the World Health Organisation.

Bank, when compared with other specialised agencies of the United Nations<sup>26</sup>, is reflected in the agreement between the former and the latter<sup>27</sup>. The first Article of the Agreement not only recognises the Bank as a specialised agency of the United Nations but also states that “By reason of the nature of its international responsibilities and the terms of its Article of Agreement the Bank is, and is required to function as, an **independent international organization**”<sup>28</sup> (emphasis added). Another distinct provision is the one on Article III. While other specialised agencies are obliged to submit the recommendations made by the General Assembly or the Council to the appropriate organ, the provision on the Bank’s agreement only requires from the institution “due consideration to the inclusion in the agenda of items proposed by the United Nations”. Regarding the administrative relationship between the UN and the Bank, the autonomy of the latter is particularly striking. On Article X Section 3, the United Nations agrees that in the interpretation of paragraph 3 of Article 17 of the United Nations Charter, which provides that the General Assembly shall examine the administrative budget of the specialised agencies, it will take into account that the Bank does not rely for its annual budget upon contributions from its members, and that the appropriate authorities of the Bank enjoy full autonomy in deciding the form and the content of the Bank’s budget.

Another important consequence of the financial structure of the Bank is that it will not enjoy all broad immunities from suit as do some other international organisations. Because of the dependence of the Bank on capital markets, and since immunity from judicial processes can be discouraging for private investors, the Bank’s charter on Article VII, Section 3 provides a waiver of immunity and allows private parties to sue the Bank in municipal courts<sup>29</sup>.

### **3 Voting Power**

Each member will appoint a Governor to the Board of Governors. The Board is the organ of the Bank that holds the ultimate decision-making power. They decide on key policy issues,

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<sup>26</sup> See Philippe and Pierre (2001) page 79-83, and White, (1996) page 153 when comparing the Bretton Woods Organisations with the World Health Organisation. Also see Bergesen and Lunde, (1999).

<sup>27</sup> 16 UNTS 341.

<sup>28</sup> Article I , Section 2.

<sup>29</sup> Given the significance of this issue there will be a separate section on this Chapter analysing it.

determine the distribution of the IBRD's net income and endorse financial statements and budgets. The system of voting, however, is not based on one vote per membership but on the number of shares that each member possesses. According to Article V, Section 3 of the Article of Agreements, each member shall have 250 votes plus one additional vote for each share of stock held. Therefore, the voting power is weighted on the sole basis of the financial contribution of each member. The number of shares varies according to the economic size of each member so, in practice, the largest industrial members<sup>30</sup> hold the greatest number of shares and have the greatest influence on the Bank's policies. One of the most important consequences of this voting mechanism is the fact that *de facto* just one member, namely the United States, as the largest shareholder (16.87%)<sup>31</sup>, has the power to veto any changes in the Bank's capital base and Articles of Agreement<sup>32</sup>. It is also true that pooling the votes of other members can also veto the decision of the Bank requiring high majority - i.e. the European Union members. However, comparing the position of the Bank with other international organisations that do not use the same voting mechanism<sup>33</sup> it can be seen that the Bank's largest shareholder enjoys much greater power<sup>34</sup>. As the Board of Governors is basically an organ orientated by international politics, and there is an interest from wealthier members to determine policies that are seen as appropriate to address development problem<sup>35</sup>, minor shareholders seldom have an important stake in the decisions taken by the Board. Nonetheless, it is important to note that the majority of decisions are taken by consensus<sup>36</sup>. Hence, the configuration of the system suggests that while the economic power of

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<sup>30</sup> United States, United Kingdom, Japan, Italy, Germany, France and Canada together hold about 45% of the Bank shares. Other major shareholders include China, India, Russian Federation and Saudi Arabia.

<sup>31</sup> For the number of shares and number of votes of each member see: <http://www.worldbank.org/html/extdr/about/voting/kird.htm>

<sup>32</sup> 85% of the shares are needed to make such changes (Article VIII of the Article of Agreements).

<sup>33</sup> i.e. Although the UN Charter does not expressly foresee the veto in its voting procedures the requirement of high majority provides a *de facto* veto power. However, unlike the Bank, the UN Charter grants the five permanent members of the Security Council the power of veto. See Efraim,(2000) Chapter IV.

<sup>34</sup> For discussion on the decision making mechanism in several international organisations see, Reinalda and Verbeek (eds.), (2003). For the particular characteristics of the World Bank see Chapter 6, Woods, Ngaire. Groupthink: *The IMF, the World Bank and Decision Making Regarding the 1994 Mexican Crisis*.

<sup>35</sup> See MacBean, (1981), Chapter 2.

<sup>36</sup> Consensus does not mean absolute agreement by all members in a formal voting procedures but rather the will of the majority expressed many times by no opposition to the decision taken. Commenting on the same practice in the IMF Efraim (2000) wisely notes that: ' The single voice heard with consensus often conceals an uncomfortable coalition between dissatisfied parties repressing dissent and hiding behind a

wealthier members determines the control and policies of the institution, minor shareholders are willing to agree with the measures suggested by them in order to gain access to funds available for loans at a favourable rate.

The Board meets only once a year and the power to make decisions on a day-to-day basis is delegated to the board of Executive Directors. The five largest shareholders<sup>37</sup> appoint an Executive Director each, while 19 Executive Directors who are elected by group of states (or constituencies) represent the other members<sup>38</sup>. The 24 members of the board meet once a week and have the power to decide, among other things, on the approval of loans and guarantees, policies and strategies, borrowing and financial issues.

#### **4 The Bank's purpose**

The purpose of the Bank is determined in the Article I of the Articles of Agreement:

The purposes of the Bank are:

- (i) To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.
- (ii) To promote private foreign investment by means of guarantees or participation in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.
- (iii) To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international

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facade of unanimity. However, this compromise is very important in avoiding difficulties and overcoming potentially serious problems, thus ensuring the Organization's maximum efficiency'. (Op.cit. page 207).

<sup>37</sup> They are United States, United Kingdom, Japan, Germany and France.

<sup>38</sup> China, Russia and Saudi Arabia, for example, have formed single-country constituencies and so each is represented by an Executive Director.

investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labour in their territories.

(iv) To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.

(v) To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

The Bank shall be guided in all its decisions by the purposes set forth above.

The main way in which the Bank fulfils its purpose is through loan operations. The Bank lends money only to developing countries<sup>39</sup>, as those are the members that are more likely to encounter difficulties in borrowing money from private sources at affordable conditions. The Bank is supposed to finance only productive projects or programmes in the territories of its members, and loans are granted not only to member governments but also to public or private enterprises. However, when the borrower is not a member government, the loan must be fully guaranteed by the member government in which country the project to be funded is situated<sup>40</sup>.

Although loan operation is the primarily way in which the Bank carries out its activities, the Bank also performs some important tasks by giving economic and financial advice. Within loan operations, the Bank discusses and helps the borrower with preparation of the projects to be submitted for loan. At that stage, even though no Loan Agreement is in place, the Bank already performs an important role<sup>41</sup>. This

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<sup>39</sup> The IBRD focuses on middle income and creditworthy poor countries, while IDA focuses on the poorest countries in the world. Operational cut off for IDA eligibility for FY 06 is \$ 965 (2004 GNI per capita). There is a ceiling of \$ 13.5 billion for borrowing.

<sup>40</sup> Article III, Section 4.

<sup>41</sup> The preparation and appraisal stages of the Project Cycle will be explained in Chapter III.

research will be primarily concerned with the loan operation of the Bank, since it is under this function that the procurement rules will be implemented. However, as rights and liabilities of the parties involved are addressed it is important to remember the entire framework in which the Bank carries out its work. The advice and help given by the Bank in the preparation stage might prove significant not only to the success of the procurement process, but may also influence the development of the entire project.

The provisions in Article I cited above are the departure points to understand the limits and objectives of the Bank's operation. There are also some practical aims, which derive from these provisions. As has already been mentioned, the Bank is a financing agency, which has the purpose of strengthening economies and expanding markets to improve the quality of life in its member countries, especially the poorest<sup>42</sup>. It is worth emphasising that the Bank does not have a charitable character, but fulfils its purposes by lending money for productive projects within the territory of its members. Developing countries borrow from the Bank because they need capital, technical assistance, and policy advice, and cannot usually get those from the general international market at affordable conditions. The Bank believes that although only developing countries are entitled to receive loans, its operation will benefit all members since it will increase the global economic growth, providing better conditions for trade and investment, higher incomes, fewer social tensions, better health and education, and environmental protection<sup>43</sup>. It is also recognised that the Bank's member countries, especially the developed countries, will also benefit from procurement opportunities derived from World Bank-financed projects<sup>44</sup>. When combining the draft of Article 1 with those practical objectives it is possible to have a basic framework for the Bank's operation to which we should always refer.

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<sup>42</sup> Article I of the IBRD's Article of Agreement.

<sup>43</sup> See: Why do we need a World Bank? Web page at: [www.worldbank.org/html/exdr/about/why.htm](http://www.worldbank.org/html/exdr/about/why.htm) as in 02/08/00.

<sup>44</sup> See: The World Bank's Role. web page at: <http://www.worldbank.org/html/exdr/backgrd/ibrd/role.htm>

Hence, the World Bank can be defined as an institution concerned with the actual implementation of projects and reforms, rather than one concerned with the formulation of recommendations to member countries, or with activities of a consultative, regulatory, quasi-legislative or quasi-judicial character<sup>45</sup>. It performs most of its functions through contracts made with member governments, public and private enterprises and also with private investors.

## 5 The World Bank as an international organisation – scope and powers

The term ‘international organisation’ is generally used in the international law literature to refer to those organisations that are primarily composed by states and are usually created by a treaty<sup>46</sup>. In this context, ‘treaty’ can be defined as a written international agreement entered by states<sup>47</sup>, which will establish the regulations and powers of the organisation. It is this constitutive instrument that will determine the organisation’s basic operational rules. In general, those entities will be given rights and duties of their own, different from those of each and every member state, and will not be subject to the authority of any single member<sup>48</sup>.

International organisations do not enjoy the same rights and powers as sovereign states. Their capacity is restricted to the powers and functions conferred to them by its members. The rights of states to create such organisations under international law have been compared with the rights of individuals to group themselves under companies and associations under domestic law<sup>49</sup>. Although this seems a rough comparison, it is appropriate to understand the powers and limitations that those institutions bear. If on one hand their freedom to act is restricted to what is necessary to fulfil their functions, on the other hand, the interpretation of the

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<sup>45</sup> See Broches, note 24, p.4.

<sup>46</sup> This is referring to intergovernmental international organisation as opposed to non-governmental international organisations (NGO’s) or multilateral public enterprises. See Sands and Klein(ed.) (2001) page 16, Henkin, (1993), Chapter 5 and Seidl-Hohenveldern, (1998), page 6.

<sup>47</sup> Vienna Convention on the Law of Treaties, Article 2, 1 (a), UNTS 331.

<sup>48</sup> See: Sands and Klein (ed.) (2001), paragraph 15-014, Schermers, and Blokker, (2004), White (1996) page 33.

<sup>49</sup> Seidl-Hohenveldern, (1998) p. 4.

constitutive instrument must be broad enough to enable them to perform their tasks in practice.

The most important interpretation of the rights and duties of international organisations and their legal personality was given by the International Court of Justice in 1949 on the case *Reparation for Injuries Suffered in the Service of the United Nations*<sup>50</sup>. In this case the International Court of Justice was asked to give an advisory opinion on whether the United Nations could bring a claim against a state which was responsible for injuries caused to a UN agent while performing its duties. There, the Court stated: “Whereas the State possesses the totality of international rights and duties recognized by international law, the rights and duties of an entity such as the Organization must depend upon its purpose and functions as specified or implied in its constituent documents *and developed in practice*”<sup>51</sup> (emphasis added). Therefore, it can be said that international organisations will have their rights and duties defined not just by what is expressed in their charter but also by what is needed to fulfil their purposes (implied powers) and by practices as consolidated under customary international law<sup>52</sup>.

Despite this wide interpretation of the rights and duties of international organisations, it must be remembered that the charter plays an important role. In fact, by determining the aims of the organisation, it imposes a limit to the extent to which an organisation can act. Moreover, they might expressly forbid certain behaviour or action, in which case the organisation will be bound to follow such a statement.

A good example of the limitations imposed by the charter of international organisations can be seen in the decision of the International Court of Justice on the case of *The Legality of the Use of Nuclear Weapons in Armed Conflict*, requested by

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<sup>50</sup> ICJ Reports 1949 174. For a good discussion on the effects of the decision recognising the rights of international organisations see Henkin, (1993) pages 348-356, Seidl-Hohenveldern, (1998) pages 3-37 and Amerasinghe, (1996). For more specific discussion on the World Bank see Broches, (1995) pages 14-22.

<sup>51</sup> Ibid., p.180.

<sup>52</sup> For the application of those source in the context of the World Bank see Mac Darrow, (2003).

the World Health Organisation<sup>53</sup>. In that instance the Court refused to give an advisory opinion on the question posed by the WHO because, according to its interpretation of the charter, that question was not within the power granted by member states to the institution. According to the Court "...international organizations are subjects of international law which do not, unlike States, possess a general competence. International Organizations are governed by the "principle of speciality", that is to say, they are invested by the States which create them with powers, the limits of which are a function of the common interests whose promotion those States entrust to them. (...) The powers conferred on international organizations are normally the subject of an express statement in their constituent instruments. Nevertheless, the necessities of international life may point to the need for the organization, in order to achieve its objectives, to possess subsidiary powers which are not expressly provided for in the basic instrument which govern their activities. It is generally accepted that international organizations can exercise such powers known as "implied" powers."<sup>54</sup> However, in the present case the Court found that to attribute to the WHO the competence to address the legality of the use of nuclear weapon would be "tantamount to disregarding the principle of speciality; for such competence could not be deemed a **necessary implication** of the Constitution of the Organization in the light of the purposes assigned to it by the member States" (emphasis added). Therefore, as an intergovernmental organisation, the Bank will be limited to the powers granted to it by member states. Such powers can be express or implied from the constituent agreement, but will always be subject to what is necessary to achieve the organisation's purposes and objectives.

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<sup>53</sup> Legality of the Use by a State of Nuclear Weapons in Armed Conflict (Request by the World Health Organization for an Advisory Opinion), Advisory Opinion of 8 July 1996, taken from the web site: [http://www.icj-cij.org/icjwww/icase.../ianw\\_ijudgment\\_advisory%20opinion\\_19960708.htm](http://www.icj-cij.org/icjwww/icase.../ianw_ijudgment_advisory%20opinion_19960708.htm) on the 11/02/01.

<sup>54</sup> Ibid. para. 25.

The functions of international organisations will be performed by their staff, and there is the possibility that those persons could commit an illegal act, either by disregarding the limit of their functions or by breaching some of the international rules they are subject to. In those cases, the organisation might be responsible for the consequences of those acts to third parties. Under those circumstances the effects of an *ultra vires* act for the organisation and for its members needs to be considered. By *ultra vires* act we mean an act that was performed in a different manner from what is determined in the organisation's constitutive document, but is still within the scope of the functions of that organisation. The ICJ, in *Certain Expenses of the United Nations*<sup>55</sup>, determined that in those instances the organisation is bound to third parties, and that the fact that the action was taken by a wrong organ of the organisation is a matter of the internal structure. Therefore, third parties' rights will be secure, even if the procedures and powers determined in the charter are not strictly followed.

Regarding the liabilities of member for those acts, the Court went on to say that the expenses, although not authorised accordingly with the UN's internal rules, were still expenses incurred by that organisation and, therefore, members would be bound to pay them. Therefore, it can be said that *ultra vires* acts bind not only the organisation, as to third parties, but also affect member states in as far as they will have to fulfil the expenses incurred by the organisation<sup>56</sup>.

## 6 The Articles of Agreements

It is now appropriate to turn to the World Bank's Articles of Agreement and to examine how this constitutive instrument frames the rights and duties of that institution, and in what manner its functions should be performed. As mentioned above, Article I of the Agreement defines the purpose of the organisation and therefore, can be seen as the departing point to understand the Bank's operation. Article 2 deals with

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<sup>55</sup> ICJ Reports 1962,168.

<sup>56</sup> Also see ICJ in the Reparation Case op. cit. at p.184.

membership procedures and the Bank's capital, and their importance has also been stressed<sup>57</sup>.

## 6.1 Standard of activities

Another very important article for the analysis of the Bank's operation is Article III, since it defines the rules to be followed under loans and guarantees agreements. Under this provision it is worth highlighting some parts of Sections 4 and 5, which are drafted as follows:

### SECTION 4. Conditions on which the Bank may Guarantee or Make Loans

The Bank may guarantee, participate in, or make loans to any member or any political sub-division thereof and any business, industrial, and agricultural enterprise in the territories of a member, subject to the following conditions:

(iii) A **competent committee**, as provided for in Article V, Section 7, has submitted a written report recommending the project **after a careful study of the merits of the proposal.**(emphasis added)

(v) In making or guaranteeing a loan, the Bank shall pay due regard to the prospects that the borrower, and, if the borrower is not a member, that the guarantor, will be in position to meet its obligations under the loan; and **the Bank shall act prudently in the interests both of the particular member in whose territories the project is located and of the members as a whole.**(emphasis added)

(vii) Loans made or guaranteed by the Bank shall, except in special circumstances, be for the **purpose of specific projects** of reconstruction or development.

### SECTION 5. Use of Loans Guaranteed, Participated in or Made by the Bank

(a) The Bank shall impose no conditions that the proceeds of a loan shall be spent in the territories of any particular member or members.

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<sup>57</sup> See above.

(b) The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations.(emphasis added)

(c) In the case of loans made by the Bank, it shall open an account in the name of the borrower and the amount of the loan shall be credited to this account in the currency or currencies in which the loan is made. The borrower shall be permitted by the Bank to draw on this account **only to meet expenses in connection with the project as they are actually incurred.**(emphasis added)

Those provisions require from the Bank absolute commitment regarding the evaluation and analysis of the projects and are designed to reassure members and investors that the institution will only finance projects that comply with a certain standard of economy and efficiency. Although the provisions do not ask the Bank to guarantee the success of all the investments, they certainly determine that any proposal should be analysed carefully, and that the Bank provides its services with a certain quality and efficiency. It is difficult to define the extent to which the standard required from the Bank goes, but given the qualification of the staff recruited and the dimension of the projects' impact within members, a high level of commitment and responsibility is clearly expected by borrowers, investors, member countries and all those affected by the Bank's operations. Any action taken by staff members falling short of what is required under the Article of Agreement, or departing from its limits, could bring liability to the Bank for the consequences of their illegal or wrongful acts<sup>58</sup>.

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<sup>58</sup> See Sands and Klein, (2001), Chapter 15. For the increased pressure over accountability of international organisations for their acts see also Wellens, (2002).

## 6.2 Limitation over political interference

Another significant provision is Section 10 of Article IV of the Articles of Agreement. This rule has a negative command, which prevents the Bank from taking into consideration the political character of the members when making a decision:

The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. **Only economic considerations shall be relevant to their decisions**, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I.

As we have seen before, when the charter of an international organisation expressly forbids the institution to perform in a certain way, the organisation has no power to overcome these rules and decide whether or not to follow them. An express negative provision limits significantly the operations of the organisation but, at the same time, allows other parties to realise what functions and strategies the members had in mind when deciding to create that organisation.

Shihata<sup>59</sup> sheds some light on the interpretation of such provisions by drawing up a list of activities considered to be prohibited by the Bank's Articles. According to him, it should be of no relevance to the Bank if the country concerned is a member of a particular political bloc, professes a particular political ideology or follows a specific political system. "At any rate, political choices, along with their underlying values and trade-offs are for each country to make; the Bank's concern is for the economic effects and resultant degree of efficiency in the allocation of resources."<sup>60</sup> However he qualifies this statement by saying that "economic considerations are relevant to the Bank's decision, even when they have political causes or origins."<sup>61</sup> Political factors and events can only be taken into account if a clear and direct economic effect can be established, and provided such economic effect is preponderant. Moreover, the Bank should not

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<sup>59</sup> Shihata, (1991-2000) Also see similar interpretation of the Articles of Agreement given by Wadrzyk, (1999).

<sup>60</sup> Ibid. page 82.

<sup>61</sup> Ibid. page 83.

act on behalf of donor countries in influencing the recipient country's political orientation or behaviour, nor base its activities on response to political pressure from a member or members, or make its assessment on the possible reaction of any particular Bank member or members<sup>62</sup>. Nonetheless, the Bank is free to acquire any relevant information about the political situation in its borrowing countries and to gain insight into the underlying social and cultural factors behind each economic situation<sup>63</sup>. According to Shihata, acquiring such knowledge is not only legitimate but essential for the Bank's ability to provide useful advice on policy reform in the economic and social sectors.

The Bank has defined an economic factor, within the meaning of the Bank's Articles of Agreement, as any factor that has a “‘direct and obvious’ economic effect relevant to the [Bank's] work<sup>64</sup>”. The Bank uses a three-part test to determine if the economic effect of a particular factor in a Bank operation is ‘direct and obvious’. The economic effect must be (1) clear and unequivocal; (2) preponderant; and (3) when the issue is associated with political actions or flows from political events, the economic effect “must be of such impact and relevance as to make [it] a Bank concern”.<sup>65</sup> However, as Bradlow accurately points out, without a temporal restriction the interpretation of what constitutes an economic consideration can include nearly all political, social and cultural issues as they could impact on a long term basis on the project financed by the Bank and on the ability of the borrower to repay the loan<sup>66</sup>.

Although the considerations above seem to be an accurate interpretation of the Article's provision, it is also important to also bear in mind the strong influence that certain members have in the decision-making process of the Bank. If on one hand it would be unlawful to take political factors into consideration when deciding for or against lending to a particular member, on the

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<sup>62</sup> Ibid. page 84.

<sup>63</sup> Shihata, (2000) (a).

<sup>64</sup> Bradlow, (1996).

<sup>65</sup> Ibid, at page 60.

<sup>66</sup> See examples given by Bradlow, (1996) at page 61/62.

other hand it is very likely that members with strong voting power could define policies that will particularly favour some political wings<sup>67</sup>.

### **6.3 Status and immunity provisions**

We should now turn to the provisions in Article VII, which deals with the status, immunities and privileges of the institution. From the beginning it determines that those rules are necessary to enable the Bank to fulfil its functions, and each member state must give the Bank the status, privileges and immunities set forth on that provision<sup>68</sup>.

Section 2 of this Article establishes that the Bank has “full juridical personality”. However, it does not define whether this juridical personality is possessed under domestic or international law. Broches<sup>69</sup> argues that the language of Section 2 only indicates the intention of member countries to give the Bank juridical personality under domestic law and not under international law. According to him, this statement is supported by the wording of Section 1 which refers to the obligation of each member state to recognise the Bank’s status within its territories. However, he also argues that although a charter grant of ‘juridical personality’ to an international organisation does not necessarily carry with it a grant of international personality, such international personality can be implied from the charter since juridical personality under municipal law does not exclude that under international law. Broches finds that the intention of member states to award the Bank with international personality is found in other articles which are drafted in such a language as to imply that the institution is a separate entity from its members and has the capacity to create international rights and obligations in relation to its members and with third parties. As an example he

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<sup>67</sup> Although staff can not be influenced by members in the preparation of projects, if there are divergences it is the Board as a whole which will finally decide on the matter. Therefore members with stronger voting power can ultimately decide on the approval of any particular loan. Particular influence of donor countries in the economic policy of recipient country can be found in adjustment operations where the adoption of free trade policies is often attached to the loan by means of ‘conditionality’ requirements.

<sup>68</sup> Article VII, Section 1.

<sup>69</sup> Op.cit. p. 18-22.

mentions several sections in Article II where ‘the Bank’ and not ‘the members’ is the one who prescribes rules, terms and condition for subscription of new members.

Moreover, if we recall the functions of the Bank and the way in which it raises the bulk of its capital, the Articles of Agreement must be understood as giving the Bank juridical personality under both sets of laws. If the Bank’s juridical personality under domestic law is granted *expressis verbis* in order to allow the organisation to exercise its functions in the territory of each member state, the international personality can be implied by the way the institution fulfils its functions. The Bank is an institution that is able to create rights and obligations by agreement with other subjects of international law such as states, and can demand the recognition of such rights and reparation for their violation<sup>70</sup>. Moreover, the charter specifically provides for the relationship of the Bank with other international organisations and foresees arrangement for co-operation with such organisations<sup>71</sup>. In practice, the Bank has entered into many agreements, which presuppose its juridical personality under international law<sup>72</sup>. Therefore there can be little doubt that the Bank is indeed endowed with international legal personality.

Section 3 of Article VII establishes the position of the Bank with regard to judicial process. The charter provides as follows:

“Actions may be brought against the Bank only in a court of competent jurisdiction in the territories of a member in which the Bank has an office, has appointed an agent for the purpose of accepting service or notice of process, or has issued or guaranteed securities. No actions shall, however, be brought by members or persons acting for or deriving claims from members. The property and assets of the Bank shall, wheresoever located and by whomsoever held, be immune from all forms of

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<sup>70</sup> The Loan and Guarantee Agreements are examples of such agreements.

<sup>71</sup> Article VI Section 7.

<sup>72</sup> ex. Convention on the Privileges and Immunities of the Specialized Agencies 33 UNTS 261, the agreement between the UN and the Bank defining the relationship between them 16 UNTS 341, among others.

seizure, attachment or execution before the delivery of final judgment against the Bank.”

This provision is drafted in such a way that it ensures that the Bank has protection against actions brought by its member countries in their own domestic courts but, on the other hand, it gives private parties the right to sue the Bank in municipal courts. Therefore divergences between the Bank and its members will be solved either through internal procedures to the Bank’s governing organs or by arbitration<sup>73</sup>, while the rights and liabilities of the Bank and private parties can be decided in municipal courts. Although members or persons acting for or deriving claims from member cannot bring actions against the Bank, any other person affected by the Bank’s operation could in theory sue the Bank. However, the interpretation of this rule seems to grant the Bank immunity from suit in certain circumstances, such as claims brought from employees<sup>74</sup>. In fact, the rule on Section 3 was meant to allow private investors with which the Bank has entered into transactions under domestic market to have access to municipal courts when a dispute arises<sup>75</sup>. This was supposed to encourage private parties and helps the Bank to raise loanable funds. However it is important to note that this provision is not restricted to claims for the enforcement of obligations arising out of borrowing and guarantees undertaken by the Bank, but extends to other courses of action<sup>76</sup>.

Although there are very few judicial decisions on the interpretation of this rule of the Bank’s Article of Agreement<sup>77</sup>, there are some relevant decisions on a similar provision from another development institution. The United States Court of Appeal, in the case Lutcher S.A. Celulose e Papel v. Inter-American Development Bank<sup>78</sup>, had to decide whether or not the Bank enjoyed immunity from suit from a private borrower. The constitutive instrument of that institution provided in paragraph 1, Section 3 of Article XI:

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<sup>73</sup> Article IX.

<sup>74</sup> See Mendaro v. World Bank 717 F.2d 610 (D.C. Cir. 1983). For employees claim against the World Bank see Gorman (2004) on International Administrative Tribunals.

<sup>75</sup> See the Mendaro case, Broches, (1995) page 9, and Sands and Klein (ed.) (2001), paragraph 15-048.

<sup>76</sup> See Lutcher S.A. Celulose e Papel v. Inter-American Development Bank 382 F.2d 454.

<sup>77</sup> Mendaro v. World Bank 1983 717 Fd2 618; Chiriboga v. IBRD, 1985, 616 F.Supp. 967; Morgan v. IBRD 1990 752 F.Supp. 492 IBRD V. District of Columbia, 1999 No. 98-7055.

<sup>78</sup> 127 U.S. App DC 238, 382 F.2d 454. For a summary see Henkin (1993).

“Actions may be brought against the Bank only in a court of competent jurisdiction in the territories of a member in which the Bank has an office, has appointed an agent for the purpose of accepting service or notice of process, or has issued or guaranteed securities [....]”

Like the World Bank Article of Agreement, Article VII, Section 3, the second paragraph of the provision also prohibited member states from bringing claims against the institution. The similarity of the provision is clear and it was the contention of the Inter-American Bank that such a rule should be interpreted as a waiver of immunity only with respect to suits brought by bondholders, and other similar creditors and the beneficiaries of its guarantees. The defendant argued that such a waiver was necessary to the effectiveness of the operation of the organisation, but to extend the waiver to borrowers would be detrimental to its functions.

The Court did not agree with the Bank. It determined that the drafters were aware of the immunity problem (as they expressly excluded member states as possible complainants) but nevertheless decided under paragraph 1 not to specify the identity of the suitor. They have actually designed a broad provision, which only establishes that *actions may be brought against the Bank* in the courts of a country where the Bank has an office. The Court went further when stating that the “provision for suit in any member country where the Bank has an office must have been designed to facilitate suit for some class other than creditors and bondholders, i.e., borrowers; creditors suing to enforce bond obligations would more likely sue in United States Courts.” The Court also compared the provision mentioned above with Article 50 of the Asian Bank’s Agreement, which expressly states to which cases the Bank is waiving its immunity.

The reasoning of the Court is also extremely relevant. The Court said that there was “no reason to believe that suits by creditors are less harassing to Bank management, or less expensive than are other kinds of suits. Just as it is necessary for the Bank to be subject to suits by bondholders in order to raise its lending capital, it may be that responsible borrowers committing large sums and plans on the strength of the Bank’s agreement to lend would be reluctant to enter into borrowing contracts if thereafter they were at the mercy of the Bank’s good will, devoid of means of enforcement”.

Therefore, it can be deduced from the arguments of the Court in this case and from the similarity of the provisions of the Inter-American Development Bank's Agreement and the IBRD's Agreement, that the Bank can be sued by borrowers for breach of their agreement, at least in US courts. However, it is important to define in which situations the waiver of the Article of Agreement will apply. In interpreting the Inter-American Development Bank charter and in the light of the Lutcher decision, the United States Court of Appeal for the District of Columbia<sup>79</sup>, stated: "While the provision might be read to establish a blanket waiver of immunity from every suit not expressly prohibited elsewhere in the Articles of Agreement (only suits by members are expressly prohibited), we reject that reading in Mendaro v. World Bank, [...]. Instead, we adopted a test for determining when, in the context of a particular suit against the Bank, Section 3 should be construed as a waiver of immunity: "Since the purpose of the immunities accorded international organizations is to enable the organization to fulfil their functions, applying the same rationale in reverse, it is likely that most organizations would be unwilling to relinquish their immunity without receiving a corresponding benefit which would further the organization's goals". [...] [Therefore] the Bank's immunity should be construed as not waived unless the particular type of suit would further the Bank's objectives". Based on this decision it is possible to affirm that actions can be brought against the Bank provided that their course of action will improve the Bank's operation<sup>80</sup>.

The consideration of US cases is important since the head office of the Bank is in the United States, and therefore those are the courts in which the Bank is more likely to be sued. In this context, consideration must be given to the US International Organizations Immunities Act. This legislation also makes reference to the constitutive agreement of the institution and,

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<sup>79</sup> Janet E. Atkinson v. The Inter-American Development Bank, October 9, 1998 at <http://search.cadc.uscourts.gov/ISYSquery/IRL44EA.tmp/2/doc> or 38 ILM (1999) 91

<sup>80</sup> The analysis of the situations where the Bank should be accountable for its acts will be considered later in this Chapter.

therefore, it is the interpretation of the clause waiving the Bank's immunity that will define the situations where a suit can be brought<sup>81</sup>.

International organisations can also expressly waive immunity in any specific situation. Under the Bank system, for instance, the Loan and Guarantee Agreements provide in its General Rules that the dispute arising out of that agreement should be solved by arbitration<sup>82</sup>. Moreover, the Bank accepts challenges in certain aspects of the project such as environmental impact through its Inspection Panel. As will be explained this Panel, although part of the Bank organisation, was set up to ensure accountability in Bank operations and therefore is awarded sufficient independence to be able to evaluate the impact of the operations in certain areas.

When discussing the privileges and immunities enjoyed by the Bank it is also important to consider the Convention on the Privileges and Immunities of the Specialized Agencies, approved by the General Assembly of the United Nations in 1947<sup>83</sup>. The immunities granted to international organisations are based on the recognition that they are needed in order to allow those institutions to fulfil their functions without the interference of municipal courts and administrators<sup>84</sup>. Article 34 of the Convention states:

“The provisions of the Convention in relation to any specialised agency must be interpreted in the light of the functions with which that agency is entrusted by its constitutional agreement.”

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<sup>81</sup> The US Code, title 22, Section 288a (b) reads as following: *International organizations, their property and their assets, wherever located, and by whomever held, shall enjoy immunity from suit and every form of judicial process as is enjoyed by foreign governments, except to the extent that such organization may expressly waive their immunity for the purpose of any proceedings by the terms of any act.* In the same decision mentioned above the Court decided that the immunity granted to international institution was based on the absolute theory, despite the changes on the bases of the immunity granted to foreign states (restrictive theory). For discussion on which theory applies see Oparil, (1991).

<sup>82</sup> Section 10.04 of the IBRD General Conditions applicable to Loan and Guarantee Agreements (dated May 30, 1995 as amended through October 6, 1999). Such General Conditions will be discussed later.

<sup>83</sup> 33 U.N.T.S. 261.

<sup>84</sup> For a comprehensive analysis of privileges and immunities enjoyed by international organisations see Bekker, (1994). Also see Sands, and Klein (ed.) (2001), paragraph 15-034 *et seq.* and Schermers, and Blokker, (2003).

Although this provision might sound as a limitation to the immunities granted to international organisations, they in fact seem to enjoy broader immunities than those granted to States<sup>85</sup>. Article 4 of the Convention provides the following:

“The specialized agencies, their property and assets, wherever located and by whomever held, shall enjoy immunity from **every form of legal process** except in so far as in any particular case they have expressly waived their immunity.” (emphasis added)

If this provision were applicable to the Bank it would not be possible to bring a claim against it whatever the cause of action. However, the Bank has waived its immunities by stating in the Annex VI of the Convention that the provision of Article 4 should be replaced by the same rule stated in Article VII, Section 3 of the Articles of Agreement. Such rule has been interpreted as constituting a waiver of immunity from suits “arising out of its external commercial contracts and activities” but still covering the institution against claims arising out of their internal operation<sup>86</sup>. As mentioned above, the application of this rule is not restricted to cases where there is a dispute between the Bank and private investors, but will extend to all courses of actions that furthers the Bank’s chartered objectives.

Article VII also makes provision for immunity of the Bank’s assets from seizure, attachment or execution. Section 3, second part, provides as follows:

*The property and assets of the Bank shall wheresoever located and by whomsoever held, be immune from all forms of seizure, attachment or execution before the delivery of final judgement against the Bank.*

This provision does not determine an absolute immunity, but merely states the conditions under which measures of executions can be carried out on the Bank’s properties and assets. It

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<sup>85</sup> States are nowadays subject to the restrictive theory of immunity while it is still uncertain whether international organisations will enjoy restrictive or absolute immunity. See Italian cases and doctrinal supporters of the restrictive theory mentioned in Sands, and Klein (ed.) note 26 paragraph 15-046. For the position on United States courts see footnote n. 81.

<sup>86</sup> Mendaro v. World Bank 717 F.2d 610 (D.C. Cir. 1983).

also should be noted that the Bank has waived its immunity from execution only against judicial decisions, retaining an absolute immunity against executive or legislative actions (Section 4).

Although the Bank has narrowed its immunity from jurisdiction and from execution, it still enjoys other broad immunities generally given to international organisations, in particular to the specialised agencies of the United Nations<sup>87</sup>. Article VII provides for immunity of the Bank's archives (Section 5), freedom of the assets from restrictions (Section 6), privilege for communication (Section 7), immunities and privileges of officers and employees for acts performed in their official capacity (Section 8) and immunity from taxation (Section 9). Section 10 requires each member to take all the steps necessary in its own territory to make such rules effective. Most of those immunities are also covered by the Convention on the Privileges and Immunities of the Specialized Agencies mentioned above.

A particularly important immunity is the one regarding immunity of archives, as they could interfere with the ability of possible complainants in providing proof of their claim. Even more significantly, the immunity of archives could lead to a limitation on the administration of justice either at a national or international level. Therefore it has been argued that unless there is a compelling reason related to the independence and functioning of the organisations, there is duty on international organisations in disclosing information held by them in proceedings in which they are parties<sup>88</sup>.

Any amendments or alterations of the Articles of Agreement are only allowed in the terms defined in Article VIII. The acceptance of three-fifths of the members with 85% of the voting power is required in order to put in place such alterations. As commented above, one of the consequences of the voting mechanism in place at the Bank is that in practice the largest member has power of veto over those decisions. Nonetheless, the amendments made so far were determined by consensus.

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<sup>87</sup> For comparison with other international institutions see Sands, and Klein (ed.) note 26 paragraph 15-044 – 15-052.

<sup>88</sup> See International Law Association, *Accountability of International Organisations*, Berlin Conference (2004) Final Report. Also see Reinisch, (2000).

## 6.4 Dispute settlement

Finally, it is important to look at the provision in Article IX of the Agreement, which defines the rules to settle disputes on the interpretation of the provisions of the charter. This provision does not provide for an external authority to address the disputes, but determines that they should be submitted to the Executive Directors with one appeal to the Board of Governors.

The Article is worded as follows:

- (a) *Any question of interpretation of the provision of this Agreement arising between any member and the Bank or between any members of the Bank shall be submitted to the Executive Directors for their decision. (...) (emphasis added)*
- (b) *(...) any member may require that the question be referred to the Board of Governors, whose decision shall be final.*

As compared with other international organisations, such as the United Nations, it can be seen that there is no reference at any point to an independent court such as the International Court of Justice, but the internal decision taken by the Board of Governors is final<sup>89</sup>. According to Broches<sup>90</sup> the decision to adopt this provision was taken because it was understood that the Bank operates in a very technical and specialised field and therefore, the interpretation of its charter should be left to members through their representatives. However, both the Board and the Executive Directors would vote according to the weighting system in place, and distortion could be seen if a member with a negligible number of shares argues against the interpretation given by a member with a greater number of shares. Although in theory this provision could lead to controversy, it must be noted that most of the interpretations given by the Executive Directors have not been appealed to the Board. They also have not arisen from a dispute between members and the Bank, or between members, but derived from the Bank's operational needs<sup>91</sup>.

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<sup>89</sup> The International Monetary Fund also has a similar provision (Article XXIX).

<sup>90</sup> Op.cit p. 11

<sup>91</sup> See example cited by Broches where the Executive Directors had to interpret the words 'the same treatment' in Article VII Section 7 to include treatment with respect to rates. *International Bank for Reconstruction and Development and International Monetary Fund v. All America Cables and Radio et al.*, F.C.C. Docket No. 9362.

The disputes that will be solved by the internal organs of the Bank are the ones arising from the interpretation of the Article of Agreement (the constitutive instrument of the institution) and not any dispute. As will be explained, disputes arising between the Bank and member states or other public or private enterprises under the Loan Agreement will be solved by arbitration by express clause of the contract entered by the parties<sup>92</sup>.

Article IX provides for one situation when the dispute should be taken to arbitration<sup>93</sup>: whenever there is a dispute between the Bank and a former member or any member during permanent suspension of the Bank. In those cases the tribunal will be constituted of three arbitrators, one appointed for each party, and an umpire who, unless agreed otherwise, will be the President of the International Court of Justice<sup>94</sup>.

## **7 The World Bank Loan Agreement – legal character and governing law**

In order to establish the legal position of the Bank in relation to borrowers and third parties involved in the procurement process, it is vital to understand first the legal character of the Loan Agreement and determine its governing law. The Loan Agreement is the document that will define the framework in which all the relationships related to the project will develop. Therefore, it is necessary to determine the status that such an agreement will have, and the rules that could be used to solve problems of interpretation and validity if they arise.

Commercial contracts usually include a choice of law rule established by the contracting parties. This is done in order to prevent future conflicts between the parties becoming even more difficult to solve given the divergences on the methodology or rules that will be applied when interpreting its terms. For World Bank projects the need to define such parameters is even more evident given the wide range of people that will be involved in projects of such dimensions. The Bank rules could be challenged not only by borrowers but by member countries that are the major lenders, and by third

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<sup>92</sup> IBRD General Conditions Article X, Section 10.04. The General Conditions will analysed further below.

<sup>93</sup> Article IX (c).

<sup>94</sup> Arbitration under those circumstances has never happened.

parties affected by the impact of the projects on issues such as the environment, the displacement of people, etc<sup>95</sup>.

As a lender institution it is likely that the Bank would choose a system of law that can guarantee its position if the borrower eventually defaults payment or ignores the agreement with the Bank on how the money should be spent. Subjecting the agreement to a system of law different from the borrower's national system seems, in this context, a logical decision. Imagine, for example, that when the repayment of the loan is due the governmental control changes to a group that is hostile to international investments made by development institutions such as the Bank. In this case, if the Loan Agreement was submitted to the national system the project could be in serious jeopardy, and the Bank could even face default. This could cause instability to the financial position of the Bank, and international lenders could redraw their applications with regard to Bank projects.

Apart from the need to guarantee repayment of the principal, the Bank also needs to ensure that its own rules related to issues such as procurement are followed. As we have seen, the Bank is concerned not only with the application of the funds in the specific project but also with the effectiveness of such implementation. As Head correctly says, "if the World Bank loan agreement could be construed as being subject to local law, some public sector Borrower (government or public-owned enterprises) might try claiming that obligations undertaken in such an agreement – for example, the obligation to follow certain procedures, rules for the procurement of goods, or to refrain from applying loan proceeds to payment of taxes on goods imported into the country for use in projects financed by the Word Bank – are void because of inconsistency with the local law. If on this grounds the Borrower were to stop following the World Bank's procurement guidelines [...], financial support for the

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<sup>95</sup> Third parties can challenge the Bank's projects through the Inspection Panel. See Chapter III. For a report on early cases see Umaña (ed.), (1998). For cases until 2002 see The Inspection Panel *Annual Report* (2002); for recent cases see Panel Reports available at <http://wbln018.worldbank.org/ipn/>. Also see Shihata. (2000) (b).

World Bank itself could crumble”<sup>96</sup>. So, which set of rules can the Loan Agreement rely upon?

The Loan and Guarantee Agreements themselves do not offer a clear statement on this issue. Usually the Agreements will incorporate a set of standard terms called General Conditions, which are designed to apply to loans made by the World Bank, and deal with issues such as repayment, loan suspension and cancellation, arbitration and effectiveness. Section 10.1 of those rules, under the heading of ‘effectiveness’ of the agreement, establishes the following:

“The rights and obligations of the Bank, the Borrower and the Guarantor under the Loan Agreement and the Guarantee Agreement shall be valid and enforceable in accordance with their terms notwithstanding the law of any State or political subdivision thereof to the contrary. [...]”

The rule cited above, unlike most choice of law clauses, has a negative character. It does not establish a set of rules upon which the contract should rely, but states that the agreement will not be subject to any national system. Broches, analysing this provision, explains that although it is not a straightforward provision, it should be read as reflecting a choice for the international law. In a lecture given in 1959, this author said that the Loan Agreement between the Bank and a member state are to be governed by international law, and would have the status of ‘treaty’. The Loan Agreement between the Bank and state-owned enterprises, although not having the status of treaty, would exclude the application of the national law in a choice of law provision<sup>97</sup>.

An extensive line of reasoning supports the position adopted by Broches. Before concluding that the Loan Agreement formed between the Bank and a member country is a treaty, Broches ascertains the World Bank’s international personality and its treaty making capacity. He then turns to the issue of whether the agreement is governed by international law. He acknowledges that the rather strange draft of this provision reflects the legal uncertainty, present in 1947, related to the personality of international

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<sup>96</sup> Head, (1996).

<sup>97</sup> See Broches, (1995). His position, however, is not free from criticism see Detter (1965).

organisations and their legal capacity. However, he concludes that the effect of the provision is greater than just ‘de-nationalizing’ the governing law of the agreement; it in fact “subjects [the loan agreements] in all respects to international law”<sup>98</sup>.

As to the loan agreements concluded between the Bank and other entities, such as a state-owned enterprise, Broches concludes they do not have the status of a treaty since the borrower does not have international legal personality. However, in these instances, he argues that the application of international law is justified since the loan agreement between the Bank and the state-owned enterprise is seen as a part of the negotiations undertaken between the Bank and the member government leading to the Guarantee Agreement, and both contracts should be understood as a unity. The reasons for this explanation run as follows: according to the Section 4, Article III of the Articles of Agreement, the Bank requires the Loan Agreement to be subjected to the Government Guarantee Agreement. Therefore even when the Bank lends directly to a entity other than a member state the loan relationship always involves contractual agreements with a member government, which are governed by international law. Moreover, under the Guarantee Agreement the guarantor’s obligation is “as a primary obligor, and not as a surety merely”<sup>99</sup>, making the guarantor a joint co-debtor. According to Broches, because the obligations arising out of the loan and the guarantee agreement are interdependent, it would be inappropriate to consider them separately.

Although being a logical solution, this leaves the loan agreement between the Bank and non-members in an awkward position since the set of rules that will regulate such contracts is not clear. Head<sup>100</sup>, however makes a valid criticism on the position adopted by the World Bank. He affirms that the use of public international law by parties who were not subjects of international law, although difficult to defend in 1959, is now well accepted and, in the light of the evolution of those concepts, he suggests

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<sup>98</sup> Note 97 page 33.

<sup>99</sup> Note 97 page 38. Also see Amerasinghe, (1996).

<sup>100</sup> Op.cit.

that a clear approach to the legal framework in which the loan and guarantee agreements are based is to be preferred. This opinion echoes the opinion of other authors. Delaume<sup>101</sup>, for example, argues that since international persons when contracting with each other can choose to submit their relationship to international or municipal law, they should enjoy the same autonomy when contracting with domestic law persons. Moreover, when considering Section 10.01 of the Bank's General Conditions, he clearly states that "the Bank might be better advised to reconsider the problem and to provide, firmly and in a positive way, that its loan/guarantee agreements, whether concluded with a member country or not, are always subject to international law"<sup>102</sup>.

This line of reasoning seems to have influenced other development institutions. Comparing the provision of the World Bank with the ones adopted by the European Bank for Reconstruction and Development (EBRD), Head points out that the EBRD expressly states that if a dispute under the Loan Agreement is subject to arbitration, public international law will be applied by the tribunal<sup>103</sup>. Moreover, the EBRD Standard Terms and Conditions carefully define which particular sources of international law should be applied, in order to avoid the many uncertainties that can arise in interpreting substantive Loan Agreement provisions<sup>104</sup>. By adopting this clear statement the EBRD does not need to distinguish the legal status of loans made to member states from those made to non-members. This positive approach reflects the great development of the international law and the emphasis on the autonomy of the parties in

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<sup>101</sup> Delaume, Issues of Applicable Law in the Context of the World Bank's Operations, in Horn and Schmitthoff, (1982).

<sup>102</sup> Ibid. page 323.

<sup>103</sup> Section 8.01 of the EBRD's Standard Terms and Conditions.

<sup>104</sup> Section 8.04 (b) (v) of the EBRD's Standard Terms and Conditions reads as follows:

(v) The Law to be applied by the arbitral tribunal shall be public international law, the sources of which shall be taken for these purpose to include: (a) any relevant treaty obligations that are binding reciprocally on the parties; (b) the provisions of any international convention and treaties (whether or not binding directly as such on the parties) generally recognised as having codified or ripened into binding rules of customary law applicable to states and international financial institutions, as appropriate; (c) other forms of international custom, including the practice of states and international financial institutions of such generality, consistency and duration as to create legal obligations; and (d)applicable general principles of law.

choosing the governing law of their agreements<sup>105</sup>. As Head accurately states, the body of public international law is now considerable enough to work as the governing law for the development banks' public sector loan and guarantee agreements<sup>106</sup>.

There is still some controversy over whether entities or other subjects of international law could completely exclude domestic law in their agreements. Broches has stated that "the loan agreement between the bank and the non-government borrower, being an agreement between a subject of international law and an entity which does not possess that quality, is certainly not an agreement governed by intentional law"<sup>107</sup>. More recently Linarelli affirmed that "the [EBRD] and non-sovereign parties to its loan agreements may not be in the position to exempt wholly their agreements from municipal law, since all sides to the transaction may not be subjects of international law"<sup>108</sup>. Moreover, in international transactions between private lenders and private borrowers it is accepted that although the parties could choose international law as the governing law of their agreements, there are some limitations on the parties' autonomy<sup>109</sup>.

However, under the particular circumstances of the World Bank's Loan Agreement, whereby one of the parties is always an international institution, deemed to be a subject of international law, and where the borrower's obligation is always guaranteed by a sovereign state,

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<sup>105</sup> For a long time, certain types of contracts between states and private parties - for example the oil concession- have included provisions submitting the contractual relationship to international law. See Texaco v. Libyan Arab Republic 55 ILR 389.

<sup>106</sup> This would include rules on treaty interpretation, (such as the Vienna Convention on the Law of treaties); on the binding character, formation, validity and performance of both treaties and contracts (principles could be taken from the UNIDROIT Principles of International Commercial Contracts, from the United Nations Convention on Contracts form the International Sales of Goods or even the CISG), and commercial and financial terms used in international transactions (such as the International Chamber of Commerce, INCOTERMS). This would also include rules and customary practices of development institutions in general (such as Procurement Guidelines). The Bank's formal interpretation of its own rule could also be relevant (such as Operational Manual). For more references see Head (1996) footnote 131 until 136 and Darrow (2003) Also see extensive literature in the Lex Mercatoria especially regarding transactions between States and foreign private persons (See, i.e. Delaume, (1989). Decisions and practice from international courts or arbitration can also be relevant. Arbitration concluded under the ICSID can be particularly relevant since it specifically relates to international investments and economic development agreements.

<sup>107</sup> Opt. Cit. Page 38.

<sup>108</sup> Linarelli, (1995).

<sup>109</sup> See Mettala, (1986).

which are also such subjects, it is appropriate to provide for the complete submission of the agreement to international law<sup>110</sup>.

This statement does not mean that domestic law is of no relevance for the loan transaction. In fact, the World Bank's General Conditions expressly refer some issues - such as manner of payment<sup>111</sup> - to the domestic law of the borrowing country. Even more relevantly, it is accepted that domestic law is applicable to determine whether the constitutional and other formal requirement relevant for the validity of the contract have been fulfilled. Given the diversity of legal systems among member governments, the Bank formally requires satisfactory evidence that the execution and delivery of the Loan or Guarantee Agreements has been duly authorised or ratified in accordance with the law of the member country concerned. Only after such evidence is given would the Bank declare the loan effective<sup>112</sup>. The practice of *dépeçage* in those instances is not only acceptable, but also desirable in order to give full efficacy to the agreement<sup>113</sup>.

The concern with the legal status and the governing law of the Loan and Guarantee Agreements derives from the fear that member states may eventually default on payment or adopt domestic legislation that significantly interferes with the implementation of the Loan Agreement<sup>114</sup>. However, it must be remembered that until now no member country has ever defaulted on payment of World Bank loans, nor has there ever been an arbitration procedure to solve problems related to the agreement. The reason for that is not that disagreements on the interpretation and implementation of the agreement have never happened, but that they are usually resolved by consultation and negotiation between the Bank, borrowers and guarantors<sup>115</sup>. It seems that the political and economical consequences of challenging or defaulting are greater than borrowers and guarantors are prepared to bear. In fact, as member countries are dependant on the World Bank for so much of their financing needs, it is a rare government that would risk

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<sup>110</sup> See Broches (1995), Linarelli (1995), Mettala (1986), Delaume (1982) opt.cite.

<sup>111</sup> Article IV, Section 4.07 of the General Conditions.

<sup>112</sup> General Conditions Article XII, Sections 12.01 and 12.02.

<sup>113</sup> This practice also occurs under inter-governmental loans and even under international transactions between states and private parties or between private parties only. See Delaume (1982) and Mettala (1986).

<sup>114</sup> See example given by Head (1996).

<sup>115</sup> See Delaume (1982), page 323.

an end to further lending from the Bank or other international sources. Nonetheless it should be recognised that a clear choice of law clause can provide greater certainty and predictability to the application and construction of the terms of the agreement<sup>116</sup>.

To sum up, it is possible to affirm that the Loan Agreement and Guarantee Agreements concluded between the Bank and member states will, in an eventual dispute, certainly be interpreted as an international agreement governed by international law. On the other hand, the agreements entered into between the Bank and entities other than states are also subject to international law by express choice of law rule on their contract.

### **7.1 Legal consequences of the governing law for the content of the agreement and its interpretation**

The UN Convention on the Treaties Concluded Between States and International Organizations or Between Two or More International Organizations brings important provisions on the interpretation of treaties. Those rules are understood as a codification of customary international law, and therefore are a source of international law that can be used in interpreting the loan and guarantee agreement<sup>117</sup>. Article 31 states that a treaty should be interpreted taking into account its terms, the context in which it was drafted, any subsequent agreement or practice between the parties and also any relevant rule of international law<sup>118</sup>. This rather comprehensive

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<sup>116</sup> See Auerback, (1993).

<sup>117</sup> There is an extensive literature on the Law of treaties, see e.g. Brownlie, (2003). See nuclear weapon case (judgment of M. Koroma and M. Weeramantry).

<sup>118</sup> Article 31 reads as follows: General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
  - (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
  - (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
  - (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
  - (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
  - (c) any relevant rules of international law applicable in the relations between the parties.
4. A special meaning shall be given to a term if it is established that the parties so intended.

provision establishes the framework for the legal interpretation of the agreement in the event of a dispute.

The provision on Article 27 of the Convention also deserves attention since it forbids both international organisations and states from invoking provisions of their internal law as an excuse for failure to perform their obligations under the treaty<sup>119</sup>. As mentioned above, this can be seen as a guarantee that no alteration to the political structure of member countries would influence their obligation in relation to the agreement concluded with the Bank. This brings credibility to the loan operations and an incentive for private investors to rely on such agreements.

Not only the agreements entered by the parties and rules in international conventions are part of the international law applicable to the relationship between the Bank and the borrower and guarantor. Other sources of international law might have a relevant role in interpreting and applying the loan and guarantee agreements. Article 38 (1) of the Statute of the International Court of Justice determines the law that should be applied by the Court when solving international dispute. Despite being only binding on the ICJ, such Article is generally accepted<sup>120</sup> as the point of departure for discussions and application of international law. Therefore, it is worth mentioning its text:

The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

- i) international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;
- ii) international custom, as evidence of a general practice accepted as law;
- iii) the general principles of law recognized by civilized nations;

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<sup>119</sup>Article 27 reads as follows: Internal law of States, rules of international organizations and observance of treaties: 1. A State party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform the treaty. 2. An international organization party to a treaty may not invoke the rules of the organization as justification for its failure to perform the treaty. 3. The rules contained in the preceding paragraphs are without prejudice to article 46.

<sup>120</sup> See Brownlie (2003) and Malanczuk, (1997) Chapter 3.

iv) subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

The draft of the provision does not establish the order the Court has to follow when deciding a case based on international law. The Court could, for example, draw on general principles before applying conventions and customs<sup>121</sup>. It is possible that the four sources of international law are needed jointly to solve the dispute. Although the authority and legal quality of all sources should be recognised, it must also be mentioned that when treaties are formed they will override any customary rules between the parties (a special law prevails over a general law). However it is possible that over time treaties could be overridden by customs (a later law repeals an earlier law)<sup>122</sup>.

Customary law and general principles of law are very hard to distinguish in practice since both of them require wide acceptance by a representative majority of the principal legal systems in order to have an obligatory character. Nonetheless, it could be said such principles usually arise from parallel recognition of certain basic rules applied in similar situations, without the need of a legislative act either in national or international levels<sup>123</sup>. They are, however, binding laws that will be identified by a comparative law study and adapted by an international judge or arbitrator to the specific needs of international relations.

Examples of general principles of law being applied by international courts include<sup>124</sup> the recognition of liability for negligence (although conditions for the determination of negligence may vary)<sup>125</sup>, responsibility (for every injury of right the

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<sup>121</sup>Harris, (2004).

<sup>122</sup>Peter Malanczuk (1997).

<sup>123</sup>See Mosler, (1995), pp. 511.-527.

<sup>124</sup>Ibidem.

<sup>125</sup>Ibidem. P.519

law gives a remedy)<sup>126</sup> and reparation of damages caused by illegal acts (such reparation should go as far as possible to “wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if the act had not been committed”. This will also include *lucrum cessans*)<sup>127</sup>. Moreover, there are some principles related with the application and interpretation of treaties such as those defined in Articles 31 to 33 of the Vienna Convention on the Law of Treaties, that are recognised not just by the parties of that agreement but also as customary international law<sup>128</sup>. Also, when Article 26 of the Vienna Convention requires good faith in the creation and performance of legal obligation, such rule is regarded as one of the basic principles of law whatever their source<sup>129</sup>. Procedural rules can also be part of international law and recognised as a general source. To this extent the ICJ recognises that often the injured party will find difficulties in furnishing direct proof of the facts, giving rise to state responsibility and therefore, in those cases, a more liberal approach towards circumstantial evidence is necessary. According to the Court “this indirect evidence is admitted in all systems of law, and its use is recognised by international decisions”,<sup>130</sup>. Given the particular circumstances of the loan and guarantee agreements it might be possible to extend such principle to situations, giving rise to the responsibility of international institutions.

## **8      Loan Agreement – dispute resolution**

Three main types of dispute resolution have been commonly adopted in international commercial contracts<sup>131</sup>. The first type provides that potential controversies will be referred to courts either from one of the party’s jurisdiction or

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<sup>126</sup> Decision given by the German American Mixed Commission in the Lusitania Case (RIAA, vol. 7, p.32, at p.35)

<sup>127</sup> Decision given by PCIJ in the Chorzów Case (Factory at Chorzów, Merits, Judgement No. 13, PCIJ Series A, No.17 (1928) pp.47-53

<sup>128</sup> Those provisions are repeated at the UN Convention on the Treaties Concluded Between States and International Organisations or Between Two or More International Organizations, which, as mentioned above, is also recognised as part of customary international law.

<sup>129</sup> See Nuclear Tests Cases ICJ Reports (1974) p.268.

<sup>130</sup> Corfu Channel Case ICJ Reports (1949) p.18.

<sup>131</sup> See Park, (1998), Delaume, (1989), Delaume (1985), and Zimbler, (1986).

from a major money centre such as London or New York<sup>132</sup>. The second type refers the dispute to arbitration, under the terms and conditions specified by the contracting parties. On the third type disputes are referred to arbitration according to the rules established under the ICSD. Under the World Bank's Loan Agreement the dispute resolution system adopted by the parties is arbitration, as provided in the General Conditions, Article X, Section 10.04. The clause reads as follows:

“Any controversy between the parties to the Loan Agreement or the parties to the Guarantee Agreement, and any claim by any such party against any other such party arising under the Loan Agreement or the Guarantee Agreement which has not been settled by agreement of the parties shall be submitted to arbitration by an Arbitral Tribunal as hereinafter provided.”

The following subdivision provides an extensive explanation of how the arbitral tribunal will be set up, how it is supposed to reach its decisions, and to what extent the parties are bound by its decisions. In particular letter (h) states that “each party shall abide by and comply with any such award rendered by the Arbitral Tribunal in accordance with the provisions of this Section”. Therefore the dispute resolution system design under this contractual clause implies not only the consent of the parties to settle their dispute out of court, but also that they agree to be bound by the result.

The strength of an arbitral award must be determined from the outset. This is a form of dispute resolution that is legally binding on the parties, in contrast to some other forms of dispute resolution - such as mediation and conciliation - which do not possess this characteristic. Moreover, in many jurisdictions arbitration awards are recognised and enforced<sup>133</sup> subject only to a limited numbers of defences related to procedural matters, such as the validity of the arbitration agreement, the opportunity to

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<sup>132</sup> Auerback, (1993).

<sup>133</sup> See Convention on the Recognition and Enforcement of Foreign Arbitral Awards, (1958) 330 UNTS 3 as supplemented by the European Convention on International Commercial Arbitration (1968) 484 UNTS 349 to which 123 countries are parties.

be heard, and the limits of the arbitral jurisdiction.<sup>134</sup> Regarding the appropriateness of arbitration as a choice of dispute resolution under the loan and guarantee agreements, it is appropriate to say that as an international agreement where the parties might fear the other side's judicial system, arbitration serves to level the playing field and therefore can be regarded as an adequate policy. Moreover, as interpretation of terms and conditions that are particularly characteristic of multilateral development institutions' lending activities might be necessary, an arbitral tribunal can provide the adequate level of expertise.

The parties to the agreements are those who are entitled to require an arbitral procedure. This means that the Bank, the borrower or the guarantor can in the event of a dispute rely on the arbitration clause present at the General Conditions applicable to the Loan and Guarantee Agreements. However, the theory of privity of the contract states that only the parties of the contract are allowed to rely on its clauses and demand the recognition of rights derived from it. Even if it is recognised that exceptions to the theory are allowed under some legal systems, it is also true that questions on standing to sue will appear in cases based on the liability towards third parties from harm caused by the implementation of the contract. Even more importantly, the legitimacy of the arbitral tribunal could be raised in tort cases where third parties are involved.

Another important feature to be considered is the possibility of enforcement of the arbitral tribunal's final decision. Firstly, on both sides of the Loan and Guarantee Agreements are States and an international organisation. This could give rise to *sovereign immunity* or '*act of State*' defences for member countries, or *international institutions immunities* defences, especially if enforcement in a foreign jurisdiction (different from the member country involved in the dispute) is needed. In the US, for example, the Act of State Doctrine generally prevents national courts from questioning

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<sup>134</sup> Ibid. art. V.

a foreign government's behaviour concerning assets within its territory<sup>135</sup>. Therefore, if for instance the borrower restricts payment of foreign currency obligations and justifies this action as a state action needed to protect domestic economy this could interfere with the loan repayment. In private loan obligations creditors have been able to avoid application of the Act of State doctrine by manipulating the *situs* of the debt<sup>136</sup>. This means that courts may deem the debt to be located outside the territory of a country imposing the exchange controls. However, when enforcing arbitration awards, rather than judicial decisions, some countries, such as the US, have eliminated the Act of State as a possible defence<sup>137</sup>.

As to defences based on sovereign immunity, they are subject to some exceptions. In most legal systems the sovereign immunity granted in foreign court covers only 'public' acts rather than 'commercial' acts<sup>138</sup>. To characterise an act as public or commercial it is important to determine the nature of the act<sup>139</sup>. In this context Loan and Guarantee Agreements are seen as commercial transactions and therefore will not allow sovereign immunities defences<sup>140</sup>. Moreover, in some legal systems to rely on sovereign immunity defences in actions to enforce an arbitration agreement or to confirm an arbitral award is much more difficult given the treaties regulating arbitration clauses<sup>141</sup>. This reinforces the adequacy of arbitral awards as a means of dispute resolution in Loan contracts.

Another good argument against defences based upon immunities is the fact that, by agreeing to submit a dispute to an arbitral tribunal, the parties – both the Bank and member countries - have waived their immunity from suit and therefore should not be allowed to defend themselves on these grounds when enforcement is finally needed.

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<sup>135</sup> Park , (1998).

<sup>136</sup> Ibid.

<sup>137</sup> Federal Arbitration Act (1994) 9 U.S.C. § 15.

<sup>138</sup> Restrictive doctrine. See Oparil, (1991).

<sup>139</sup> Ibid.

<sup>140</sup> See for United States, 28 U.S.C. § 1603 (d), for British regulation see State Immunity Act, 1978 ch. 33 § 3 (3) (b).

<sup>141</sup> See for United States, (1994) 28 U.S.C. § 1605 (a), for British regulation see State Immunity Act, 1978 ch. 33 § 9.

However, the clause on enforcement under the Loan Agreement has a very peculiar provision. It reads as follows:

(k) “If, within thirty days after counterparts of the award shall have been delivered to the parties, the award shall not be complied with, any party may: (i) enter judgment upon, or institute a proceeding to enforce, the award in any court of competent jurisdiction against any other party; (ii) enforce such judgment by execution; or (iii) pursue any other appropriate remedy against such other party for the enforcement of the award and the provisions of the Loan Agreement or the Guarantee Agreement. **Notwithstanding the foregoing, this Section shall not authorize any entry of judgment or enforcement of the award against any party that is a member of the Bank except as such procedure may be available otherwise than by reason of the provisions of this Section.**” (emphasis added)

Despite the difficult draft of the provision Delaume correctly explains that “enforcement will be possible only to the extent permissible under the relevant domestic immunity rule”<sup>142</sup>. This means that by agreeing with the arbitration clause member countries have waived their immunity from suit and are subjected to the arbitral court. Nonetheless enforcement against them is restricted to what is allowed under municipal law of the country where enforcement will take place. Therefore, although the contractual rights on dispute will be subjected to the arbitral tribunal, which will base its decision on international law, the enforcement of arbitral decisions will depend on the domestic law of the forum where proceedings are brought, and which will decide on issues of sovereign immunities.

If an arbitral award needs to be enforced against the Bank, it seems that the borrower, or the borrower and the guarantor, can institute proceedings in any court of competent jurisdiction<sup>143</sup>. Therefore, the arbitration clause in relation to awards rendered against the Bank serves as a waiver of the Bank’s immunity from the

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<sup>142</sup> Delaume, (1985).

<sup>143</sup> Broches (1995) page 52.

jurisdiction of domestic courts even in actions brought by member countries. This constitutes an exception to the charter rule prohibiting member governments from bringing actions against the Bank<sup>144</sup>.

## 9 Responsibility towards third parties

As mentioned above, the immunities and privileges granted to international organisations are based on the need to secure their functions. However, the expansion of the activities performed by those organisations inevitably will lead to risk to third parties<sup>145</sup>. The Bank, for instance, will conduct its operations in a large number of member states, and will enter into a legal relationship not only with those states but also with other international organisations and with individuals<sup>146</sup>. In this context, it is natural that on the implementation of its activities, it will receive allegations that the organisation is responsible for violations of either its contractual or its non-contractual obligations. It is the awareness of this potential risk that brings us to a vital question: in what situations, if at all, should the Bank be held accountable for its acts?

The attribution of responsibility to an international organisation can be based first, in its international legal personality. According to the Reparation case one of the features that will derive from the capacity of possessing rights and liabilities under international law is the duty of bearing international responsibility in certain cases. Specifically, the Court affirmed that the United Nations “is a subject of international law and capable of possessing rights and duties... it has to maintain its rights by bringing international claims”<sup>147</sup>. Moreover, the Court has drawn attention to the responsibility of the UN for the conduct of its organs and agents<sup>148</sup>.

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<sup>144</sup> Ibid. 53.

<sup>145</sup> See remarks made by Bradlow as chairman of *The Accountability of International Organizations to Non-State Actors* at the American Society of International Law Proceedings (1998). For a deep discussion on the responsibility of International Organisations see Hirsch, (1995). For environmental accountability see Rodgers, (1990). For remedies see Wellens (2002)

<sup>146</sup> For further discussion on the accountability of the Bank under financed projects see Chapter IV

<sup>147</sup> Op.cit. page 179.

<sup>148</sup> As the International Court of Justice has observed, “the question of immunity from legal process is distinct from the issue of compensation for any damages incurred as a result of acts performed by the United Nations or by its agents acting in their official capacity. The United Nations may be required to bear responsibility for the damage arising from such acts”. *Difference Relating to Immunity from Legal Process*

The main objectives of attributing responsibility to an international institution is to prevent further breaches of their obligations and to provide some form of remedy to the injured party. The challenge, however, is defining a balance between these aims and giving international organisations some freedom to perform their obligations<sup>149</sup>. The Committee on Accountability of International Organisations of the International Law Association has established some guidelines, which were understood as crucial to determine the standards by which the performance of international organisations should be evaluated<sup>150</sup>. According to them, the operation of the institutions should be measured based on principles of good governance, objectives and principles common to all international organisations, objectives and principles common to particular categories of international organisations, specific objectives and principles of individual international organisations as laid down and elaborated in their primary and secondary rules, both of a substantive and procedural nature, the applicable law and practice of international organisations demonstrating a certain pattern of conduct<sup>151</sup>.

Further developing the content of such measures it was suggested<sup>152</sup> that the principle of good governance would include transparency in both the decision-making process and the implementation of institutional and operational decisions, a large

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<sup>149</sup> See *A Special Rapporteur of the Commission on Human Rights*, I.C.J. Reports 1999, p. 62, at pp. 88-89, para. 66.

<sup>150</sup> See International Law Association, Taipei Conference (1998), first report. In its report the committee pointed out that the rules "will have to keep the balance between preventing the necessary autonomy in decision-making of international organisations and guaranteeing that international organisations will not be able to avoid accountability" at p. 602.

<sup>151</sup> The International Law Association has consultative status, as an international non-governmental organisation, with a number of the United Nations specialised agencies. Its objectives, under its Constitution, include the "study, elucidation and advancement of international law, public and private, the study of comparative law, the making of proposals for the solution of conflicts of law and for the unification of law, and the furthering of international understanding and goodwill". The Association's objectives are pursued primarily through the work of its International Committees, and the focal point of its activities is the series of biennial conferences. The conferences, of which 69 have so far been held in different locations throughout the world, provide a forum for the comprehensive discussion and endorsement of the work of the Committees. The Association works principally through its International Committees. They are established to undertake research and to prepare reports on selected areas of international law (public, private or commercial). In the biennial conferences the reports are discussed and considered by the membership and other interested parties in attendance. The documents issued by this institution although not legally binding represents a wide range of scholars from a number of different nationalities. Therefore, they are regarded here as a guide to the new developments on the issue.

<sup>152</sup> See International Law Association, Taipei Conference (1998), first report.

<sup>153</sup> See International Law Association, London Conference (2000), second report.

degree of participation in the decision-making process, access to information to all potentially concerned and/or affected by the decision at stake, a well functioning international civil service, sound financial management and appropriate reporting and evaluation mechanisms.

Besides the principle of good governance, specifically mentioned among the principles common to international organisations were the principle of good faith, the principle of constitutionality, the principle of institutional balance, the principle of supervision and control, the principle of stating the reasons for decisions or a particular course of action, the principle of procedure regularity, the principle of objectivity and impartiality, and the principle of due diligence<sup>153</sup>. Therefore, it can be said that international organisations are expected to operate according to those principles and any departure from them could, in general, give rise to the organisation's liability.

In its final report the Committee also developed the framework in which the potentially affected parties could bring their claim<sup>154</sup>. Firstly, it was recognised that "every international wrongful act entails the international responsibility of international organisations". On the explanation of such terms, it was determined that there is a 'wrongful act' when by action or omission the international organisation breaches an applicable international obligation. Such an act or omission must be attributed to the international organisation and must be characterised under international law, regardless of the legality of the act under the internal law of the organisation. Moreover, the international obligation must be actual, so a breach will only occur if the international organisation was bound by the obligation at the time the act or omission occurred. It is also recognised that the conduct of organs, officials and agents are attributed to the international organisation provided that they are acting in their official capacity.

However, there are some difficulties in defining a clear link between the wrongful act and the attribution of responsibility to an international organisation for

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<sup>153</sup> See International Law Association, Berlin Conference (2004), final report.

<sup>154</sup> Although the Committee acknowledged their need, such development was left to a later stage.

such an act. According to Hirsch, international institutions can be held responsible when there is a control link between the illegal act and the organisation.<sup>155</sup>. There are cases where the organisation will direct its members to act according to decisions taken by the organisation's organs<sup>156</sup>. In those cases, it may be doubtful as to whether the organisation or the member, or even both, is responsible for the consequences of an illegal act. In this context it is important to determine the extent to which the member had discretion to apply the illegal measure. If the member state has had the freedom of whether or not to implement the decision, then it should bear the responsibility. On the other hand, if the national authorities did not have discretion on whether to adopt the measure, then the organisation is the one responsible for the consequences of the illegal act<sup>157</sup>.

However, it is possible to have cases where both will have a significant contribution to the decision-making process, which will, ultimately, justify joint responsibility between them. As an example of this situation, Hirsch cites cases where the organisation authorised a member to adopt a particular measure in accordance with its internal law. He emphasises that when the permission or approval is significant for the implementation of the measure there should be joint responsibility<sup>158</sup>. It is submitted that this rule, based on the control exercised by each subject, is appropriate, since it strikes a balance between the need to ensure compliance by members with the

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<sup>155</sup> Hirsch, (1995) p.62/63 (noting that international institutions can be held responsible when it can be established a control link, an institutional link or a territorial link). The ILA also adopted the control link as the basis for attributing responsibility. It says “control over the organs and individuals by a subject of law is the basis for attribution of acts or omissions by such organs and individuals to the subject of law exercising control”. Final report page 29. Also see the ICJ judgment on the Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America) Merits, Judgment, ICJ Reports 1986, p. 4, where it used the notion of “effective control”.

<sup>156</sup> Like, for example, when the member states have to implement an EC Regulation.

<sup>157</sup> If, however, the decision manifestly violates principles of international law, member states should be bound not to follow them or be held jointly responsible if they do. See Hirsch (1995).

<sup>158</sup> Op.cit. p.85.

organisation's decision and, at the same time, provides the necessary incentive for both subjects not to violate third parties' legal rights<sup>159</sup>.

The second concern of the ILA report is with remedies against international organisations<sup>160</sup>. Although it was recognised that there might be limitations on remedies for non-state third parties, the right of remedies was recognised as a general principle of law. In fact, not only should some kind of remedy be available, but also such remedies must be "adequate, effective and in the case of judicial remedies, enforceable". Moreover, parties that could be affected by the implementation of the international organisation's activities must be informed of the remedies available to them.

The lack of some form of remedies was seen as a denial of justice. However, it was established that not only judicial remedies such as the award of damages would count as remedies, but that political and administrative measure could also be recognised as alternative measures. Therefore in some instances the best remedial outcome might be the apology expressed by the executive head of the organisation or the implementation of new guidelines to prevent future breaches.

Regarding complaints brought by non-state parties, it was specifically suggested that international organisations should consider resorting to a less formal mechanism such as mediation, or some kind of ad hoc mechanism such as the establishing of an ombudsman office. However the ILA report made clear that the need for judicial review should not be undermined, and international organisations were urged to limit their immunity from suit under domestic courts to what was needed for the fulfilment of their functions. This statement follows the increased claim for accountability of

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<sup>159</sup> The European Court of Justice has some interesting decisions on the strength of this control link under Loan Agreements concluded by the EBRD. Case C-395/95, *Geotronics v. Commission of the European Communities*, (1997) ECR I-2271 *Société Louis Dreyfus & Cie v. Commission of the European Communities* Case 386/96, judgement of the Court on the 5 May 1998, (1998) ECR I-2309 Those cases are discussed in Chapter IV.

<sup>160</sup> ILA Final Report, Part Four. For a comprehensive debate over remedies against International Organizations see Wellens (2002).

international organisations before non-state parties. As Reinisch correctly explains, “it seems crucial that the vindication of “civil right and obligations” of private parties vis-à-vis international organisations themselves is sufficient guaranteed”<sup>161</sup>. In fact, it was advanced that limitations on international organisation immunities should be mirrored to limitations applied to state immunities with reservations regarding the functions of some organisations<sup>162</sup>.

There is some debate on whether damage should be regarded as an essential element of responsibility<sup>163</sup>. The International Law Commission, for example, did not include damage as an essential element of international organisation responsibility<sup>164</sup>. By citing the ICJ, the Commission said that the “question of immunity from legal process is distinct from the issue of compensation for any damages incurred as a result of acts performed by the United Nations or by its agents acting in their official capacity”<sup>165</sup>. However it should be remembered that the determination of damages might be essential for the adoption of the appropriate remedy and for the award of compensation. Under the draft of the convention on State responsibility this is acknowledged under Article 31 where states are compelled to provide full reparation for the injury caused by the wrongful act<sup>166</sup>.

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<sup>161</sup> For further explanation of the role of national courts see Reinisch, (2000).

<sup>162</sup> The International Law Commission has been considering the issue of responsibility of international organisations; see first report of the Special Rapporteur (A/CN.4/532), considered at Report of the International Law Commission on the work of its fifty-fifth session, Chapter IV (2003). For discussion on sovereign immunity under state loans see Wood, (1995), Chapter 13.

<sup>163</sup> There are some treaties that require the element of damage as a precondition for the determination of responsibility, e.g., Article 263 (3) of the UN Convention on the Law of the Sea on the liability of states and international organisations for damages caused by pollution of the marine environment.

<sup>164</sup> Article 2 of the International Law Commission’s Draft on International Organizations’ Responsibility and commentary of the Commission on this article adopted at the fifty-fifth session (2003), Article 2 reads as follows: There is an internationally wrongful act of an international organization when conduct consisting of an action or omission:

- (a) Is attributable to the international organization under international law; and
- (b) Constitutes a breach of an international obligation of the international organization.

<sup>165</sup> See comments on page 47.

<sup>166</sup> Article 31 reads as follows:

#### Reparation

1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.

2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.

Under the Bank's system, proof of damage has not been required when determining the requests that could be brought to the Inspection Panel. Although a close analysis of the Inspection Panel system will be undertaken later, it is worth mentioning here that clause 12 of the Resolution establishing the Panel does not require from the complaining party proof of actual damage of their rights but only potential damage. What the complaining party must demonstrate is "that its rights or interests have been or are likely to be directly affected by an action or omission of the Bank as a result of a failure of the Bank to follow its operational policies and ... provided in all cases that such failure has had, *or threatens to have*, a material adverse effect." (emphasis added)

Hence under international law it is possible to say that damage, although an important element in establishing the reparation of the injury caused, is not necessarily a precondition of attribution of responsibility. When an international obligation is violated the wrongdoer is already responsible for this act<sup>167</sup>. In this context damages will be important to the evaluation of the appropriate remedies and compensation due.

## **10 Applicability of international principles of accountability to the World Bank**

For the Bank to be held accountable under the Loan and Guarantee Agreements it is necessary to prove that an unlawful act has occurred and that such an act is attributed to the Bank. Schlemmer-Schulte suggests that the analysis of the Bank's accountability should be divided into three parts; the recognition of the accountability of an international organisation, its liability under domestic law, and its international responsibility under international law<sup>168</sup>. The first concept is based on the recognition that accepting accountability in certain instances can actually improve the performance

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<sup>167</sup> See comments of the International Law Commission on Article 2 of the draft on Responsibility of States for internationally wrongful acts, noting that the Permanent Court of Justice in *Phosphates in Morocco* affirmed that when a state commits an internationally wrongful act against another state international responsibility is established "immediately as between the two States". *Phosphates in Morocco, Preliminary Objections*, 1938 P.C.I.J., Series A/B, No. 74, p. 10 at p.28.

<sup>168</sup> See Sabine Schlemmer-Schulte in discussions held during the panel *The Accountability of International Organizations to Non-State Actors* at the American Society of International Law Proceedings April 1-4 1998, 92 ASILPROC 359.

of the organisation<sup>169</sup>. As the author describes, “when applied to international organisations, the concept [of accountability] developed into a call from many sides, especially those outside of the organization, to develop a process to monitor development assistance so that the mission of international organizations, specifically development organizations, would improve and could be checked externally. [...] This acceptance enables the Bank to better serve its members and address development situations affecting people in the member countries”. This line of reasoning has in fact motivated the creation of the Inspection Panel, which is an organ of the Bank in charge of receiving complaints from affected people in member countries where the Bank finances projects, and checking on whether the staff have violated internal policies when designing, appraising and implementing the project<sup>170</sup>.

Regarding the legal liability of the institution under domestic law, there are also some relevant considerations. Firstly, the Bank’s immunities from suit must be considered. As mentioned before, such issues could be overcome by a waiver, and in fact the Articles of Agreement have provided such a waiver if the action passes the test of furthering the Bank’s objectives<sup>171</sup>. Secondly, actions under domestic law must be based either under a contractual relationship or on liability in tort. On both grounds the affected party will have to prove that its rights have been (or will be) violated by an unlawful act of the Bank. The difficulty lies in the fact that the project itself is implemented by the borrower, who subcontracts with other firms. The Bank, therefore, does not cause direct harm to the people affected by the project. However, if it is established that in fact the Bank has control over the borrower’s actions, then the

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<sup>169</sup> Also see Reinisch, (2000).

<sup>170</sup> As will be seen later, the Inspection Panel does not deal with complaints arising under the procurement process. For accountability over human rights claims see Darrow, (2003).

<sup>171</sup> See Medaro, Lutcher and Atiknson cases, notes 74, 76, 79.

unlawful act might be attributed directly to the institution or jointly to the bank and the borrower<sup>172</sup>.

International responsibility of the Bank can arise if the institution is found to have violated its duties under international law. In this case the Bank will be held accountable for its actions or omission. Such violations can originate from the non-compliance by the Bank staff with the Bank's internal policies and procedures, or from the breach of international law. In those instances the principle of good governance requires the Bank to consider the substance of a complaint with all necessary care and to give a reasoned reply. Thus, there should be some form of review mechanism that provides an effective response to aggrieved parties and some form of remedial outcome. The lack of such a mechanism could be seen as a denial of justice which will be a breach of law on its own. At the moment, the Bank, as many other international organisations, does not have such a review mechanism in place. However, the growing pressure over international organisations to recognise accountability for their actions might trigger new developments in this direction. This is the natural course, especially if the Bank acknowledges its actual interference in the various parts of the project as a casual link between the Bank's financing activity and the harm caused to people affected by the project.

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<sup>172</sup> *Constructores Civiles de Cetroamerica S.A. v. Hannah*, 459 F.2d 1183. See further comments in Chapter IV.

## CHAPTER III – THE WORLD BANK’S CONCERNS WITH PROCUREMENT

### 1 Introduction

As mentioned in Chapter II, the IBRD was created at the end of the World War II with the purpose of helping in the reconstruction of Europe. Within the following years the IBRD would expand its operations and today the World Bank is a multilateral institution whose main purpose is to reduce poverty by promoting sustainable economic growth in its client countries. It is important to note that the Bank was not created with a direct anti-poverty remit, but relies on the fact that helping developing countries to become modern industrialised economies would certainly raise the productivity, living standards and conditions of labour in those countries. The wealthier members will also benefit from this process since they will be able to expand trade, job opportunities and incomes, as well as enjoying the advantages of a better global environment<sup>173</sup>. It is also recognised that the Bank’s member countries, especially the developed countries, will also benefit from procurement opportunities derived from World Bank-financed projects<sup>174</sup>.

The IDA was established with the purpose of providing loans to the poorest developing countries at a favourable rate<sup>175</sup>. The IDA funds come mainly from the wealthier member countries and its loans are made only to governments. According to its Article of Agreement, the IDA will further the development objectives of the IBRD and supplement the latter’s activities.

The Bank’s assistance is provided mainly in the form of loans to specific predefined projects<sup>176</sup>. The loans are primarily given to governments and government agencies of member

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<sup>173</sup> See IBRD web site at [www.worldbank.org/html/extdr/backgrd/ibrd/role.htm](http://www.worldbank.org/html/extdr/backgrd/ibrd/role.htm)

<sup>174</sup> In fact the United States, Germany, Japan, France, United Kingdom, Italy and Canada together accounted for more than 57% of the total foreign disbursement of the Bank according to *The World Bank Annual Report 1999* (this figure does not include adjustment lending operations). US\$ 3.5 billion were disbursed by the IBRD and IDA as payments to donor countries for supplying on foreign procurement in the fiscal year 1999.

<sup>175</sup> Only countries with an average annual per capita income of \$1,506 or less are eligible for IDA credits, while countries with an average annual per capita income between \$1,506 and \$5,445 are eligible for IBRD credits.

<sup>176</sup> The Bank also provides development policy lending to support structural reforms in a sector or the economy as a whole. However, since the Guidelines only apply to procurement under investment operations, development policy lending will not be explained in this work.

countries, but other institutions (such as state owned enterprises and private firms) can eventually be awarded funding if they can obtain a guarantee from their government.

The World Bank Annual Report 2004 reveals that in that year the total IBRD and IDA lending reached \$20.1 billion, comprising 245 projects distributed across various sectors in different parts of the globe<sup>177</sup>. It is important to note that the Bank only financed part of the total cost of the projects<sup>178</sup> and its lending stimulated further funding from commercial banks and other private agencies, as well as from the borrower governments. Therefore, the value of the procurement opportunities that arise from projects funded by the Bank is significantly more than the figure mentioned above.

The actual contract (or contracts) by which projects are implemented is concluded between the borrowing country and private contractors. The Bank's interest in procurement derives from Article III, Section 5 (b) from the Articles of Agreement, which stipulates that the funds it lends will be allocated only for the purpose for which they were granted, with due attention to economy and efficiency. The aiding institution is, therefore, concerned with the effective application of the money granted and usually requires the use of its own rules on public procurement.

This Chapter aims to explain the Bank's policies regarding procurement under investment operations, and how they frame the legal relationship between the institution, the borrower, bidders and contractors. This Chapter will not aim to explain the detailed rules and procedures but will provide a general overview of the World Bank's activities and procurement concerns.

## 2 Project Cycle

Before turning to the specific topic of procurement, it is worth analysing the way in which the projects financed by the World Bank develop, and identifying the sort of opportunities available for private firms.

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<sup>177</sup> The World Bank, *Annual Report* (2004), Summary of Fiscal 2004 Activities.

<sup>178</sup> 40% on average, according to The World Bank, *Guide to International Business Opportunities* (1997) in projects funded by the World Bank (hereafter called GIBO).

The Bank, in consultation with local officials, regularly undertakes an economic study and sector analysis of each borrowing country's needs in order to define an appropriate framework for the lending programme, and a Country Assistance Strategy (CAS). The CAS describes the Bank's strategy based on an assessment of priorities in the country and indicates the level and composition of assistance to be provided. As part of the preparation process consultations are held with members of the financial sector, civil society representatives, industrial associations, representatives of the private sector, and other interested parties<sup>179</sup>. This study serves as foundation from which specific projects are identified<sup>180</sup>. Although the CAS is prepared with the participation of the governments of borrowing states, it is not a negotiated document and differences between the country's own agenda and the strategy proposed by the Bank are highlighted in the CAS document submitted for Board consideration<sup>181</sup>.

All the projects funded by the Bank must comply with four pre-requisites. They must be "technically and financially sound, produce acceptable rates of return, contribute to the country's economic growth and development and, be environmentally sustainable"<sup>182</sup>. Little guidance is given on the exact meaning of those words and in fact there are controversies on how the acceptable standards should be accessed<sup>183</sup>. Over the years there have been significant changes in the Bank's development orientation and in the quality of its lending<sup>184</sup>, and therefore it is difficult to establish an overall standard acceptable throughout the Bank's history of project lending. However, following the institution obligation under its Articles of Agreement, the Bank has repeatedly emphasised its concerns with the income distribution, development of local resources and institutions, training of local personnel and environmental and human impact of the

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<sup>179</sup> It is possible to provide input to the CAS through the World Bank web site at <http://www.worldbank.org/html/extdr/casconsult.htm>

<sup>180</sup> The analyses of the borrower procurement system and possible suggestions of reform are also part of the CAS. The Bank prepares a document called *Country Procurement Assessment Report* (CPAR) in which it identifies the strengths and weaknesses of the borrower procurement system and defines a strategy to make the necessary reforms.

<sup>181</sup> For further information see <http://www.worldbank.org/html/pic/cas>

<sup>182</sup> GIBO page 6.

<sup>183</sup> See Pohn and Dubravko (1992), Devarajan et al, (1997) and Wadrzyk, (1999).

<sup>184</sup> See World Bank Annual Report 2001.

projects<sup>185</sup>. Moreover, the Bank has promoted a liberal market environment with emphasis on the development of the private sector and has supported international free trade practices<sup>186</sup>. These economic policies are based on the idea that they will contribute to the economic growth of borrowing countries and also permit the adequate maintenance and repayment of the projects.

Every financed project follows a well documented Project Cycle during its lifetime. The Project Cycle is the basic framework used by the Bank to design, prepare, implement and supervise projects. For the whole duration of the Project Cycle the Bank and the borrower will work together although they would have different and, sometimes, conflicting roles and responsibilities<sup>187</sup>. The Project Cycle is divided into six different parts: identification, preparation, appraisal, negotiation and loan approval, implementation and supervision, and evaluation.

Identification: In the first part of the process, the Bank, based on its studies<sup>188</sup>, will identify reforms that are also supported by the borrowing country. Where both share interests, of the borrowing country will propose projects for the Bank's assistance. Although only the member governments can propose projects, the identification of those can come from different sources including other multilateral development institutions or even private sponsors. After the identification of the implementing agency, and after the Bank has designated staff to manage the project, the Bank and the borrower undertake a feasibility study where key principles and conditions of the project will be detailed. The Bank will assign a Bank-sponsored identification mission to assist borrowers at this stage. The identified projects are published in the World Bank Monthly Operational Summary (MOS), which is an important source of business opportunities for firms with an interest in participating in the procurement process for World Bank projects. The Bank also publishes a Project Information Document (PID) which provides further details about the identified project, such as its proposed objective, likely risk and timetable for approval.

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<sup>185</sup> See The World Bank *Operation Manual*.

<sup>186</sup> See United Nations Publication, Africa Recovery, *World Bank calls for better aid targeting*, (1998) and World Bank Operation Manual OD 8.60.

<sup>187</sup> For updated information on the project cycle see [www.worldbank.org/WBSITE/EXTERNAL/PROJECTS](http://www.worldbank.org/WBSITE/EXTERNAL/PROJECTS)

<sup>188</sup> Projects begin to be identified at the CAS.

Procurement planning also starts at the identification stage. For each project proposed a Task Team is formed. Each Task Team includes a procurement specialist (PS) or procurement-accredited staff (PAS). The PS or PAS will evaluate the implementing agencies in order to determine their ability to carry out project procurement and the risks associated with the procurement operation<sup>189</sup>. The assessment will include many aspects of the procurement activity including suitability of laws and regulations, organisation of the procurement unit, and support and control systems including auditing and anti-corruption practices, record keeping, skills of the staff involved, private sector assessment, etc. If deficiencies are identified, the Task Team will formulate an action plan to strengthen the agency's capacity and reduce the risks<sup>190</sup>. It is expected that the identification stage could last up to a year and a half<sup>191</sup>.

Preparation: The preparation stage aims to design a detailed proposal that will consider various aspects of the projects. Based on the cost-benefit analysis, the best method to achieve the project's objective will be defined. The technical, institutional, economic, environmental and financial issues facing the project will be studied, and alternative methods proposed. An assessment is required of projects proposed for Bank financing to help to ensure that they are environmentally sound and sustainable (Environmental Assessment)<sup>192</sup>. Although the responsibility for preparation rests on the borrower, the Bank will also be involved at this stage to ensure that the proper procedures have been followed. In some instances, the Bank also provides assistance to the borrower in preparing the project. Consultants could also be hired to carry out this work, and the Bank will assist the borrower in financing this service, provided that it is procured according to the Bank's Guidelines.

Procurement planning will continue at the preparation stage. The PS or PAS will assist the borrower in preparing the optimum contracting strategy for the project. During this study the PS or PAS is instructed to take into account any technical or management constraints that the

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<sup>189</sup> See World Bank Office Memorandum (1998).

<sup>190</sup> Operational Manual BP 11.00 and the Bank-Financed Procurement Manual.

<sup>191</sup> The World Bank website Resource Guide: Project Cycle at [www.worldbank.org/WEBSITE/EXTERNAL/PROJECTS/PROCUREMENT](http://www.worldbank.org/WEBSITE/EXTERNAL/PROJECTS/PROCUREMENT)

<sup>192</sup> Potential harm to the health, productive resources, economies and cultures of indigenous people are also identified by the Indigenous People Development Plan.

borrower may be facing<sup>193</sup>. The procurement plan drafted at this stage will cover the list of appropriate contract packages, the overall project procurement programme, including timing of the contracts, the optimum method for procuring the necessary goods, works and services, the required Bank standard bidding documents and the institutional arrangements necessary to carry out the procurement<sup>194</sup>.

Appraisal: In the third part of the project cycle the proposal prepared by the borrower will be analysed by the Bank. This is a major review of all aspects of the proposal. The Bank staff, under the supervision of the Task Team Leader, will reassess the technical, financial, economic, social, environmental and institutional impacts of the project. The types of goods, works and services necessary for the accurate implementation of the project will also be reviewed. Contractors looking for opportunities in financed projects should be aware that the Project Information Document will be updated at this stage.

This is an important phase in procurement terms since this is the time when the project's arrangements are firmed up and the borrower, under the Bank's supervision, will develop a procurement plan and insert any agency-strengthening action plan into a coherent overall project strategy<sup>195</sup>. As part of the procurement plan the Bank and the borrower will agree on the particular contracts for the goods, works and services required to carry out the project during the initial period of at least 18 months<sup>196</sup>. The Bank and the borrower will also agree on the methods for procurement of such contracts and the standard bidding documents to be used in the project. The General Procurement Notice (GPN), required by para. 2.7 of the Procurement Guidelines will be issued at this stage<sup>197</sup>. Another responsibility of the PS or PAS in the appraisal stage is to draft the Bank's procurement supervision plan. Based on the assessment of the contracting entity made at the identification stage and the level of risk and institutional weakness encountered, the

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<sup>193</sup> BP 11.00 paragraph. 3

<sup>194</sup> Ibid. For comments on the relevance of packaging for this work see Chapters VII and VIII

<sup>195</sup> *Operational Manual* BP 11.00 number 5 (c)

<sup>196</sup> A procurement plan is required by the procurement Guidelines para 1.16 and should be updated annually or as needed throughout the duration of the project.

<sup>197</sup> If there is advanced procurement under the proposed project, the GPN is issued at earlier stages of the project.

PS or PAS will propose the levels of prior and post review and the frequency of any required procurement audit<sup>198</sup>.

All the details of the project will then be outlined in the Project Appraisal Document, which is available to interested parties after the loan is approved<sup>199</sup>. In particular the procurement section will address issues such as the estimated costs and methods of procurement, the assessment of the implementing agency's capacity to implement the project, together with any corrective measures, an assessment of the compatibility of the borrower's national procurement regulations with the Guidelines (in cases where National Competitive Bidding will be required<sup>200</sup>), a defined procurement timetable and procurement supervision plan, and a brief description of the borrower's system of recording procurement information<sup>201</sup>.

Negotiation and loan approval During the next stage, the negotiations between the borrower and the Bank will be intensified in order to arrive at the loan agreement. Procurement is also included in the negotiations and the Bank will require the adoption of the Bank's Guidelines when procuring goods, works or services in projects financed by the institution<sup>202</sup>. Where National Competitive Bidding is used, the Project Appraisal Documents should discuss the compatibility of the borrower's procurement regulations and procedures with the Procurement Guidelines and explain any changes or waivers required for discussion in the loan negotiations<sup>203</sup>.

It is interesting to note that the Bank requires the adoption of the Guidelines regardless of the

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<sup>198</sup> *Operational Manual* BP 11.00 number 5 (a) and World Bank Office Memorandum (1998).

<sup>199</sup> In development lending operations the Bank will issue a Program Document which sets out the Bank's appraisal and assessment of the feasibility and justification for the program.

<sup>200</sup> National Competitive Bidding is the competitive bidding procedure normally used for public procurement in the borrowing country. It is usually used in cases where the product being procured is unlikely to attract foreign trade. To be acceptable under the Bank's financed procurement those rules must be reviewed and modified to comply with the Bank's procurement objectives and must be broadly consistent with the provisions on International Competitive Bidding. Any modifications will have to be included in the Loan Agreement. See *Guidelines Procurement under IBRD Loans and IDA Credits* May 2004 rule 3.3.

<sup>201</sup> *Bank-Financed Procurement Manual*, July 2001, Section 8.3.1.

<sup>202</sup> *Bank-Financed Procurement Manual*, Chapter 1 Section 1. When the contract is to be financed by the borrower or by other lenders, other procedures might be followed provided that the Bank is satisfied that these procedures are economical and efficient and do not jeopardise the successful implementation of the project.

<sup>203</sup> idem Section 8.3.1 (iii).

assessment previously made of the contracting agency<sup>204</sup>. Discussion on procurement issues will involve mainly thresholds, contract packages and financial issues (especially in cases of joint finance). The Regional Procurement Adviser must clear any changes made in this stage<sup>205</sup>. After agreeing with all the details, the Loan Agreement is submitted to the Executive Directors of the World Bank for approval and, when signed, the document will become legally binding on both parties.

**Implementation and supervision:** It is at the implementation stage that the procurement procedure and the actual contract will often take place. The borrower will be obliged to follow the procedures agreed in the loan documents rigidly, and the Bank will not only supervise this activity but will be called many times to approve the draft of the advertisements, bidding documents and final award. The disbursement of the loan is also conditional on the actual fulfilment of the procurement plan<sup>206</sup>. The PS or PAS will evaluate the borrower's procurement actions in order to ensure compliance with the provisions in the Loan Agreement. Problems in the procedures are reported to the Task Team Leader and to the regional procurement advisor, and correction or revisions of the procurement plan might be suggested<sup>207</sup>. On the completion of the project the Bank will issue an Implementation Completion Report containing the results and assessing the operation.

Most of the opportunities for private firms will arise at this stage. On the implementation of the project, companies from all countries will have the chance to bid for contracts varying in size and value.

**Evaluation:** Finally the Bank will evaluate the actual results of the project and compare them with what was expected at the beginning<sup>208</sup>. The causes of eventual successes and failures will be identified and lessons for the future will be identified. The project review is undertaken

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<sup>204</sup> No exemption is given in the procurement Manual to agencies that are found to have sound procurement practices.

<sup>205</sup> *Operational Manual* BP 11.00 number 6.

<sup>206</sup> *Operational Manual* OP 12.00 number 1.

<sup>207</sup> *Operational Manual* BP 11.00 number 7. The Bank's Report on the Status of Project Execution (SOPE) is now made available to the public.

<sup>208</sup> The audit prepared by the Operations Evaluation Department will entail a review of the project completion report and also the preparation of a separate report to be submitted to the executive directors and to the borrower. Those reports are not released to the public.

by the Operations Evaluation Department, which selects for performance assessment projects that offer the potential for further learning (either because of particularly good or bad performance). About one in four of the completed projects is selected for a Project Performance Assessment<sup>209</sup>.

It is clear from this description that unlike a commercial bank, the Bank is not merely a lender but is deeply involved in choosing, planning and guiding the implementation of its projects. Therefore, it seems that the Bank contributes as much as the borrower to the eventual success or failure of the project. However, it is interesting to note that the Bank does not take any risk. The borrower, besides bearing the risk of possible social and environmental damages, and is bound to pay the full amount of the lending, even in the event of failure.

The Bank has been severely criticised, especially during the last few years, for the high number of failures of projects that it has financed<sup>210</sup>. Even the Bank's own analysis has shown that the quality of Bank-supported projects by the time they come to an end is below a satisfactory level, taking into account three related dimensions - outcomes at the time of evaluation, sustainability of benefits and institutional development impact<sup>211</sup>. Although many problems were detected, including the suitability and design of the project, the analysis made by the Bank's Operations Evaluation Department shows that the Bank's supervision and the borrower implementation performance are crucial to the outcome of the projects<sup>212</sup>. The general costs of such projects have severe adverse effects on the poorest countries in the world and certainly impair, instead of promoting the development of such countries. Nevertheless, the Bank has never suffered default of payment from any of its borrowers<sup>213</sup>. Two main reasons can explain this: firstly, the Bank makes 'defensive lending', which means that it gives new loans to enable the borrower to cover old ones; secondly, the borrower does not want to default because of the lack of credibility that would result, leaving the government with no possibility of

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<sup>209</sup> See <http://www.worldbank.org/oed/eta-tools.html>

<sup>210</sup> For an extensive list of complaints from a diverse range of sources see Rojas, (1998). For criticism directed at MDBs see Head (2004)

<sup>211</sup> See 1999 Annual Review of Development Effectiveness, Chapter 2 at <http://www.worldbank.org/html/oed>

<sup>212</sup> Idem at page 8 Box 2.1 While quality at the entry and borrower compliance increases the project's likelihood of success by around 20% each, improved Bank supervision increases the likelihood of success by 51 % and borrower performance by 43 %.

<sup>213</sup> See Delaume (1985), page 323.

arranging international loans<sup>214</sup>. Indeed, the power exercised by the Bank in the fragile economies of developing countries can be devastating if not exercised with extremely care and responsibility.

Procurement represents an important aspect of the implementation of the project and might have a significant impact on the rate of successful outcomes. The adoption of an efficient procedure and the presence of an enforcement mechanism that guarantees the observance of the rules might be vital in order to increase the credibility of the project and to stimulate the participation of private firms in competition.

### **3 The World Bank Procurement Guidelines**

While an adequate procurement practice does not guarantee the success of these projects, poor practices can certainly make it more difficult to achieve. Hence, the Bank's interest in procurement derives from the need to ensure that the resources will be allocated for the purpose for which the loan was granted, and also that it will be done in an efficient way<sup>215</sup>.

The Guidelines, Procurement under the IBRD Loans and IDA Credits and Selection and Employment of Consultants by World Bank Borrowers<sup>216</sup>, and the Standard Bidding Documents set out the details of the procedures required by the Bank. These rules are designed to address four major concerns: firstly, to ensure that the goods and services needed for the project are procured with due attention to economy and efficiency; secondly, to secure compliance with the Bank's interest in giving all eligible bidders from developed and developing countries an opportunity to compete in providing goods and works financed by the Bank; thirdly, to encourage the development of domestic contracting and manufacturing industries in the borrowing country, stimulating development in those countries; and finally, to ensure transparency in the procurement process<sup>217</sup>.

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<sup>214</sup>Caufield, (1998).

<sup>215</sup>IBRD Article of Agreement, Article III, Section 5 (b).

<sup>216</sup>Both documents have been revised in May 2004.

<sup>217</sup>Guidelines Procurement under IBRD Loans and IDA Credits para. 1.2.

The Bank believes that the most efficient way to achieve those objectives, when procuring goods and works, is through International Competitive Bidding (ICB)<sup>218</sup>. This rule requires the borrower to advertise bidding opportunities internationally, therefore enabling the greatest number of suppliers to be aware of the project. The publicity for the contracts is usually undertaken in two stages: firstly, just after the appraisal the borrower issues a General Procurement Notice (GPN) which is advertised in the United Nations publication Development Business, informing readers of the works and goods that will be procured. The second stage takes place after the documents are ready for the implementation of the project, and the borrower is compelled to advertise each particular package of contract in at least one national newspaper in its own country (and in any official gazette, if such exists). Further publication in Development Business for specific projects will usually be required when procuring large and complex projects<sup>219</sup>. At this second stage the borrower is also bound to send detailed information to potential bidders which had showed interest by answering the GPN<sup>220</sup>.

The Guidelines also establish a series of procurement procedures to be followed. For example, it defines rules on pre-qualification of the bidders; the strict cases where a two stage bidding procedure can take place; the procedures to be followed when opening, evaluating and awarding a contract, rules on specifications, and all other specific aspects that the bidding documents should contain such as currency of payment, language of the bidding documents, price adjustments, possibilities of negotiation, etc.

As mentioned above, the ICB procedure was chosen by the Bank because it was seen as securing the goals of the project, achieving best value for money, giving access to suppliers from all countries, ensuring that a transparent decision is reached through objective criteria, and

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<sup>218</sup> The details of the procedure are set out in the Guidelines: Procurement under the IBRD and IDA Credits.

<sup>219</sup> Borrowers will no longer be obligated to publish in the print version of United Nations Development Business (UNDB) Specific Procurement Notices (SPNs) for goods and works under US\$10 million. As a result of these changes, the on-line and print versions of UNDB may no longer be considered to be identical. Certain SPNs may only appear on-line and not in print. These changes make the hard-copy version of UNDB practically obsolete. Since the on-line version of UNDB was launched in December 1998, subscribers have had the option to receive only the hard copy (US\$495 per year), or both (US\$695 per year).

<sup>220</sup> There is a simplified ICB process (Quick Disbursement Operations) which are used for procurement under adjustment operation. This kind of procedure does not require the publication of GPNs or SPNs.

stimulating the participation of suppliers from developing countries. Moreover, other advantages of such proceedings have been identified<sup>221</sup>: it facilitates monitoring of the whole process by the Bank and bidders; it provides an easy way to reassure shareholders that the money is being spent on the projects and not being wasted in corrupt practices, and will increase competition leading to an efficient application of resources.

However, the great emphasis on transparency has a ‘cost’. The ICB has been severely criticised for being an extremely onerous and time-consuming procedure, which sometimes leads to an inefficient procurement. Moreover, the way officers of the Bank conduct this procedure in practice can cause serious negative effects to the final goal of the project.<sup>222</sup> A clear example is the potential exclusion of qualified bidders that do not have sufficient economic strength to cope with the heavy documentation burden and high financial requirements imposed, despite having the capacity to perform the work or supply the goods procured with equal or higher quality than any other international company<sup>223</sup>. Apart from running the risk of becoming more expensive, the project will take longer to be implemented (the ICB procedure takes from eighth to twenty months), delaying, therefore, the results that those goods or works are supposed to bring<sup>224</sup>. Furthermore, ICB has been criticised as being a procedure that aims to favour the largest multinational firms<sup>225</sup>.

Thus, it is possible that transparency could compromise some of the objectives of the Guidelines, in particular the economy and efficiency requirements. Arrowsmith correctly advocates that “strict competition requirements with only limited exceptions based on objective and verifiable criteria [...] may lead to more commercial procurement for cases in which corruption, discrimination or simply bad judgement would otherwise have led to an abusive or unwise choice of supplier [...]. However, they will produce a less commercial result when,

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<sup>221</sup> See Arrowsmith, Linarelli, and Wallace, (2000).

<sup>222</sup> See examples given by Tucker (1997), pg. 153/154 and also (2001).

<sup>223</sup> There has been a complaint on this grounds under Brazilian courts: See TRF 1 Região Apelação em Mandado de Segurança 95.01.19153-2/TO *Pavitergo – Pavimentação e Terraplanagem Goias Ltda v. União Federal e Estado de Tocantins*.

<sup>224</sup> For further identification of the problems with the World Bank procurement procedure see Tucker,(1997) and (2001).

<sup>225</sup> See Rojas, (1998) citing Cheryl Payer, *The World Bank. A critical analysis*, Monthly Review Press, 1982.

without the requirement, the particular (honest and competent) purchaser would have obtained a more advantageous deal or relationship through other means [...]”<sup>226</sup>. Given the fact that the contracting agency is assessed in a case by case basis, the PS or PAS should be concerned with establishing the appropriate balance between the costs of a transparent procedure and the benefits of allowing some discretion to the purchaser. This analysis, of course, will take into account several factors. The skills of the procurement staff involved in the project will certainly have considerable weight, but probably more important than that would be the assessment of the monitoring system in place. A strong monitoring system accompanied by a related measure such as accountability for bad practices and strong anticorruption policies would reduce the need for transparency and increase the likelihood of good procurement decisions<sup>227</sup>.

It is fair to say that section three of the Guidelines allows for other types of procedures: Limited International Bidding, which permits direct invitation of bidders and is used for contracts of small values or where there is a limited amount of suppliers; National Competitive Bidding, where contracts that are unlikely to attract foreign competition will be advertised at a national level and national language will be used in the bidding documents; Shopping (international and national), where three quotations can be used to procure off-the-shelf products of small value; Direct Contracting, where it is permissible to buy from a particular supplier in cases where there is only one source; Force Account, where the use of the borrower’s own personnel and equipment is the only practical method for constructing a given kind of work; Procurement through UN agencies, for off-the-shelf products of certain primarily areas; and some other kinds of procedures that follow the established commercial practices. Nevertheless, the use of those procedures is secondary and ICB is usually preferred<sup>228</sup>. Therefore, some of the problems that occur during the procurement process could be directly related to the selection of the procedures adopted.

In practice the Bank does not rely on the borrower’s experience and expertise to deal with a less transparent procedure. Moreover, since the Bank has the power to significantly

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<sup>226</sup> Arrowsmith, (2002) (a).

<sup>227</sup> For further discussion on this issue see the enforcement Chapter of this work.

<sup>228</sup> Tucker, note 222.

interfere in the procurement plan, human resources from the borrowing country will not be stimulated to find the most efficient way to procure goods, works and services but only to blindly follow the Bank's rules. Therefore, in the future, assets gained during the Bank's projects might face potential problems when maintenance or replacements are needed<sup>229</sup>.

It is interesting to note that the Guidelines emphasise the fact that the responsibility for the implementation and decision under the procurement process rests only on the borrower. The Bank, in this context, will only supervise the procedure. However, if the Bank does not agree with the decision of the borrower or, if the borrower does not strictly follow the rules imposed by the Bank, the funds for the project can be suspended. Therefore, it can be said that "although a development bank does not direct the borrower to award the contract to any particular offerer or to take any other action in connection with the procurement, it has the power to pursue, which provides it with the ability to exert significant pressure"<sup>230</sup>.

The procedures for contracting consultants' services vary significantly for contracts for goods and works. The rules established for those procedures are set out in the Guidelines: Selection and Employment of Consultants by the World Bank Borrowers. The method of selection under this procedure is not through ICB but starts from selecting a small number of firms from which a high quality bid is expected. This rather subjective criterion reflects the weight attached to quality rather than to price in choosing the consultants. It is worth mentioning that anticipated consulting assignments must be included in the General Procurement Notice, and large value contracts must also be advertised in a national newspaper and in Development Business<sup>231</sup>. Not all interested firms will be invited to bid but a short-list should be prepared by the borrower and approved by the Bank with at least three, and a maximum of six firms.

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<sup>229</sup> It is interesting to note that the Bank has been engaged in financing the reform of procurement systems in some of its member countries relying on the UNCITRAL Model Law on Procurement of Goods, Construction and Services. However, even when the borrower has already implemented the reform, and procurement personnel have been trained, the Bank still insists on the use of the Guidelines.

<sup>230</sup> Arrowsmith, Linarelli, Wallace, (2000), p.111. For further discussion on the relationship between the Bank, borrowers and bidders see the enforcement Chapter.

<sup>231</sup> Contracts expected to cost US\$200,000 equivalent.

The Bank's concerns with the quality of the service provided can also be observed in the award criteria. Although in the evaluation of the bids quality and costs will be taken into account, the final weight of the 'costs' will normally range from 10 to 20 points out of a total score of 100. However, as correctly pointed out by Tucker<sup>232</sup>, the Bank does not evaluate and rank the supplier's previous performance unless it is a very poor one, as is usually the case with the private sector. As a consequence, since the degree of fulfilment of the contract initially proposed by the consultant is not taken into account when considering future contracts, the bidder does not have the incentive to design a proposal that in practice will work with high efficiency. After signing the contract, their actual performance only has to be minimally satisfactory for them to be allowed to enter future proceedings, where once again what will be accessed is not their efficiency but the quality of the bid that they submitted.

The Bank maintains a database of firms interested in working on Bank-financed projects (DACON), which can be used to assist the borrower to identify firms that would be eligible for short-listing. It is important to note that registration on this list is not compulsory in order to be short-listed, and that the information contained in it is only descriptive, and does not imply the Bank's endorsement or approval. As mentioned above, the Bank will have the role of reviewing and approving the borrower's short-list to ensure that only capable firms are considered for selection. As with the procurement of goods and works, the Bank emphasises the fact that the selection process is entirely the borrower's responsibility. However, it can be said that once again the borrower's decision suffers from severe interference by the Bank.

A few other provisions of the Guidelines are important when examining the Bank's policies on procurement for the purpose of this study<sup>233</sup>. First, as a development institution, the Bank is concerned with the participation and development of national firms in the bidding procedure. When procuring goods, the Bank allows in some instances the borrower to establish a margin of preference in favour of goods manufactured in its own country. Domestic contractors

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<sup>232</sup> (1997).

<sup>233</sup> Those provisions will be carefully analyzed in latter Chapters. Here, it is provided just a brief overlook of the legal challenge that they might pose.

can also be granted a preference margin when procuring for work contracts. The domestic preference is significant (7.5% for work contracts and 15% of the CIP price for goods), and the borrower will need the Bank's approval and will be subjected to the terms and conditions stated in the World Bank Procurement Guidelines Appendix 2. In the Consultants Guidelines, the development of national firms is stimulated by including as one of the award criteria the extent of participation by nationals in the performance of the assignment.

It seems that in the last few years the IBRD and IDA payments to borrowing countries for supplying local and foreign procurement have increased significantly, from US\$ 7.2 billion in 1999 to US\$ 9.7 billion in 2000. Of the US\$ 9.7 billion, 8.9 was paid for in-country procurement and 0.8 billion from clients outside the borrowing country<sup>234</sup>. Hence, suppliers from developing countries are apparently becoming more competitive and gaining ground in the international market. However, there is evidence from World Bank officials that in practice international firms are getting national firms to bid on their behalf in order to qualify for domestic preferences. This, besides increasing the value of procurement, does not bring the benefits to the domestic industry aimed by the Bank<sup>235</sup>.

Finally, in Appendix 3 of both Guidelines the Bank alerts potential suppliers to the role that the Bank, the borrower and the bidders will have in the procurement process. From those statements it becomes clear that the Bank understands that the borrower is the one legally responsible for the procurement and that the interest of the institution is with the adequate application of the funds. However, it is not entirely clear what are the legal foundations, the rights and liabilities, which are attached to the position taken by the lending institution in the procurement field. As has been noted in the description above, the decision-making power of the Bank is undeniable, but the formalities of the documents point to the procuring entity (the borrower) as the only one with a legal relationship with the bidders. But are the statements reflecting the real legal position of the parties, or trying to deny a relationship between the Bank

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<sup>234</sup> Presentation given by Colleen Gorove, Business Partnership & Outreach Group, Working with the World Bank Group.

<sup>235</sup> Other arguments on the provision of domestic preferences will be provided at Chapters VII and VIII.

and the bidders that actually exists, or, at least, should exist? These questions remain unanswered in the context of procurement procedures conducted by the World Bank. However, on projects financed by the European Bank of Reconstruction and Development, the European Court of Justice has found the lending institution accountable for its decisions during the procurement process in some particular cases<sup>236</sup>. Although the basis for the legal relationship between the EBRD and bidders is peculiar to the European system, it is submitted that a similar relationship should be acknowledged in procurement procedures conducted in World Bank financed projects.

#### **4 The Internal Rules Regarding the Application of the Guidelines**

Apart from the Loan Agreement provisions, the Bank's operations are also guided by some internal rules that are binding on its staff when actually performing its day to day operation. The Operation Manual, which is the codification of the Bank's policies and procedures, brings some important procurement provisions. The Operation Manual is designed by the Bank's Operation Policy and Strategy Vice Presidency, which is the organ that gives support to the executive board in its operational capacity<sup>237</sup>, and is composed of the Operational Policies and Bank Procedures Documents. The Bank's Operational Policies (OPs) are short, focused statements that follow from the Bank's Articles of Agreement. They provide staff with direction and guidance in pursuit of the policies established by the Board, define the parameters for the conduct of operations, and also describe the circumstances under which exceptions to policy are admissible and clarify who authorises such exceptions. Bank Procedures (BPs) describe how Bank staff must carry out the OPs by describing the procedures and documentation required, ensuring consistency in the Bank's operations. There is also a code of Good Practices (GPs) which contains recommendations and guidance on policy implementation<sup>238</sup>. It is worth mentioning that although these internal rules are only binding within the organisation, once they

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<sup>236</sup> For reference of such cases and a deeper discussion on the enforcement mechanism see Chapter IV.

<sup>237</sup> The Executives Directors' power to edit such rules derives from the Articles of Agreement (Article V Section 4 (a)) which provides that "the Executive Directors shall be responsible for the conduct of the general operations of the Bank..." .

<sup>238</sup> For further information on the Banks' *Operational Manual* see documents available at: <http://wbln0018.worldbank.org/institutional/manuals/opmanual.nsf/textonly>.

are published and open to public scrutiny they might generate a legitimate expectation that the provisions will indeed be followed<sup>239</sup>.

The OP 11.00, BP 11.00 and the Procurement and Consultants Manuals are the main internal rules regarding the procurement procedures<sup>240</sup>. The OP and BP 11.00 bring provisions on the responsibilities and duties of the Bank's staff during and after the procurement process. There is also a lengthy description of the roles of the borrower and the Bank, and how they should perform these in practice. Although this work will not be concerned with all the detailed rules of procurement, it is worth commenting on the provisions that establish the procurement policies of the Bank.

Following Article III, Section 5 (b) of the Articles of Agreement the Bank's interest in procurement derives from the need to ensure that the resources will be allocated for the purpose for which the loan was granted, and also that this will be done with due attention to economy and efficiency. Since the Articles themselves give no specific instruction on how to conduct procurement policies and practices, in order to fulfill its obligations, the Bank needed to establish practical rules which would guide staff during the implementation of the projects it helps to finance. Those rules needed to be designed in such a way that they would be formal enough to allow some predictability on the Bank's projects but also easy enough to change in order to incorporate past experiences and changes in conditions. In this context, the OP 11.00, para. 4, reinforces the four basic procurement concerns stated in the Guidelines. These are the rules that will in practice direct the conduct of the Bank throughout the procurement process, giving full applicability to the functions defined in the Articles of Agreement. It is by interpreting and understanding those principles that the procurement process should be guided in practice.

Other important provisions are OP 11.00, para. 13 – 16, which defines the role of the borrower and the Bank. If on the one hand those provisions expressly provide that the borrower is

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<sup>239</sup> For the purpose of receiving complaints from affected parties in World Bank financed projects, the Bank has set an Inspection Panel. The Panel has as one of its main objectives to determine compliance by staff with the Bank's internal regulations and address any faults that have occurred. However, the Panel does not deal with procurement complaints. For further comments see Chapter IV.

<sup>240</sup> See OP 11.00 and BP 11.00 July 2001 (Revised December 2004) available at: <http://wbln0018.worldbank.org/institutional/manuals/opmanual.nsf/textonly>.

the one responsible for the implementation of the project, on the other hand they imply a significant engagement of the Bank in defining the rules and supervising the projects. Moreover it reminds the staff that the Bank has the power to cancel the agreement if the rules are not followed as agreed. This leaves the institution in an ambiguous position where it accepts no responsibility for the outcome despite being the rulers of the whole process. It is fair to say that the borrower also participates in the process of drafting the procedures. However, its negotiating power is weak given its economic and financial position when asking for aid from a development institution.

The World Bank policy of denying responsibility for the implementation of the procurement despite being deeply involved with the whole preparation and supervision is not particular to this institution. In fact other development institutions will take the same approach. Nonetheless, the study of the Bank's policy is particularly significant given the fact that it has been seen as a role model for other agencies. Moreover, with 183 members, most of which are eligible for funding, the Bank is one of the largest institutions providing financial aid for development.

The Bank's policies against fraud and corruption are also of great relevance for procurement. In fact the Bank requires from both the borrower and from the bidders "the highest standard of ethics" during the procurement and execution of the financed contracts. Although the term 'ethics' is not defined in the rules, the Guidelines determine the meaning of 'corrupt and fraudulent practices'. If misprocurement is detected the Bank will act not just within the loan agreement to cancel the portion of the loan related to the contract, but might also declare a firm ineligible for -financed contract. Therefore, not only will borrowers be subjected to the Bank's decisions, but also bidders. In order to make such rules enforceable the Guidelines require a provision to be included in the contract giving the Bank full access to the contractor's accounts and records related to the performance of the contract<sup>241</sup>.

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<sup>241</sup> The application of the Bank's anti-corruption policy in procurement is discussed in Chapters IV, VII and VIII.

Under OP 11.00 and BP 11.00 a full explanation and guidance on the appropriate action is given to Bank staff for cases where misprocurement is identified. Under such procedures, the caution with which a violation is determined is striking. First the borrower is notified and is given the chance to bring the procurement to conformity. Only if the borrower refuses to rectify the situation is the issue brought to the country director. Moreover, given the sensitivity of the issue, several officials from the Bank are called to clear notices and advise the borrower and the country director on the appropriate course of action.

However, it is interesting to note that despite the sanctions imposed on firms caught engaged in fraudulent and corrupt practices, the country director responsible for the country from which those firms are nationals is not notified of their practices. Moreover, it seems that malpractices are not communicated to other development institutions or to other creditors engaged in the same project. Therefore, although a firm might be banned from receiving Bank funds, it could still be awarded other contracts under the same project if such contracts are financed by other creditors. As mentioned previously, another deficiency of the Bank's system is the fact that it does not keep a record of poor practices. If a firm is not strictly found to have violated the Bank's ethics standards despite running the contract negligently, it could still be eligible for future tendering.

Another important internal document that regulates procurement is the Bank-Financed Procurement Manual. The Manual does not introduce any new policies but it does explain in great detail how specific aspects of the procurement should operate consistent with the Guidelines, the OP and the BP. The main objectives of this set of internal rules is to provide advice and assistance to Bank staff on how to carry out their responsibilities and to help them advise borrowers on how to deal with their own obligations<sup>242</sup>. From the outset the Manual establishes what the Bank understands as essential elements of 'proficient public procurement'. Six pillars are identified: economy, efficiency, fairness, reliability, transparency, and

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<sup>242</sup> World Bank, Bank-Financed Procurement Manual page ix.

accountability and ethical standards<sup>243</sup>. According to the Manual a good procurement system would aim to give the purchaser the best value for money using simple and speedy procedures that produce results without prolonged delay. Moreover, it would have clear and transparent rules that would be ‘impartial’, ‘consistent’ and ‘reliable’, providing all interested firms with the opportunity to participate in the procedures. In order to secure this standard a good procurement system would also hold officials accountable for neglecting or bending the rules and would provide an effective mechanism by which challenges could be made and appropriate sanctions enforced. Therefore, when carrying out their day to day tasks the Bank staff would have to aim to adhere as closely as possible to this role model, rather than just citing and imposing rigid rules.<sup>244</sup>

## 5 Co-finance

When determining the use of the Guidelines to procure goods, works and consultants’ services it is important to address problems that might arise when the project is co-financed by the Bank and other sources, such as bilateral aid programmes, regional development banks or commercial banks<sup>245</sup>. The co-financed projects can be structured in two ways: in a parallel financing arrangement, in which the project can be divided into different parts and contracts awarded separately; or in a joint financing, where the financing of the project is shared between the Bank and the co-lender. In the first case, if the Bank and the co-lender do not impose the same procurement requirements, each contract will be awarded according to the procurement rules imposed by the institution financing that contract. Under these circumstances it is common for the co-lender to require the borrower to follow an aid programme from the donor country (‘tied aid’). Those programmes will usually impose limitations on the use of the funds provided, allowing only bids from firms that originate from the country offering finance<sup>246</sup>. In those cases the Guidelines will be followed only in the part of the project where the Bank’s funds are applied. In joint financing arrangements the Guidelines will have to be followed, and the procurement will

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<sup>243</sup> World Bank, Bank-Financed Procurement Manual page x.

<sup>244</sup> Ibid.

<sup>245</sup> As mentioned the Bank only finances part of the project.

<sup>246</sup> For further discussion on the problems of tied aid see Calarier, (1996).

be open to all eligible bidders according to the Bank's rules. Therefore the Guidelines are applicable to projects financed in whole or in part by the Bank<sup>247</sup>.

Although the Guidelines are only applicable to contracts financed from a Bank loan, they do not leave to the borrower's discretion the choice of the procurement procedures to be used in the rest of the project. In fact the Bank needs to be satisfied that all the procedures related to the project will be carried out with diligence and efficiency, and that the product finally obtained is of adequate quality, delivered at the appropriate time and bought for an adequate price<sup>248</sup>. If on the one hand by retaining the power to analyse the procurement procedures related to the project the Bank is concerned with the economical and financial viability of the project, on the other hand the Bank has the power to set the standard of procurement and might compromise the freedom of the borrower to arrange other ways of awarding contracts with other creditors.

In practice, the borrower might end up with several different sets of rules to be applied to different contracts within the same project. Depending on where the money is coming from, the borrower would have to take into consideration the procurement procedures imposed by the financing institution. This diversity of procedure is certainly not beneficial either to the officials carrying out the procurement or the bidders who will have to conform to different requirements each time an offer is made. In fact, compliance with donor procedures has been identified as the second biggest impediment to effective aid delivery<sup>249</sup>. In order to minimise this inconvenience, Multilateral Development Banks have been called to harmonise their sets of procurement procedures<sup>250</sup>. The need to harmonise procurement rules was identified as far back as the 1990s, when informal meeting between the heads of procurement on common procurement concerns began. In 2001, the need for structured harmonised documents was highlighted in the G8 Finance Ministers' Meeting. There MDBs were specifically called to bring about closer co-ordination in

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<sup>247</sup> Guidelines rule 1.5.

<sup>248</sup> Ibid.

<sup>249</sup> OECD, (2003) (a) pp 13-15,

<sup>250</sup> For a deeper discussion on the need to harmonize procurement rules see Nwogwugwu, (2005).

order to accelerate the harmonisation process<sup>251</sup>. In particular a progress report on harmonisation of procurement and financial management was assigned to the World Bank, in consultation with the other MDBs. In October 2002 the Heads of Procurement agreed on harmonised pre-qualification documents for civil works contracts<sup>252</sup>. Moreover, the MDBs agreed on a set of standard bidding documents for the procurement of goods. In 2004 the World Bank issued a new set of procurement Guidelines for goods and works and has also issued new Guidelines: Selection and Employment of Consultants by World Bank Borrowers<sup>253</sup>. Further harmonisation of the procurement procedures of donor entities are still being carried out. Lending institutions are also revising their regulations in order to give national procurement rules of the borrowing country a broader role in the allocation of the lending money<sup>254</sup>.

## **6      World Bank Regulations and National Rules**

Apart from the procurement rules incorporated into the Loan Agreement and internal rules of the institution there are some national rules that could be significant to the procurement process. These could be national rules that would have priority over the Guidelines, such as constitutional law, or rules that would be applicable in the absence of any provision to the contrary. There might still be rules that are not directly applicable to procurement but would also have an impact on the procurement process, such as rules on the extent to which public officials' decisions can be challenged. Those rules deserve especial consideration as they may cause the whole process to differ from country to country, and potential bidders may have to consider them before deciding to enter the competition. Particular attention should be drawn to rules that would have priority over the Guidelines, as this might have a significant effect on the operation.

As mentioned before, the Bank's rules in procurement are incorporated under the Loan Agreement and are part of the contract between the Bank and the borrower. In Chapter II it was

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<sup>251</sup> See Report of G-7 Finance Ministers and Central Bank Governors, July 2001, Rome Italy at <http://www.g7.utoronto.ca/g7/finance/fm010707.htm>

<sup>252</sup> Further discussions on the differences and similarities of MDBs procurement and on other efforts on harmonization see Nwogwugwu, note 250.

<sup>253</sup> All relevant procurement documents are available at: [www.worldbank.org/projects/procurement](http://www.worldbank.org/projects/procurement).

<sup>254</sup> See OECD (July -2000) (a) also cited in Nwogwugwu, note 252.

noted that the Loan Agreements have the status of treaties, and therefore the borrower cannot rely on national regulations as an excuse not to implement it. However, there are divergences in doctrines which try to explain the relationship between treaties and constitutional law<sup>255</sup>. In some countries the constitution is understood as the highest law and treaties (including regulations derived from them) cannot oppose its principles<sup>256</sup>. Treaties are found to have priority over most domestic law but not over the constitution. This view is shared by countries such as France, where the fulfilment of treaty rules is based on art. 55 of the Constitution<sup>257</sup>. In the USA the Constitution is found to limit the treaty power of the President and Senate. Justice Black's opinion in *Reid v. Covert* is conclusive: "No agreement with a foreign nation can confer power on the Congress, or on any other branch of the Government, which is free from the restraints of the Constitution"<sup>258</sup>. Therefore, in the USA, treaties are equal in status to congressional legislation unless they are contrary to the Constitution, in which case the latter will prevail.

This position is also found in the constitution of some countries that are borrowers of the Bank. In Brazil, for instance, treaties are found to have priority over federal legislation but cannot contradict any constitutional principles<sup>259</sup>. This is also the case in Russia, where despite having a broad constitutional clause as to give international law, including "generally recognised principles and norms of international law", priority over national legislation, it does not give priority to these sources over the Constitution itself<sup>260</sup>. Therefore, it is important to note that if the constitution of borrowing countries provides principles or rules that must be applied to the procurement process, they could have priority over the clauses of the Loan Agreement. If there is a contradiction between the Loan Agreement and constitutional law, the effectiveness of the former on the national level can be jeopardised.

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<sup>255</sup> See discussions over the dualist and monist theories in Malanczuk, (1997) Chapter 4; Mello (2001) cap. IV.

<sup>256</sup> Malanczuk, (1997) page 65; Mello, (2001) page. 213.

<sup>257</sup> See Mello, (2001) page 122.

<sup>258</sup> See Noak and Rotunda, (1995) page 217.

<sup>259</sup> Supremo Tribunal Federal Agravo Reg. em carta rogatoria N. 8279-4 Republica Argentina, Ementario no 1999-1 D.J. 10.08.2000 Rel. Min. Celso de Mello and Mello, (2001) chap. IV.

<sup>260</sup> Malanczuk, (1997).

Although the choice of the issues that comprise the constitutional text and the level of detail at which this document treats them varies on a country by country basis, depending on the political environment present in a given historical moment, in theory the constitution will try to establish just the basic framework upon which national legislation will be built. Therefore it is expected that only principles, and not detailed regulations would be present at the highest law. In this context, despite the fact that specific procurement principles are not a common feature of constitutions, it is not uncommon to have administrative principles, which will apply to public activities at all levels, incorporated into the constitutional text. Even the utilities sectors are usually subjected to some of the disciplines imposed upon public activities and therefore might also have to follow some of the constitutional rules.

It could be correctly argued that at least some of the principles guiding the governmental activity would coincide with the Bank's objectives and therefore no clash would occur. In fact, national governments are expected to be keen to spend their budget in the best possible way (getting 'value for money') and to regard principles of economy and efficiency highly. Moreover, ethical concerns, the need to avoid corrupt practices and to determine the accountability of government officials might coincide with the Bank's transparency objectives. However, national legislation might also be concerned with other issues such as promoting the development of minority groups or protecting national businesses, protecting national security, preserving the environment, etc<sup>261</sup>. Those are policies that do not encounter a counterpart on the Bank's procurement objectives and therefore are potentially a cause of dispute.

It is possible for example to envisage a constitutional clause attributing a monopoly to a government enterprise to deal with oil, gas or nuclear mineral transactions. Those commodities could be seen as key to national security, and therefore closely controlled by the government. In those cases, if Bank aid is being used for the building and operation of a power plant, it is possible that procurement procedures would be needed for the supply of one of those energy sources. However, the Guidelines prevent government enterprises from participating in the

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<sup>261</sup> For a full discussion on national objectives of procurement systems see Arrowsmith, Linarelli, Wallace (2000). For discussion on secondary procurement concerns see Chapter VI.

tendering procedures unless they are legally and financially autonomous and operate under commercial law<sup>262</sup>. Therefore the only firm or firms which are allowed to deal with those goods under national law might not be eligible to supply them under the Bank's Guidelines. In this context the borrowers might be trapped into a situation where it is not possible to fulfil both its obligations under the loan agreement and its constitutional requirements. In this case, borrowers could not use the loan for payment of such supplies.

If under domestic law the borrower cannot issue documents that contradict constitutional commands, under international law it would be accountable for the breach of its obligation. In fact, the Permanent Court of Justice has affirmed that "a State cannot adduce another State its own Constitution with a view to evading obligations incumbent upon it under international law or treaties in force"<sup>263</sup>. Therefore, the borrower would still have to face the consequences of the breach, which in most cases would be the suspension, or cancellation of the loan operation.

Not only constitutional regulations cause problems for procurement procedures. It is also possible to have secondary legislation which will be significant to the procurement. Environmental legislation could be one example. Suppose for instance that there is a national rule limiting the level of emissions of certain substances, such as carbon monoxide. In this case the procurement procedures might reflect this regulation by including a clause whereby bidders would have to undertake the obligation of not exceeding the limit set by the legislation. However, the Guidelines restrict the prequalification criteria to those based upon "...the capability and resources of prospective bidders to perform the particular contract satisfactorily...". Therefore, in principle, firms cannot be disqualified based upon the environmental standards which they operate. Whether compliance with national environmental legislation is within the meaning of being capable of fulfilling the contract is not clear (see Chapter VII). Therefore the borrower might be caught in a difficult situation where issuing bidding documents that correspond to its obligation under the loan agreement might mean the infringement of national environmental obligations.

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<sup>262</sup> Guidelines: Procurement under IBRD Loans and IDA credits paragraph 1.8 (c).

<sup>263</sup> *Polish Nationals in Danzig* (1931), PCIJ., Ser A/B, No 44 p. 24.

The legal effect of such overlap will generally be the treaty provisions overriding the national legislation<sup>264</sup>. This is due to the fact that under some jurisdictions treaty provisions will become part of national law when incorporated by parliament, and therefore the conflict of two national laws that will have to be resolved by national principles regarding conflict of laws, which will usually mean that new legislation will overrule older ones. However, this is not always the case. In fact, challenges might be brought under national courts, and the interpretation of the national court in applying the Guidelines might be that capability to fulfil the contract will mean capability to comply with any applicable legislation, and that suppliers are bound to observe the limit states by the law. If the Bank insists on the exclusion of such criteria, the political pressure of groups supporting the environmental legislation might bring about resistance to the project, or even to World Bank investment as a whole.

Divergences between the national and international obligations of the borrower can cause significant delays to the project implementation, and in the worst scenario, the complete failure of the whole Agreement. It is also appropriate to remember that the Bank is usually only one of the financiers of the project and problems arising from the Bank's share of the loan may impact on the obligation of the borrowers towards other creditors. Hence the Guidelines should provide clear guidance on the application of national legislation to financed projects<sup>265</sup>.

Even when there is no direct contradiction between national regulations and the Bank's rules it is still very likely that the former would play an important role. If a problem occurs during the procurement procedure bidders would have to rely on the enforcement mechanisms available at the national level since there is no formal rule stated in the Guidelines. As has been discussed previously, the Guidelines firmly attribute to the borrower the responsibility of running the procedure and dealing with complaints. Although the Bank could be notified by bidders of any communication or complaints sent to the borrower, the Bank does not have the legal

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<sup>264</sup>See discussion above. There is extensive literature regarding the clash between national law and treaty rules. For comments and references see for example Malanczuk, (1997).

<sup>265</sup> See further discussion on the application of national policies in Chapter VIII.

responsibility to take any action to address the issue. Therefore, it is under the borrower's national rules that bidders could find assistance to their cause<sup>266</sup>.

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<sup>266</sup> Further discussion on the enforcement mechanism is held in Chapter IV.

## **CHAPTER IV – ENFORCEMENT MECHANISM**

### **1 Introduction**

As we have seen in Chapter III, the Guidelines: Procurement under IBRD Loans and IDA Credits and the Guidelines: Selection and Employment of Consultants by the World Bank borrowers are documents that are usually incorporated by reference under the Loan Agreement signed between the Bank and the borrower. In order to guarantee the effective application of the procurement requirements the Guidelines assigns two distinctive roles to the Bank; a supervisory role, which includes the prior and post review of procurement documentation and the auditing of some procurement processes, and a less formal role when dealing with complaint settlement. Moreover, there are mechanisms used to enforce other World Bank policies such as deterrence of fraud and corruption, which are also relevant as they can be seen as an addition mechanism to enforce the procurement guidelines.

In this context, this Chapter will aim to provide an analysis of the enforcement mechanism under the current system. First, we will look at the Guidelines' provisions on enforcement and at internal rules that provides guidance on the enforcement of the Guidelines' provisions. Cases of prior and post review will be determined and the role of bidders accessed. In addition, we will look at the enforcement measures against fraud and corruption and at the role of procurement audit in supervising compliance. On the second part of Chapter, we will analyse the accountability of the World Bank for its actions during the procurement proceedings.

### **2 The Bank's Rules on Enforcement Under the Current System**

#### **2.1 The Review Procedures**

The provisions regulating the review of procurement decisions can be found in the introductory part and in Appendix 1 of both Guidelines. According to the Bank's Procurement Manual "The Bank's review process ensures that Bank funds are used for the purposes intended and that procurement procedures outlined in the Loan Agreement are followed in letter and spirit

before the Bank commits funds for the relevant goods, works or services”<sup>267</sup>. Therefore the review mechanism is set not with the intention of giving aggrieved parties the means to review procurement acts and decisions, but to reassure the lender that the borrower is complying with its contractual obligations.

The definition of the cases subjected to prior or post review is determined by the Loan Agreement. As a general rule the threshold for prior review will be set in order to incorporate contracts for about 50 to 80% of the total value of financed contracts in a project<sup>268</sup>. When a prior review requirement is set, the Bank’s staff will have to approve all relevant documents and decisions made by the borrower before these are released to the public or to bidders<sup>269</sup>. Moreover, any steps taken by the borrower which differ slightly from the original documents will have to be notified and discussed with the Bank. For high value contracts above the threshold of US \$25m for goods and works, and of US \$10m for consultant services, the Bank sets up an Operations Procurement Review Committee whose primary responsibilities include - among other things - review and clear prequalification and contract recommendations.

For lower value contracts the institution will make a post review to the procedure. All the major documents referent to the process must be kept by the borrower during the project implementation and up to two years after the closing date of the Loan Agreement, and must be provided to the Bank upon request<sup>270</sup>. The post review evaluation will be carried out in a random sample of awarded contracts and procurement related documents<sup>271</sup> and should misprocurement

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<sup>267</sup> Procurement Manual, Section 20.1.

<sup>268</sup> The coverage range will vary between sectors and projects and will take into account the nature and size of contracts as well as the procurement capacity of the borrower’s implementing agency. When discussing the procurement threshold with the borrower Task Team Leaders are advised that the desirable coverage is about 80% and that coverage of about 50% is only acceptable in special circumstances. See Procurement Manual, Section 20.3.

<sup>269</sup> This will include the advertising procedure, prequalification documents (when applicable), bidding document and any addenda, bid evaluation and proposal for award of contract, the contract documents and any significant modification agreed during execution. For a more detailed list of the documents see the Guidelines Appendix 1 and the Procurement Manual Section 20.2.

<sup>270</sup> Guidelines: Procurement under the IBRD and IDA Credits, Appendix 1, 5.

<sup>271</sup> The suggested range for post reviews vary from 1 in 4 down to 1 in 20 contracts. In special circumstances the proportion may be reduced to as low as 1 in 50. For further details see the Procurement Manual Section 20.6.2 .

be detected, the borrower must take corrective action and submit to a tighter review of past and future procurement documentation<sup>272</sup>.

The single most striking characteristic of the review provisions is the mandatory letter that is present in all articles. For example, the Guidelines Appendix 1, rule 2 (a) says that “the borrower *shall* [...] furnish the Bank with the draft documents to be used, [...] and *shall* introduce such modifications in said procedure and documents, as the Bank shall reasonably request” (emphasis added). Such provision sounds unambiguously imperative and, if it does not transfer the power of the decision to the Bank, it certainly makes apparent the strong role conferred onto the lending institution in the whole procedure.

The imperative character of those rules is consonant with the statement in Section 1.12 of the Guidelines, which provides as follows:

1.12 The Bank does not finance expenditures for goods and works which have not been procured in accordance with the agreed provisions in the Loan Agreement and as further elaborated in the Procurement Plan. In such cases, the Bank will declare misprocurement, and it is the policy of the Bank to cancel that portion of the loan allocated to the goods and works that have been misprocured. The Bank may, in addition, exercise other remedies provided for under the Loan Agreement. Even once the contract is awarded after obtaining a “no objection” from the Bank, the Bank may still declare misprocurement if it concludes that the “no objection” was issued on the basis of incomplete, inaccurate, or misleading information furnished by the borrower or the terms and conditions of the contract had been modified without Bank’s approval.

If misprocurement is detected the Bank might take several courses of action, each of which is equally disruptive to the project and may cause the borrower serious problems. The Bank may suspend and cancel the portion of the loan referent to the misprocured contract, or

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<sup>272</sup> For contracts not subjected to prior review the withdrawals from the Loan Account can be made on the basis of Statement of Expenditures. See Guidelines Appendix 1 rule 5 and Procurement Manual Section 20.6.3.

decide to suspend or cancel the entire loan and to accelerate the maturity of the principal<sup>273</sup>. Although the decision to take such actions against the borrower is not common practice, the threat of taking them is still the main weapon that the Bank can use to persuade the borrower to follow the rules strictly<sup>274</sup>. In fact, the Bank relies on the review procedures as the main method of detecting breaches, and on the suspension and cancellation clauses as the main caveat to guard against breaches from occurring, or to correct those that have already occurred.

As the Guidelines for procurement of contracts financed by the institution tries to ensure economy and efficiency in the projects, the Bank's role in reviewing and approving all relevant documentation, especially for high value contracts, is seen as necessary to ensure the enforceability of the rules. In order to guarantee that all relevant decisions will gain the approval of the Bank's staff, the Task Team Leader must issue 'no-objection letters' to all borrower actions subject to prior review<sup>275</sup>. Such a notice would state that based on the evidence provided by the implementing agency, the Bank has no objection to the decision taken.

It is important to note that by giving such notice the Bank does not guarantee the legality of the procedure, but only scans the documentation received to verify that it complies with the conditions of the Loan Agreement. Therefore, if the documentation received is formally correct, the 'no objection' notice would probably be issued without a rigorous analysis of the accuracy of the substantive material. This might lead to situations where the procedure has not been followed in practice but the incomplete, inaccurate or misleading documentation is furnished by the borrower. This was the case in Indonesia where Mark Baird, as a director of the World Bank office in Jakarta, received a page proof to show that an advertisement for US \$200,000 in supply contracts had been published. However, when the Bank's staff bought the paper where the

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<sup>273</sup> See IBRD General Conditions Applicable to Loans and Guarantee Agreements for Single Currency Loans, dated May 30,1995 (as amended through October 6, 1999), Section 6.02 (suspension) , 6.03 (cancellation) and 7.01 (acceleration of maturity).

<sup>274</sup> In fact, misprocurement was declared in Indonesia, see reference to this case at note 307.

<sup>275</sup> See Procurement Manual Section 3.2.

advertisement was supposed to be, the page the World Bank had paid for was instead taken up with Bloomberg financial market data<sup>276</sup>.

Examples such as this demonstrate that the examination of documents is usually not the most effective way to detect breaches or to test the efficiency of the procedure to get the best possible value for money. As will be further developed in Chapter V, suppliers might have an important role in improving the implementation and enforcement of the rules as they usually are in a better position to detect breaches and have a greater incentive to complain when the rules have been breached. It is probably in recognition of the great contribution that interested parties can make to the enforceability of the procurement rules that Appendix 4 of the Guidelines allows suppliers to contact the institution to report faults or misbehaviour of the borrower.

## **2.2 The Role of Bidders Under the Current System**

The rules defined in Appendix 4 should be followed not only in cases where misprocurement is reported, but also to address any other issue that bidders might be concerned with, such as imprecision in the bidding documents about technical or financial aspects of the project, payment, language of the documents, etc. Such issues, especially in complex projects, are likely to cause divergences and the need to address them becomes evident. Nonetheless, there is no formal complain mechanism set out in the Guidelines, either through the Bank or through the borrower legal system, or through an independent system such as arbitration<sup>277</sup>.

According to the Guidelines, bidders should address their questions about the bidding documents or any other issue that might arise during the procedure to the borrower<sup>278</sup>. Bidders, however, are free to send to the Bank their correspondence with the borrower. If the Bank receives the complaint before the closing date for submission of the bids, it might refer to the borrower, making comments and advising as to the action to be taken. If the communication is

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<sup>276</sup> See case reported by Shari and Cohn (2000).

<sup>277</sup> It is worth mentioning that when the contract is already concluded between the borrower and the supplier, the Guidelines, in rule 2.42, state that disputes arising out of the contract should be solved through arbitration. This provision can bring about a number of problems since it is still not clear whether it should be interpreted as involving just technical issues of the contract, or if issues such as validity should also be decided by arbitration.

<sup>278</sup> Guidelines: Procurement under the IBRD and IDA Credits, Appendix 3, 6-9.

received after the opening of the bids, and this is a case where the Bank will only carry out a post review, the Bank might send the communication to the borrower with considerations and appropriate actions, and will examine the procedure later to see if the instructions were followed. If, however, a prior review is due, the Bank in consultation with the borrower, will try to address the issue, if appropriate<sup>279</sup>.

It is worth observing that the Bank will not exchange correspondence with the bidders, but only with the borrower. This policy is adopted in accordance with the statement in Appendix 3, 2, where the Bank emphasizes that “the borrower is legally responsible for the procurement. It invites, receives and evaluates bids and awards the contract. The contract is between the borrower and the Supplier or Contractor. The Bank is not a party to the contract”. The position adopted by the lender is of mere listener to the complaint. It does not acknowledge any responsibility for decisions even if the borrower is just following the orientation received from the Bank’s staff. In fact, the Bank will not even disclose to the complaining parts its communications with the borrower. Moreover, the Bank does not promise to investigate, pursue or address the complaint. The Bank uses the suppliers’ information as a means to secure its agreement with the borrower without giving to the supplier any kind of legal rights against the decisions reached either by the lender or by the borrower.

It is difficult to understand how this position can be reconciled with the principles that the Guidelines aim to achieve. In general, procurement systems that place significant weight on the concept of transparency use some sort of enforcement mechanism that is external to the procurement agency and the people involved in taking decisions during the process<sup>280</sup>. This is done for several reasons. Firstly, in a transparent system the aim is to demonstrate to all interested parties that the procurement process is being done in accordance with the regulations. Moreover, if breaches are detected, procurement officials might then be held accountable by an independent court or administrative tribunal. Therefore, an external means of enforcement is used as a powerful way not only to settle complaints but also to achieve an effective application of the

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<sup>279</sup> Guidelines: Procurement under the IBRD and IDA Credits, Appendix 3, 13.

<sup>280</sup> See Arrowsmith, Linarelli, and Wallace, (2000), Chapter 12.

rules. The more effective the enforcement, the more credible the rules became. In a stable and reliable environment, suppliers would be more willing to take part in the procedures, as risks can be more easily accessed, and taxpayers and investors would be more confident that their money is being properly spent. Therefore, it is surprising that even though the Procurement Guidelines state transparency, economy and efficiency as the main goals, there are no clauses setting up an external system of enforcement where interested parties could challenge the decisions taken by the borrower and the lender.

In practice, however, there is evidence that bidders will take their complaints to the Executive Directors of their countries and request them to pursue the claim. Although the Guidelines do not mention this kind of complaint, the Procurement Manual provides guidance to staff on how to deal with them<sup>281</sup>. If a complaint is channelled through an Executive Director's office the Task Team Leader or the Procurement Specialist involved in the project must acknowledge the complaint and send it for the borrower's consideration immediately. Moreover, at the request of the Executive Director, the Country Director must explain in great detail how the specific issue raised was addressed and resolved. If he is not satisfied with the response, the complaint is brought to the Director of the Operational Procurement Review Committee, who has to review the complaint in cooperation with senior management, and provide a response<sup>282</sup>.

This kind of internal mechanism for dealing with complaints seems to be the most effective mechanism available to bidders. If a reliable review system is not available through the borrowers national legal system bidders are more likely to bring the complaint to their Executive Director, since this is the only mechanism that can assure them that their complaint will be looked at. According to the Bank's organisation charter, the Executive Directors are placed in the highest position and all staff below them should pay due attention to the issues raised by the Directors. Therefore, any complaint raised by EDs must be carefully addressed.

An example of the mechanism used to help firms to bring complaints to their Executive Directors can be found in the Canadian Business Guide, a publication by the Office of Liaison

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<sup>281</sup> Procurement Manual Section 5.2.

<sup>282</sup> Ibid.

with International Financial Institutions in the Canadian Embassy in Washington<sup>283</sup>. In explaining the function of the office, the Guide states the following:

“The OLIFI [Office of Liaison with International Financial Institutions] staff can provide information, advice and assistance to Canadian business people pursuing procurement opportunities with the World Bank and the Inter-American Development Bank. [...] OLIFI also works in close cooperation with the Canadian Executive Directors’ office at the Banks, to fully protect and promote Canadian interests, and particularly to resolve any procurement or other commercial dispute that may arise”.

Moreover, the Guide explains that although the Guidelines state that the borrower is the one responsible for the procurement process, about 10-15% of the marketing initiative should be directed at Washington level “in order to gather and update essential project intelligence”.

When discussing the interference of Executive Directors in the procurement process, a remark must be made regarding the differentiated levels of power enjoyed by each Executive Director. As mentioned in Chapter II, the voting power of each ED is associated with the number of shares they represent. Larger shareholders will be able to provide to their business people a more efficient mechanism of support, as they will have an individual ED defending their interests. On the other hand, suppliers from minor shareholding countries might not have any access to their EDs, as they will be representing the interests of several different countries. Moreover, since EDs representing major shareholders are the ones actually making everyday decisions at the Bank, it is possible that staff will be more careful in pursuing the issues raised by them than the complaints raised by other EDs. Since internal communication between EDs and staff is not disclosed to the general public it is not possible to determine the degree of efficiency and fairness with which complaints are handled. Therefore, the review mechanism based on the interference of EDs in the procurement procedure to secure the interest of bidders does not comply with the principle of transparency, or give all eligible bidders a level playing field on which to compete.

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<sup>283</sup> Office of Liaison with International Financial Institutions, The Canadian Embassy, *A Canadian Business Guide: The World Bank and the Inter-American Development Bank*, (online).

If we consider only the Guidelines' provisions, it is not clear what the legal position of bidders is. Although it is certain that the Guidelines provide rights and obligations for third parties, especially bidders, they do not confer on them a contractual position in relation to the lender. The Bank excludes itself from any responsibility, and specifically refers to the borrower's responsibility in relation to bidders. Nonetheless, the Bank encourages bidders to send to the institution any complaints that the borrower does not address properly, and requires its staff to be prepared to deal with the complaints as they are brought forward.

In this context, the Guidelines suggest that the legal relationship between the lender, the borrower and bidders should be framed as follows. The Bank and the borrower have a clear contractual relationship guided by the Loan Agreement. Any disputes between them will be solved according to the arbitration procedures defined in the Agreement. However, it is interesting to recall that so far, Loans Agreements have never been challenged by borrowers, despite the failure of many projects.

The borrower and the bidders will develop their relationship firstly according to the bidding documents. In those documents the borrower agrees to follow certain rules when selecting the winning bid, and bidders relying on such an agreement will design and submit their bids. The legal relationship arising during the procurement process will depend on the national legislation regulating procurement. Rights and obligations could be guided by principles of civil law, administrative law or contract law. Disputes between these two are likely to be solved by the national legal system of the borrowing country, if it allows such a challenge to governmental decisions<sup>284</sup>. At the second stage, the borrower and the winning supplier will enter a contractual relationship which will be subject to the applicable law and the dispute settlement defined in the bidding documents. The standard bidding documents provided by the Bank and required to be used for procurements financed by the institution state that any dispute between the purchaser

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<sup>284</sup> National enforcement mechanisms will be further developed in Chapter V.

and the contractors should be settled by arbitration conducted in accordance with the procedures set out in the contract<sup>285</sup>.

Finally, and most unclear of all, is the relationship between the Bank and the bidders. This cannot be solved by reference to any contractual connection or by direct reference to the Guidelines, as the parties have not agreed to any legal relationship with each other. However, as will be further discussed in subsection 2 below, the rights reserved by the Bank to interfere with the decisions during the procurement process should have the correspondent obligation of responding, in accordance with its culpability, to any unlawful decision taken during the procedure. Moreover, as the Bank might interfere directly with the legal rights of a bidder it should recognise the rights of the other party to be heard and to have an impartial decision on the matter.

### **2.3 Mechanism for Enforcing the Bank's Policies on Fraud and Corruption**

A particularly important form of misconduct in public procurement is related to the issue of corruption. Corruption is a complex phenomenon that can involve several actives<sup>286</sup>. There is wide agreement that it flourishes in an environment where agents have the power to allocate benefits, the opportunity to do so with discretion, and with little accountability<sup>287</sup>. In this context, a poorly managed procurement system, coupled with a deficient enforcement of the procurement regulations is a perfect environment for corruption. It should be noted that this section is not concerned with the issue of fraud and corruption from a general point of view, but intends to analyse the Guidelines' provisions that are aimed at deterring such practices. Such rules are a

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<sup>285</sup> Standard Bidding Documents for the Procurement of Goods May 2005, General Conditions of Contract, Clause 10. The Special Conditions of Contract defines the arbitration procedures that can be used. The purchaser is allowed to choose between the UNCITRAL Arbitration Rules, the Rules of Conciliation and Arbitration of the International Chamber of Commerce, the Rules of Arbitration Institute of Stockholm Chamber of Commerce, the Rules of the London Court of International Arbitration or adjudication or arbitration in accordance with the law on the purchaser country (if the supplier is a national of the purchaser country). For works there is a different form of dispute resolution see Standard Bidding Documents for the Procurement of Works May 2005, General Conditions of Contract, Clause 20.

<sup>286</sup> For different definitions of corruption see Shihata, (1997). Also see Marquette, (2003); Westring and Jadoun,, (1996) and Anechiarico and Jacobs, (1995); Priess, (2002). For the economic impact of corruption see Rose-Ackerman, (1978); Rose-Ackerman, (1999).

<sup>287</sup> Klitgaard, (1998) pp3-6; Bannon, 1999; Shihata (1997); Rose-Ackerman, (1999); Harms, (2000); Baistrocchi, (2002); Zagaris and Ohri, (1999); Linarelli, in Arrowsmith and Davies (eds.) (1998); Anechiarico and Jacobs, (1996).

reflection of the increased emphasis placed by the Bank on stopping fraud and corruption and their objective under the procurement system is to provide accountability and secure compliance under financed projects. Therefore, this section will be limited to the enforcement mechanism introduced under the Guidelines, directed at securing World Bank policies.

The World Bank has adopted a broad definition of *corruption* to include all conducts that involve “the abuse of public office for private gain”<sup>288</sup>. Although corruption is not particular to the public sector, several reasons explain why governments, development institutions and indeed the international community are more concerned with corruption in the public sector than in the private sector<sup>289</sup>. Firstly, effects of corruption in the public sector are greater. The inefficient use of constrained budgets means that spending on key sectors such as health and education will be reduced<sup>290</sup>. The increase of costs and the uncertainty of government conduct will negatively influence investment and could therefore affect the country’s growth<sup>291</sup>. As to the effects in the domestic scenario, public support for government activities might be undermined by the perception that public money is being used for private gain<sup>292</sup>. Moreover, the conduct of the public sector might set an example for the whole business community. The lack of confidence in the procurement system will also affect the willingness of firms to compete for public contracts, therefore affecting the chances of securing a contract which represents good value for money<sup>293</sup>.

Apart from arguments based on macro-economic perceptions and ethical values, there might also be financial reasons to combat corruption. If the cost of setting a review mechanism is lower than the value of savings arising from its effective operation, than it is financially worthwhile to implement it<sup>294</sup>.

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<sup>288</sup> Ian Bannon, 1999.

<sup>289</sup> Regarding the distinction made between the public and private sectors in corruption legislation see Law Commission Consultation Paper No 145, *Legislating the Criminal Code: Corruption* 6.18-6.34.

<sup>290</sup> Ian Bannon, 1999.

<sup>291</sup> Ian Bannon, 1999; and Harms, (2000) citing Paulo Mauro, *Corruption: causes and Consequences and Agenda for Further Research*, Finance and Development, March 1998, pp. 11-14. Also see Haarhuis and Leeuw, (2004).

<sup>292</sup> Shihata, (1997).

<sup>293</sup> Arrowsmith, Linarelli and Wallace (2000) p. 32

<sup>294</sup> Ibid.

Corruption is a two-way practice. If in one hand, you have public officials who are ready to receive an unlawful benefit without fear of punishment, on the other hand you have companies who will offer bribes in order to be included as bidders, or to be the only qualified bidder, or even to be selected as the winning contractor. In fact, as developing countries have been criticised for the lack of enforcement of domestic legislation against corruption, international firms have been found to display conduct when doing business in developing countries that they would not attempt in their own country<sup>295</sup>. Therefore, to set up efficient policies to combat corruption, measures should be drafted to prevent corruption on both the demand side and the supply side<sup>296</sup>.

In the last few years, several international initiatives have been developed in an effort to combat corruption in the public sector. Developing countries have received funds to reform legislation, strengthen institutions, and sometimes to deal specifically with the problem of corruption. Moreover, the OECD has developed recommendations to member countries stating measures that should be taken to prevent their own firms from engaging in corrupt practices in other countries.

The World Bank has also engaged in the fight against corruption<sup>297</sup>. The Bank's concern with this issue stems from the Articles of Agreement requirements, in which the Bank has to ensure that the proceeds of its loans are used only for the purpose for which they were granted, and that this is done with due regard to considerations of economy and efficiency<sup>298</sup>. The Bank provides four main reasons for its anti-corruption policies:

“Corruption hurts the poor most severely: it diverts public services from those who need them most and strangles private sector growth.

Corruption undermines public support for development assistance by creating an erroneous perception that all assistance is affected by corruption.

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<sup>295</sup> Early, (1996), at 221-222.

<sup>296</sup> For efforts to combat corruption under the supply side see recommendations of the Organisation for Economic Co-operation and Development at <http://www.oecd.org>. Also see Arrowsmith, (1997). For the efforts on the demand side see Harms, (2000).

<sup>297</sup> See World Bank, Helping Countries Combat Corruption, Progress at the World Bank since 1997, 2000.

<sup>298</sup> International Bank for Reconstruction and Development, Articles of Agreement (as amended effective February 16, (1989), Article III, Section 5 (b).

Corruption can impede developing countries' access to increasingly discriminating private capital.

The Bank has a fiduciary duty to its member countries to ensure that financial support reaches its intended targets.”<sup>299</sup>

Following these lines, in 1997 the Bank’s Board of Executive Directors decided on an anti-corruption strategy, which identified that action was needed in four key areas: prevention of fraud and corruption in projects financed by the Bank; direct assistance to member countries that ask for help in curbing corruption; analysis of corruption issues in the country lending decisions, and contribution to international efforts to fight corruption<sup>300</sup>. Moreover, the Bank needed to set the example and targeted corruption within the institution.

In order to target fraud and corruption in financed projects, in 1997 the Bank introduced into the Procurement Guidelines a specific provision on fraud and corruption. Under procurement proceedings for contracts financed by the institution, the term ‘corrupt practices’ refers to “the offering, giving, receiving or soliciting of anything of value to influence the action of a public official in the procurement process or in contract execution”<sup>301</sup>, while ‘fraud’ is defined as “a misrepresentation or omission of facts in order to influence a procurement process or the execution of a contract”. Collusive practices and coercive practices are also included under prohibited practices. The former is defined as a “scheme or arrangement between two or more bidders, with or without the knowledge of the borrower, designed to establish bid price at artificial, non-competitive level”; while the latter is defined as “harming or threatening to harm, directly or indirectly, a person or their property to influence participation in a procurement process, or affect the execution of contract”<sup>302</sup>.

Although this broad definition was adopted to harmonise the conduct expected from borrowers and bidders in all projects financed by the Bank, it does not take into account the

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<sup>299</sup> Note 297 at page 1.

<sup>300</sup> Note at 297 page 2.

<sup>301</sup> Guidelines: Procurement under IBRD and IDA Credits, Section 1.14 and Guidelines: Selection and Employment of Consultants by World Bank Borrowers, section 1.25.

<sup>302</sup> Ibid.

diversity of cultures in borrowing countries. In some African and Asian countries, for example, gift-giving practices and loyalty to friends and family is seen as acceptable conduct<sup>303</sup>. In those instances, the standard set by the Bank is an external imposition of values that are hard to enforce and control. Nonetheless, as the Bank needs to ensure the credibility of its operation as whole, the decision to define the types of conduct that would not be accepted in financed projects is justified. Moreover, particular local practices that could lead to allegations of misconduct can be more closely analysed by the procurement personnel involved in the project and should be taken into account both when setting the procurement requirement under the Loan Agreement and when investigating allegations of misprocurement.

Despite the Bank's requirement from both the borrower and contractors to "observe the highest standard of ethics during the procurement and execution" of contracts, allegations of fraud and corruption in financed projects are not uncommon. The causes for such problems are not entirely clear, but it has been alleged that institutional problems in receipt countries - such as low pay, lack of experience, lack of effective legislation, cultural practices - coupled with the desire of firms to obtain financed contracts at any cost may contribute considerably to misprocurement in World Bank projects<sup>304</sup>. Hence, the Bank has issued measures to combat corrupt and fraudulent practices both from the supply and the demand side.

As for the measures for preventing the recipient country from engaging in illicit practices, the Bank can cancel either all or part of loan if misprocurement is detected<sup>305</sup>. Moreover, since 1996 the Bank has not relied on national courts to identify corrupt and fraudulent practices, but retains the right to determine whether those practices have occurred in financed projects, even when a "no objection" notice has already been issued. In addition to contractual measures, the Bank has also provided assistance to the borrower to reform its procurement system and to implement anti-corruption policies. When the assessment of the implementing agency identifies a high risk of such practices, the Bank requires that corrective

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<sup>303</sup> Salbu, (1999).

<sup>304</sup> World Bank, Helping Countries Combat Corruption report, pages 2-9.

<sup>305</sup> Guidelines Section 1.14 (c).

measures should be implemented before the Loan is approved in order to lower the risk of the operation.

As for the policies towards firms engaged in corrupt and fraudulent practice, the Guidelines states that the Bank<sup>306</sup>:

- (b) will reject a proposal for an award if it determines that the bidder recommended for award has, directly or through an agent, engaged in corrupt, fraudulent, collusive or coercive practices in competing for the contract in question; [...]
- (d) will sanction a firm or individual, including declaring it ineligible, either indefinitely or for a stated period of time, to be awarded a Bank-financed contract if it at any time determines that the firm has, directly or through an agent, engaged in corrupt, fraudulent, collusive or coercive practices in competing for, or in executing, a Bank-financed contract; and
- (e) will have the right to require that a provision be included in bidding documents and contracts financed by a Bank loan, requiring bidders, suppliers and contractors to permit the Bank to inspect their accounts and records and other documents relating to the bid submission and contract performance and to have them audited by auditors appointed by the Bank.

It should be noted that although the international agreement adopting the use of the Guidelines was concluded by the Bank and the borrower, the document creates requirements for third parties. Those requirements are followed by a series of remedies and penalties imposed by the Bank on bidders if the lender finds out that the former was engaged in corrupt, fraudulent, collusive or coercive practices. In fact the Bank has debarred 238 firms so far for their conduct abroad<sup>307</sup> - and has published their names and addresses on the Bank's web site so that borrowers, interested persons and the general public have access to this information.

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<sup>306</sup> Guidelines, Section 1.14  
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See  
<http://web.worldbank.org/external/default/main?theSitePK=84266&querycontentMDK=64069700&contentMDK=64069844&menuPK=116730&pagePK=64148989&piPK=64148984>. Most of those firms are from Indonesia where 116 firms have been debarred. This followed from the Indonesia CPAR 2001 where it was identified that corruption was a major concern in the procurement context (not only in Bank financed projects but in national procurement as well).

The words of the provision demonstrate the great power of intervention reserved by the lender institution. Despite the Guidelines' statement that the borrower is the one responsible for the procurement procedure, the Bank reserves for itself the power to *reject* the proposal that was *recommended* by the borrower in the case of corruption or fraud. This interference is justified by the lending institution by the provision in its Article of Agreement, incorporated in the Guidelines, stating that the Bank is required to ensure that the loan is used only for the purpose that it was granted, and that the procedures are run with attention to considerations of economy and efficiency<sup>308</sup>. In this context, the Bank would have a duty to intervene only if the issue affects the economy and efficiency of the project.

Corruption and fraud interfere, in general, with those two concepts. However, it is not impossible to foresee a case where corruption or fraud might not cause any harm to the economy of the project. Suppose, for instance, that a firm, that in fact made the best bid, offers a bribe to a government official to speed the process. In this case, could the Bank reject the proposal? The answer to this question is not clear in the Guidelines but it is arguable that the Bank could, for the following reasons. Firstly, the borrower and the bidder would have broken their agreement to maintain a high standard of ethics throughout the procedure. Secondly, the Bank, as a development institution, is also concerned with the need to minimise, as much as possible, corrupt practices since it is common wisdom that corruption usually leads to the wasting of government money. Thirdly, as the lender institution, the Bank has said it will only fund projects that are procured according to the Loan Agreement, and, therefore, any departure from the rules can suspend or cancel the loan in whole or in part.

In its fight against corruption in financed projects the Bank has also established mechanisms for detecting corruption. Suspicions of fraud and corruption should be reported to the Department of Institutional Integrity Investigations Unit (INTIU)<sup>309</sup>. Reports of illegal activities can be made on the bases of confidentiality and anonymity using one of several means

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<sup>308</sup> Guidelines: Procurement under the IBRD and IDA Credits, 1.2.

<sup>309</sup> Formerly known as Anti-corruption and Fraud Investigations Unit (ACFIU). See Procurement Manual Section 6.2.

of communication set up by the Bank – free phone hotline, P.O. Box hotline, website complaint form, or e-mail.

## **2.4 Procurement Audit**

In the last few years the Bank has performed several audits on various projects throughout the world<sup>310</sup>. During the fiscal year 1999, 26 of the 65 audits performed were completed, with a result of 22 cases of misprocurement, with a contract value of US\$ 37 million being identified<sup>311</sup>. The importance of audits has increased with the shift in the Bank's lending portfolio. Over the years, the Bank has changed from financing mainly large infrastructure projects to social, environmental, and other types of lending that requires a large number of smaller contracts<sup>312</sup>. This large number of small contracts means that a large part of its resources is not being subjected to prior review procedures. The Bank has to rely on the borrower to conduct the procurement according to the Guidelines and will only review the borrower's decisions on a sample basis<sup>313</sup>.

In this context the increase in the number of procurement audits is meant not only to improve the Bank's supervisory role in the procurement process, but also to keep the institution informed about the borrower's capacity to maintain adequate records of the operations. Moreover, audits should identify any problems affecting the implementing agency that could interfere with the procurement process<sup>314</sup> and suggest corrective measures<sup>315</sup>. It should be noted that the use of audits is in addition of the lender's right to have the procurement arrangements verified by a staff member at any time.

The audit team will usually be composed of one member of the Bank's staff with experience in public procurement under financed projects, and either individual consultants or a

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<sup>310</sup> See Celarier, (1996).

<sup>311</sup> World Bank, *Helping Countries Combat Corruption* (2000), p. 15. Those figures refer to all misprocurement based on any reason and not only based on fraud and corruption.

<sup>312</sup> World Bank, *Helping Countries Combat Corruption* (2000), p. 9

<sup>313</sup> See post review evaluation supra.

<sup>314</sup> Vulnerability for fraud and corruption is one of the issues that could be addressed in the audit report.

<sup>315</sup> Such measure may include review of prior review thresholds, training staff, hiring of procurement specialist etc. For further information see the Procurement Manual Section 20.09 .

consultant firm<sup>316</sup>. They should be granted access not only to the procurement documents being kept by the borrower but also to the project sites, in order to verify the compliance of the completed work, delivered goods or service provided with the requirements and specifications defined in the contract. Moreover, auditors may compare the prices paid under the financed contracts against local and international prices in order to assess the cost effectiveness of the contract<sup>317</sup>.

Another prerogative of audit teams is that they could have the contractor audited. As mentioned above, the Guidelines state that the Bank can require a provision to be included in the contract between the borrower and the supplier permitting the Bank to inspect the contractors' accounts and records, and to have them audited by auditors appointed by the lending institution<sup>318</sup>. Therefore, the control exercised by the Bank is not only towards the borrower's compliance with the Loan Agreement, but also towards the effective observance by contractors of the terms and conditions agreed with the borrower.

In procurement audits carried out in several projects in the African region, the Bank found problems and irregularities in various areas. The findings of such audits are summarised as follows:

- (i) Compliance with basic requirements specified in the Loan Agreement and guidelines:
  - A) Lack of appropriate procurement planning including contract packaging and procurement scheduling has led to uneconomic procurement and lack of transparency.
  - B) Thresholds for shopping procedures and aggregate limits for procurement under shopping are sometimes exceeded by very large amounts, leading to misprocurement.
  - C) There has been splitting of contracts with a clear (though not expressed) objective of avoiding International Competitive Bidding (ICB) procedures .
  - D) Lack of transparency in the choice of firms selected under shopping procedures has lead to costlier procurement and unacceptable procurement practices.

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<sup>316</sup> See Procurement Manual page 188.

<sup>317</sup> Procurement Manual page 186.

<sup>318</sup> Guidelines Section 1.15 (e).

(ii) Compliance with procurement process – bidding documents: A) Procedures for ‘National’ or ‘International’ Shopping procedures are not transparent enough, in many cases as bid invitation letters did not specify (a) deadline for submission or receipt of quotes; (b) delivery period; and (c) payment terms. B) Bidding Documents and/or solicitation letters sometimes seek for the supply of a particular make and model of a vehicle or equipment; C) Absence of appropriate provisions relating to Pre-shipment Inspection and Manufacturer’s Warranty in the bidding documents may facilitate corrupt or fraudulent practices.

(iii) Compliance with bid evaluation and contract award processes: A) The crucial element of public bid opening is not always followed for some ICB/NCB (National Competitive Bidding) contracts. B) The evaluation of bids for some contracts is not always consistent with the bidding documents.

(iv) Inadequate contract management: A) Full payments are made although delivery of goods is not completed and/or the works are incomplete. B) The supply of refurbished or used equipment, or equipment not meeting specifications or end-users’ needs is not infrequent, involving fraud and/or corruption. C) Delivery notes or receipts for goods are often unavailable. This constitutes inappropriate records management. D) The defects identified in completed construction works are not conveyed systematically to the contractor for rectification before the defects liability period has expired. E) Failure to enforce performance security, or to collect liquidated damages for delayed completion of works or delivery of goods is a frequent occurrence. F) Failure to obtain ‘performance security’ at the start of the contract or in accordance with the wording and terms of the contract is also a recurring phenomenon.

(v) Filing papers, maintaining asset registers and physical verification: A) The overall state of filing and documentation and contract documentation is often deficient. B) Signed contract documents for goods, works and consulting services are often not complete. C) Contract variations are not properly authorised or recorded. In some cases, where the equipment supplied is different from that contracted, contract variations are not properly authorised or recorded. D) Loss to the government may occur when performance security papers are not found in the files. E) Non-availability of output reports under consultant contracts is another area of concern .F)

Asset registers are not maintained in many projects. G) Asset Verification Inspections are not regularly carried out by the government or the Bank. H) There is need for regular ‘end use’ audit by the government and the Bank.<sup>319</sup>

The conclusions reached by those audits demonstrate that there are problems in the implementation of the procurement process. The conclusions also tell us that the adoption of the World Bank Guidelines alone does not provide a secure and reliable environment in which it is possible to prevent misconduct. As the rules need to be tuned on a case by case basis, an effective procurement is only achieved by the work of qualified staff both on the borrower’s side and on the Bank’s side. For example, the procurement planning and the establishment of the thresholds for ICB procedures need to be carefully discussed at the preparation stage so that the implementing agency will not depart from them at a later stage. It is clear from the conclusion mentioned above that, given the number of projects and contracts involved, the Bank is not able to supervise them carefully, and rules have been poorly enforced.

One disadvantage of relying on audits to ensure borrower compliance with the Loan Agreement is that by the time audits are carried out the contracts have already been awarded and might have been substantially completed. If irregularities are detected at this stage, the Bank could declare misprocurement and cancel the correspondent portion of the loan<sup>320</sup>. This attitude might, however, compromise the time scale and financial arrangement for the entire project. Moreover, there might be funds that have already been disbursed, making them harder to recover. As the Bank’s president stated in an internal memo: “Disbursements are often made on the basis of statements of expenditure, without the supporting documentation. We depend on our borrowers to have handled these contracts with due diligence and according to the agreed procedures... As a public institution we are accountable for helping our borrowers to see that the

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<sup>319</sup> World Bank, *Africa Region*, (2001); Procurement Audits, at <http://www.worldbank.org/afr/findings/infobeng/infob60.htm> visited at 11/05/05. For an example of procurement problems in Africa see *Ghana, Country Procurement Assessment Report 2003*, available at [http://www-wds.worldbank.org/servlet/WDS\\_IBank\\_Servlet?pcont=details&eid=000160016\\_20040521150219](http://www-wds.worldbank.org/servlet/WDS_IBank_Servlet?pcont=details&eid=000160016_20040521150219).

<sup>320</sup> Misprocurement was in fact declared in FY 98-00 and in FY 01 in Indonesia. The total amounted to US\$ 9 million (see The World Bank, *Indonesia CPAR Reforming the Public Procurement System*, (2001)).

money allocated under Bank-financed operations is being spent on what it should be spent on and that our borrowers are getting good value for what is being spent. An annual financial audit alone is not enough, nor is routine supervision by the Bank”<sup>321</sup>.

If audits are not sufficient to ensure that the money is being correctly allocated and that the borrower is getting good value for money, other mechanisms should be in place. One alternative is to lower the prior review thresholds so that supervision can be undertaken before the contract is awarded. However, it is possibly not cost effective for the Bank to hire staff to accomplish this task. The analysis of hundreds of contract documents would overwhelm the institution with work that is not necessarily worthwhile, as irregularities will probably not be found in many contracts.

Another alternative is to inhibit irregularities through further legislation. Borrowers and contractors could be asked to comply with even stricter standards of transparency, and open competition can be required even in cases of small contracts. However it is doubtful that the costs brought to the process with such measures will be lower than the benefits that will derive from them. In fact, bureaucracy and slowness in procurement procedures has been identified as one of the biggest causes of corruption and other irregularities<sup>322</sup>. “Not only do slow procedures give corrupt practices time to move, they also give them an excuse for their actions”<sup>323</sup>. Even auditors agree that there are usually enough laws and regulations in place; the problem is how to enforce them<sup>324</sup>.

To enhance the enforcement of the Guidelines, one option is to set a formal review mechanism whereby bidders and other interested parties could bring complaints and worries during the procurement procedure. Although this alternative would still bring about more work for the Bank personnel, it would diminish the number of contracts to be reviewed as the Bank would know which procedures were more likely to have suffered irregularities. Moreover, if the procedures were reviewed before the contract was awarded, the effects of irregularities could be

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<sup>321</sup> Citation extracted from Celarier, (1996), p. 51, citing Wolfensohn internal memo.

<sup>322</sup> Tucker, (2001) and Borge, (online) as visited on 07/11/2000.

<sup>323</sup> Tucker, (2001) page 26.

<sup>324</sup> Borges, note 322.

avoided, instead of being detected only afterwards, when the remedies available are limited. The setting of a formal complaint mechanism can even prevent irregularities from occurring since procurement officials and bidders are aware that any misconduct could expose them<sup>325</sup>.

Although the advantages of a formal complaint mechanism will be discussed later in the Chapter, it is important to stress that it should provide the necessary incentive to the interested parties. There should be remedies available either to correct the irregularity or to compensate the parties that have incurred in losses because of it. Such complaint mechanisms would not replace audits but will complement them in their task of bringing accountability to finance projects.

### **3 Accountability of the World Bank**

As mentioned earlier in this Chapter, the Bank has until now successfully avoided any legal relationship with bidders, despite its power to interfere with procurement decisions. While the relationship between borrowers and the lender is determined by the Loan Agreement, and any problems would be decided either by negotiation or by arbitration, it is not clear how third parties affected by the lender's decisions could seek redress.

In Chapter II, the accountability of international organisations towards third parties was discussed in general terms. There, it was recognised that the implementation of the projects financed by the Bank could harm third parties involved in the process and that it was necessary to determine the accountability of the institution in those instances. In order to determine such accountability, it is necessary to define the situations when international institutions, such as the Bank, could be held accountable for their acts. Under this issue we have seen that the most difficult challenge is to define a balance between the need to preserve the necessary autonomy in decision-making for international organisations and to provide affected parties with the means to seek reparation for the damage caused by their operation. In this context, privileges and immunities enjoyed by international organisations can only be justified to protect the organisation from undue interference. However, as Wellens correctly observed, “if an international

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<sup>325</sup> See Borges, note 322, where the author comments that there is a consensus among auditors that it is much better to prevent corruption from occurring than to try to detect it afterwards.

organisations should be enabled to conduct its affairs without undue interference this does not entail the privilege of never having to defend a lawsuit”<sup>326</sup>.

It has also been discussed how privileges and immunities, usually enjoyed by international institutions, apply to the Bank. In the second Chapter it was mentioned that despite being an international organisation which in principle would enjoy broad immunities from suit, the Bank’s charter has waived its immunity in certain circumstances. In interpreting this provision, the US courts have adopted a negative test for determining the situations in which such a waiver should be applied. Immunity will not be considered to be waived unless the particular type of suit would further the Bank’s objectives. Therefore, for establishing that a waiver would apply in the procurement context it would be necessary to prove that such claims will not impair the Bank’s objectives, but in fact will contribute to the better operation of the institution. In fact, the Articles of Agreement provide some principles that could be regarded as basis for procurement claims, such as the relevance of economic considerations, the high standard of efficiency required in the projects, the need to provide opportunities for contractors from all member states, etc.

On determining the elements that must be present for a claim to be pursued, we have said that there must be a breach of an international legal obligation (illegal act) and that this must be attributed to an act of the organisation. In order to determine whether the act should be attributed to the international organisation or the member states it is important to ascertain who has the power to control the decision that affects the claimant’s rights. If the organisation has this power, it should be the one responsible for the consequences of its acts.

A number of cases arose under the regional level of the European Union, in which firms situated in the community have challenged decisions of the European Commission for its supervisory role in respect of procurement procedures carried out in projects funded by the European Community. Despite the differences between the European system and the World Bank

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<sup>326</sup> Wellens (2002), p.118.

rules, a brief analysis of those judgements might be useful to improve the comprehension of the legal consequences of the decisions taken by lender institutions<sup>327</sup>.

The European Court of Justice has repeatedly determined that the decisions taken by the lending institution only have the purpose of ensuring that the procurement procedure meets the conditions established in the financing agreement. The court denied that the bidders could have an action against the European Commission, arguing that the borrowing state is the only one responsible for preparing, negotiating and concluding the process. Moreover, the court stated that the Commission's decisions on the course of their relationship with the recipient country are not of 'direct concern' to the bidders. According to it, interference of this kind in the procedure would be against the sovereignty of the state since the Commission would be dealing with issues reserved to the borrower's sphere of responsibility<sup>328</sup>.

Such decisions seem to be tied to the formalities of the agreements rather than to the reality of the procurement process. Certainly, the Commission has the power to alter significantly the course of the procedures and the final decision. A significant move toward this practical approach was taken by the European Court of Justice in 1997 in case C-395/95, *Geotronics SA v. EC Commission*<sup>329</sup>. This case concerns loans granted under the EC's PHARE programme, and the complaining party wanted to challenge the decision by which they were excluded from the procedure due to divergences over the origin of the product. In that case the Court decided<sup>330</sup> that although the loan agreement established that the borrower was the one responsible for the procurement process, the decision taken by the Commission to exclude the complainant from a tendering procedure had a direct influence on the legal position of the latter<sup>331</sup>. As to the

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<sup>327</sup> For specific analysis of the legal framework under the European Community see Kalbe, (2001).

<sup>328</sup> See the decision on the following cases: Case 126/83, STS Consorzio per Sistemi di Telecomunicazione vis Satellite SpA v EC Commission, 1984 ECR 2769; Case C-257/90, Italsolar SpA v EC Commission, 1993 ECR I-0009; Forafrique Burkinafabe SA v EC Commission, 1993 ECR I-2161.

<sup>329</sup> ECR I-2271.

<sup>330</sup> Case C-395/95, Geotronics v. Commission of the European Communities, (1997) ECR I-2271

<sup>331</sup> Although in general the decision to reject a bid is taken by the contracting authority, in this instance the Commission formally declared that it rejected the bid. The ECJ stated that the decision of whether the Commission had rightly or wrongly assumed the position of the contracting authority was of substance and not of admissibility. At the end the Court said that the Commission had competence to reject the bid because on this particular instance there was a joint call for tender (both the Romanian Ministry and the Commission were mentioned as responsible for the project).

allegation that the borrower had discretion to award the contract to a specific supplier despite the refusal of the Community funding, the Advocate General said that this “suggestion is so hypothetical as not to deserve any further comment”<sup>332</sup>. Although the Court did not discuss this allegation in the *Geotronics* case, it commented on a similar allegation in the *Société Louis Dreyfus & C<sup>e</sup> v. Commission of the European Communities*<sup>333</sup>. In this case there was a Loan Agreement from the Community to the Soviet Union and the complainant, a company incorporated under French law, was challenging the Commission’s decision not to allow a modification to the terms of the contract concluded between them and the borrower agency. The Court determined that “...for a person to be directly concerned by a Community measure, the latter must directly affect the legal situation of the individual and leave no discretion to the addressees of that measure who is entrusted with the task of implementing it...”<sup>334</sup>. Moreover, on the allegation that the Community was only concerned with the compliance of the modification of the contract with the rules that regulated the Community funding and therefore was not binding on the borrower contract with the complainant, the Court said: “Exportkhleb’s [borrower agency] option to perform the supply contracts in accordance with the price conditions repudiated by the Commission and thus to forgo Community financing was purely theoretical and [...] was therefore not sufficient to prevent the appellant from being directly concerned by the contested decision”.

Furthermore, in American case law it is possible to find decisions which link the degree of operational involvement of the aid agency with its vulnerability to be sued by the decisions taken under the procurement process. In the *Constructores Civiles de Cetroamerica S.A. v. Hannah*,<sup>335</sup> a case in which a Honduran company (CONCICA) questioned in the US Court for the District of Columbia<sup>336</sup> the decision of the US Agency for the International Development (USAID) to declare that one of the bidders was unqualified, the Court determined that “although

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<sup>332</sup> Ibid. p.2279.

<sup>333</sup> Case 386/96, judgement of the Court on the 5 May 1998, (1998) ECR I-2309.

<sup>334</sup> Paragraph 43.

<sup>335</sup> 459 F.2d 1183.

<sup>336</sup> It is important to note that, since the World Bank headquarters is in Washington, the same Court will have jurisdiction to try actions brought against the World Bank.

AID is not strictly speaking a party to the contract, there are *sufficient, substantial* contacts with AID/Washington”<sup>337</sup>(emphasis added). In this particular case, the loan agreement between the USAID and the Central American Bank for Economic integration, which was the immediate credit institution and the actual lender to the Nicaraguan Government, stated that both institutions had to jointly approve contractors. USAID in Washington considered CONCICA unqualified despite a positive evaluation from the USAID regional office, CABEI and the Nicaraguan Government.

The same line of argument can be applied to justify the accountability of the World Bank under its procurement system. Just as in the examples mentioned above, the Bank controls the power to determine whether bidders could continue in the tendering procedure. It is not the borrowers’ national rules in procurement that are being applied, but the Bank Guidelines as interpreted by the Bank staff responsible to the project. Therefore, even if the borrower disagrees with the Bank’s rules and interpretations, it could not depart from them without jeopardising the funds allocated to the project. As the US District Court correctly observed, the borrower would not conclude such contracts if the aid were not granted

For bidders and contractors to bring a claim against the Bank they must establish their legal ground of stand. The question that remains to be answered is whether contractors are a legitimate party to bring complains against the organisation. There is no clear exclusion in the legislation analysed so far. As we have seen, only member states are expressly forbidden under the Articles of Agreement to bring claims against the organisation. However, they could bring an arbitration procedure should there be a dispute concerning the Loan or Guarantee Agreements. However, does the Bank have legal duties in relation to bidders and contractors?

Firms that have brought a case challenging the decision of the European Commission have based their action on Article 173, second paragraph, of the EC Treaty, in which it is determined that “any natural or legal person may institute proceedings against a decision address to that person or against a decision which, although in the form of a decision address to another

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<sup>337</sup> Ibid. 1191.

person, is of direct and individual concern of the former". Unfortunately, there is no correspondent provision in the World Bank system.

In establishing the accountability of the Bank towards third parties it is important to recall the division of levels of accountability suggested by Schlemmer-Schulte<sup>338</sup>. According to him the analysis of the Bank's accountability should be divided into three parts; the recognition of the accountability of an international organisation, its liability under domestic law, and its international responsibility under international law<sup>339</sup>. The first concept is based on the recognition that accepting accountability in certain instances can actually improve the performance of the organisation<sup>340</sup>. Regarding the legal liability of the institution under domestic law it must be considered the Bank's immunity from suit. As mentioned before, such issues could be overcome by a waiver, and in fact the Articles of Agreement have provide such waiver if the action passes the test of furthering the Bank's objectives<sup>341</sup>. Moreover, actions under domestic law must be based either under a contractual relationship or on liability in tort. Since the parties of the loan and guarantee contracts are the Bank and member countries and state entities or private investors there is no privity of contract with third parties affected by the project.

However it is interesting to note that many jurisdictions recognise the right of third parties based on a contractual relationship not concluded by them. Third parties' rights can be protected based on several grounds: public policy, fraud or misrepresentation, good faith and fair dealing, etc. The lack of a contractual relationship between the lender and the third parties is not a decisive factor that would prevent the lender from being liable for its decisions. In fact it seems that the degree of liability attributed to commercial lenders should be determined according to the level of control enjoyed by the institution. If the borrower's decisions are not taken autonomously

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<sup>338</sup> See discussion in Chapter II.

<sup>339</sup> See Sabine Schlemmer-Schulte in discussion held during the panel The Accountability of International Organizations to Non-State Actors at the American Society of International Law Proceedings April 14 1998, 92 ASILPROC 359.

<sup>340</sup> This argument was also used by Reinisch, (2000) pages. 256/257. Under the Bank's system see Inspection Panel discussed below.

<sup>341</sup> See Mendaro, Lutcher and Atiknson cases Chapter II. In the case *Constructores Civiles de Centroamerica S.A. v. Hannah*, the USAID, as an arm of the government, alleged sovereign immunity defences. However, the Court did not accept those allegations since the Administrative Provision Act by proving judicial review in an action brought by "any person adversely affected or aggrieved by any agency action" Congress waived the right of sovereign immunity.

and suffer from significant lender interference, than the lender should be accountable for any wrongdoing that affects the rights of interested parties. On the other hand, if the borrower takes control of the implementation of the procurement procedure it will be responsible for any decision taken. Under domestic legal systems, the attribution of liability according to the degree of control exercised by the lenders is not a novelty. Under some jurisdictions lenders are responsible for actions taken when controlling the borrower's business<sup>342</sup>. Moreover, lenders could be liable if the courts find that they have been negligent in their supervisory role towards the borrower's actions<sup>343</sup>. Although lenders' liability provisions may vary in each jurisdiction, it is interesting to observe that courts are prepared to look beyond the contractual relationship of the Loan Agreement and decide upon the factual evidence presented to them.

Following this line of reasoning, the court in the *Constructores Civiles de Centroamerica S.A. v. Hannah*<sup>344</sup> case identified three main aspects that linked the decision taken by the lending institution with the bidder's loss of the right to remain on the procedure: the contract only comes into existence when the lending institution approves it; the requirement of continue consultation between the borrower and lending institution; and the fact the money that will be spent on such contracts comes from the lending institution and should be used in the most appropriate way to preserve the lender's resources<sup>345</sup>. Therefore, under some domestic jurisdictions, it seems that if bidders overcome the immunity defence, they could have a court decision attributing liability to development institutions for their decisions under procurement proceedings they help to finance<sup>346</sup>.

International responsibility of the Bank can arise if the institution is found to have violated its duties under international law. In this case the Bank will be called to repair the

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<sup>342</sup> See cases cited by Burke, (1989). Also see Burkhart, (1999), and Balnchard, Lenders Liability Law Page (online).

<sup>343</sup> The basis for attributing liability in those cases is the priority given to the public concern with some issues such as environmental damage. In those instances the attribution of liability to the lenders aims to ensure that lenders are careful when choosing the borrowers and the projects they will help to finance. The lender is seen as a private enforcement agent of the regulation. See Burke (1989).

<sup>344</sup> 459 F.2d 1183.

<sup>345</sup> Arrowsmith, Linarelli, and Wallace, 2000, page. 148.

<sup>346</sup> The relevance of this case rests on the fact that since the Bank's headquarters are in Washington and the Bank's Article of Agreement states that the Bank could be sued in the courts of the country where they have an office, actions brought against the Bank might be tried before the same court.

damage caused. Such violations can originate from the non-compliance by Bank staff with the Bank's internal policies and procedures, or from the breach of any international law rule. Although it is unlikely that individuals or corporations will appear before international tribunals to settle procurement-related complaints against the Bank, international law issues might be appreciated by a national court if it has jurisdiction over the cause. In deciding to take jurisdiction, national courts might rely on the fact that there is no legal enforcement mechanism available to bidders when the lender's decisions are being questioned. As Wellens accurately points out, "[...] the guarantee of effective legal protection must be considered a general principle of law, which (increasingly) underlies the common constitution traditions of member states of international organisations"<sup>347</sup>. The right to an effective remedy system as a norm of international law includes both the right to effective access and the substantive right to a remedy<sup>348</sup>. Moreover, if in most jurisdiction individuals have access to redress mechanisms against the state, it is not unreasonable for them to expect similar remedial mechanisms to be available when their interests have been harmed by international organisations<sup>349</sup>. In fact, if a judicial review of governmental decisions by established courts is possible and deemed desirable, Bowett argues that there is no reason why the same should not apply to international organisations<sup>350</sup>.

Until this moment the World Bank has managed to avoid such discussion. The only mechanism in place available to suppliers is the informal procedure described in Appendix 4 of the Guidelines, by which the Bank will receive and consider complaints but does not keep contact with the bidder, nor is bound to take any action. However, note that the Bank does not avoid a legal relationship with other parties involved with its functions. Bondholders and other creditors, for example, are able to sue the Bank. Moreover, the Bank maintains an Inspection Panel which has the power to investigate complaints involving the Bank's failure, through act or omission, to

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<sup>347</sup> Wellens (2002), page 16. Also see International Law Association, Berlin Conference (2004), final report and Reinisch, (2000).

<sup>348</sup> Wellens, (2002) page 17.

<sup>349</sup> Wellens, (2002) page 16.

<sup>350</sup> Bowett, in Lowe and Fitzmaurice (eds.) (1996) at p. 190.

follow its operational policies and procedures<sup>351</sup>. Such complaints can be made by any group of private complainants who allege that they have been directly and adversely affected by the failure of the Bank, and they can request the institution to act in accordance with its rules and policies. Nevertheless, complaints against procurement decisions are expressly excluded from the scope of the operation of the Inspection Panel.

The importance of the Inspection Panel in this discussion is that, as pointed out by Bradlow, it constitutes the first formal acknowledgement that international institutions have a legally significant non-contractual relationship with private parties that is independent of either the organisation's or the private actor's relationship with a member state<sup>352</sup>. Moreover, the Bank has accepted its responsibilities for the consequences of its actions by setting up an independent forum where injured private parties can bring their complaints.

The exclusion of procurement decision from such a process could have several explanations. On a speculative analysis it can be said that firstly, as the Bank insists that the borrower is solely responsible for the process of running and choosing the contract, it was felt that the inclusion of bidders' complaints in the Inspection Panel system would violate the sovereignty of the borrower; secondly, bidders might not be organised enough to lobby within the Bank to insist on having their complaints heard; moreover bidders might feel that, if no efficient remedy is available, there is no real advantage to bringing a complaint. Moreover, it is still unclear how, if at all, the Panel would be able to deal with complaints that require interference into the borrower's internal affairs to be solved. The enforcement of the decisions reached by the Panel is another issue that can cause a number of problems, especially in cases where there are concurrent responsibilities of both the Bank and the borrower. Therefore, although in theory this procedure could include complaints by bidders relating to procurement, this might not be the most appropriate way to address the problem.

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<sup>351</sup> The Inspection Panel (the "Panel") is an independent forum established by the Executive Directors of the World Bank by IBRD Resolution No. 93-10 and the identical IDA Resolution No. 93-6 both adopted by the Executive Directors of the respective institutions on September 22, 1993 (collectively the "Resolution").

<sup>352</sup> Bradlow, (1994). Also see Shihata, (2000) (b).

In the next Chapter the importance of creating a complaint mechanism accessible by private firms will be discussed. Moreover, a range of possible alternatives will be presented, along with the advantages and disadvantages of each. The remedies available are also an important issue in public procurement processes, since they need to be effective in preventing breaches, take into account the speed of the procedure, and provide incentives to private firms.

## **CHAPTER V – REVIEW MECHANISM**

### **1 Introduction**

As seen in the previous Chapter the enforcement mechanism proposed under the Guidelines might not be satisfactory for several reasons. First, it might not bring effective deterrence of breaches. Second, the system brings little incentive for interested parties to bring a complaint and relays mostly on the Bank’s supervisory role. Thirdly, the actual enforcement mechanism does not acknowledge the lender’s accountability despite giving the lender a great discretion in decision making during the procurement process. In this context, it is suggested that there is scope for improvements of the review mechanism as established in the Guidelines.

This Chapter will make some recommendations on possible ways to reform the current enforcement system. In the first part of the Chapter, the advantages of giving bidders a more prominent role will be evaluated. In addition, some relevant considerations of drafting a review mechanism such as the burden of proof, stands to sue, the speed of the procedure and possible remedies will be discussed. In the second part, three possible ways to address complaints will be evaluated namely, review by an internal organ of the Bank; review through national courts; review through arbitration. Finally, it will be argued that although there is no wholly satisfactory enforcement mechanism, the best way forward is the setting of a formal review panel which will be charged with looking at complaints and draft recommendations. Although remedies will be limited under such a mechanism, it will improve the current system by bringing more accountability to the procurement process.

### **2 The Role of Private Parties in Achieving Procurement Objectives**

When establishing a procurement system based on transparency and clear rules and objectives, most jurisdictions provide for some kind of mechanism whereby decisions taken from the procuring agency are reviewed by an external body. Those might be judicial or administrative bodies making binding decisions, or just recommendations. Despite the method chosen, it is

generally recognised that if an effective procurement system is in place, there should be also a rigorous and impartial review procedure of some kind<sup>353</sup>.

The people most likely to trigger a review procedure are those affected by the decisions taken by the procuring agency, namely private parties which have lost contracts. However, other parties might also be concerned with the outcome of the procurement process, such as taxpayers worried about the waste of public money, particular groups of people affected by the winning proposal, non-governmental organisations that oversee the activities of the government, etc. The attribution of rights to bring a complaint to those parties comes from the recognition that they will contribute to enforcing the existing procurement rules, and will bring accountability to the system.

However, the mere existence of bidding procurement rules does not necessarily mean that some kind of review procedure will be available to private parties<sup>354</sup>. The UNCITRAL Model Law<sup>355</sup>, for instance, does not set detailed provisions on review mechanisms. Instead of insisting on the adoption of an independent review body with powers to make binding decisions<sup>356</sup>, the Model Law suggests a two stage procedure whereby complaints are brought first to the procurement agency<sup>357</sup> and if the issue is not satisfactorily addressed, a separate review authority within the administration could review the decision taken in the first instance<sup>358</sup>. Moreover, even the timid provisions set out in the Model Law could be left out altogether by governments establishing procurement regulations. In fact the Model Law expressly states in a footnote to

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<sup>353</sup> See Arrowsmith, Linarelli and Wallace, (2000), Chapter 12.

<sup>354</sup> In fact, the review of procurement decisions is seen as a sensitive matter (see provisions in the Model Law and Guide to Enactment). Even when a review mechanism is in place several factors might affect the effective use of litigation as a means to seek redress, such as lack of culture in litigation, fear of losing future business, lack of effectiveness of remedies, etc. For further explanation see Arrowsmith, Linarelli and Wallace, (2000), Chapter 12.

<sup>355</sup> The UNCITRAL Model Law on Procurement of Goods, Constructions and Services is particularly relevant as it serves as guide to some countries which are in the process of establishing a new procurement system or reforming the existing one. The provisions on remedies for aggrieved firms are set out in Chapter VI Articles 52-57.

<sup>356</sup> It is fair to say that Article 57 provides for the judicial review of procurement decisions. However, the Guide to Enactment suggests that Article 57 is included just to conform to the existence of any judicial review otherwise available under national law. It does not indicate that a review by judicial authority must be available. For further comments on the provisions see Arrowsmith, Linarelli and Wallace (2000). For discussion the review of those provisions see Arrowsmith (2004) (a)

<sup>357</sup> Articles 53-55.

<sup>358</sup> Articles 54-55.

Chapter VI that “because of constitutional or other considerations, States might not, to one degree or another, see fit to incorporate [the articles or review]”. Furthermore, the Model Law left certain areas unregulated, such as the question of the independence of the administrative review body, the form of the relief to be given (which might include orders or recommendations), and there were no provisions for a judicial or quasi-judicial proceeding<sup>359</sup>.

The position adopted in the Model Law (and under some domestic legal systems) can be contrasted with the position adopted by international liberalisation agreements on the same issue. The right to complain given to private parties in international trade agreements, such as the Government Procurement Agreement and the European Community Remedies Directives<sup>360</sup>, is usually associated with a system that is based upon a dispute resolution primarily through a judicial, or rule-based, system. Those systems are concerned with the objective application of the rules and with the effective implementation of the decision taken in dispute settlements. In this context, private parties can have a significant role in the enforcement of the agreement. Since, in general, private parties could directly benefit from the effective application of the rules, they would have the greater incentive to bring an action when those have been breached<sup>361</sup>. Another advantage of engaging private firms in the enforcement system is the increase in the number of disputes over rules that are uncertain. This would allow the courts (boards or tribunals) to clarify such provisions. Greater clarity on the rules brings more certainty to the system, and helps to lower the risks of operation.

The enforcement systems designed under those international agreements differ from the one set up under domestic legal systems for several reasons. Firstly, international agreements are usually negotiated between parties, which have similar bargaining power. When negotiating the specific characteristics of the enforcement mechanism, countries can discuss their concerns with

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<sup>359</sup> However, it should be noted that modifications of those provisions have been discussed by the Working Group I (Procurement) at its sixth session (2004) (Document A/CN.9/568) and although the establishment of detailed procedures were seen as inappropriate it was suggested that further Guidance should be included in the Guide to Enactment. In addition it was determined the need for independent review bodies (either through courts or court administrative review). It was also suggested that the exception list in Article 52 be deleted. Modifications, however, have not taken place yet.

<sup>360</sup> See Directive 89/665/EEC (1989) O.J. L395/33 for the public sector and Directive 92/13/EEC (1992) O.J. L76/14 for utilities sector.

<sup>361</sup> Reich, (1999), p. 334.

other members of the trade group and try to accommodate any relevant requirement. Moreover, the parties are sometimes free to determine the extent to which they will refer its procurement purchasing to the agreement<sup>362</sup>. In some instances, some member countries might even be exempt from following some of the rules. The rights given to private firms also vary and, although the basic principles are set up in the agreement, each country is left with a margin of discretion on how to implement them in the national system<sup>363</sup>.

The World Bank system, however, operates in a different environment from both domestic systems and international agreements. Usually the borrower needs the loan and is not in a position to refer to the market to get it, given its lower rate on creditworthiness. Under these circumstances the Loan Agreement clauses are not widely negotiated and the borrower has to accept the model ‘suggested’ by the lender. The Bank, therefore, imposes the application of the Guidelines and subjects the disbursement of the funds to the strict observance of the rules. In this context, the greater incentive to the borrower in complying with the rules comes from the need to receive the loan, and not from a designed review mechanism that brings accountability.

However, in the context of the World Bank system, the possible role played by private firms in securing the enforcement of the rules should not be undermined. Allowing suppliers to bring complaints within the Bank’s system can still have several advantages. The settlement of concerns brought by suppliers might bring clarity to the interpretation of the Guidelines. Clear rules improve confidence of suppliers when bidding, and eventually might lead to greater competition and the conclusion of better contracts. In this context, the intervention of private parties in the procurement process could lead to a more efficient procurement, in which best value for money is often achieved. Moreover, private parties can alert the Bank about breaches that could be happening in the procedure (especially in those cases where the Bank will only

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<sup>362</sup> For coverage under the EU system and the GPA agreement see Arrowsmith, Linarelli and Wallace, (2000), pages 324 and 194.

<sup>363</sup> For a general review of the EU and GPA enforcement mechanisms see Arrowsmith, Linarelli and Wallace, (2000), pages 754-757 and Reich (1999). For national implementation of EU remedies directive see Arrowsmith (2005), Arrowsmith (1999), Pachnou (2000) and (2005) (a), Brown (1998), Arrowsmith ed. (1993) and Tyrell and Bedford (eds.) (1997). For specific discussion on the use of centralised enforcement see Delsaux (2004) and Pachnou (2005) (b). For discussions on the GPA enforcement system see Arrowsmith, (2002) (b); Footer, (1995) and Davies, (1997).

carry out a post review of the procedure), allowing the mistake to be corrected in due time and avoiding the risk of having to start a new procedure.

The improvements that the participation of private parties brings to the procurement process are in line with the objectives that the Guidelines aim to achieve. As mentioned in Chapter III, the main concerns addressed by the Guidelines are: firstly, to ensure that the goods and services needed in the project are procured with due attention to economy and efficiency; secondly, to secure compliance with the Bank's interest in giving all eligible bidders from developed and developing countries an opportunity to compete in providing goods and works financed by the Bank; thirdly, to encourage the development of domestic contracting and manufacturing industries in the borrowing country, stimulating development in those countries; and finally, to ensure transparency in the procurement process.

As to the first concern, an enforcement mechanism open to private parties could bring clarity and reliability to the system, making it more efficient and improving the chances of obtaining a profitable contract. Such an enforcement mechanism might also provide a fair and equal ground to compete for both national and international suppliers. If in the actual system suppliers have to rely on national legislation and judicial mechanisms to address their concerns, it is not unreasonable to suggest that national suppliers would have some advantages over international suppliers, since they are more aware of the requirements and nuances of the enforcement system. If on the other hand, suppliers are to trigger the informal mechanism through their representatives in the Bank, this also does not provide a fair level of dispute settlement mechanism. As mentioned before, the access to Executive Directors is limited, especially for suppliers in developing countries, and the power exercised by each Director is different, and therefore suppliers from minor shareholders' countries are unlikely to have their complaint addressed.

The development of the domestic industries might also be positively influenced by the creation of a formal complaint mechanism. In some jurisdictions, the existence of procurement rules does not necessarily give the right to affected parties to complain against procurement

decisions<sup>364</sup>. In other instances, the right to complaint might be given only to a limited number of people, such as taxpayers and government officials. When the right to complaint is limited under national regulation, suppliers are left with little hope of having their concerns addressed. This uncertainty increases the risk of presenting a bid and might elevate the price of the contract, or even discourage good suppliers from engaging in the procedures. The establishment of a complaint mechanism for projects financed by the Bank might provide a model for national procurement and might encourage domestic firms to engage in contracts with governmental authorities. Some firms might even specialise in supplying goods and services to the public sector.

Probably the greatest advantage of a formal complaint mechanism is the transparency it will bring to procurement decisions. Under a transparent system, parties not only understand and rely on the rules that are being applied, but also are reassured throughout the process that such rules are indeed being followed. Decisions taken under such a system are made public and justified. Documents are open to interested parties to consult and any concern or complaint is dealt with seriously. In summary, the establishment of a formal complaint mechanism provides a clear, transparent and fair way of dealing with all the concerns presented by interested parties. Issues of corruption, for example, can be openly addressed and resolved. Moreover, an effective enforcement mechanism will not only identify and punish any malpractice, but will also function as a deterrent to breaches as the perpetrators will be aware of the possibility of being exposed.

Although the creation of an effective complaint mechanism is unlikely to have adverse effects on the procurement, some problems might deter private parties from bringing a claim. Private parties might not be willing to bring a dispute against the procuring agency (or the Bank) for fear of jeopardising the possibility of future contracts. This factor was detected in the European context, for example. Empirical research has shown that in some countries suppliers are unwilling to bite the hand that feeds unless they have a strong case<sup>365</sup>. Moreover, private firms

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<sup>364</sup> See Arrowsmith, Linarelli and Wallace, (2000), page 752.

<sup>365</sup> See Pachnou (2005) (a).

might have difficulties in detecting and proving such breaches<sup>366</sup>. In addition, suppliers might have no incentive to complain if an effective remedy system is not in place to ensure that they could have either the contract or compensation for failure to observe the rules<sup>367</sup>. Therefore, ideally, the complaint mechanism should try to maximise the advantages that private parties could bring to the procurement system, and provide a greater incentive to them in bringing those complaints without causing difficulties or compromising the effective running of the procurement procedure.

### **3 Relevant Considerations When Setting a Review Mechanism**

Before turning to the analysis of the possible review systems, it is necessary to frame some relevant issues. Therefore, in this section, four general issues relevant to all forms of review mechanisms will be considered; namely, the burden of proof and evidence, determination of who has the right to complain, the importance of the speed of the procedure, and remedies.

#### **3.1 Burden of Proof and Evidence**

One of the main concerns when setting a review mechanism where both the borrower's actions and the decisions of the Bank can be challenged regards the allocation of the burden of proof and the access to evidence. Despite the method or jurisdiction of the trial, private parties will have to prove their claim. As Wellens correctly points out “[a]ny third-party dispute settlement procedure derives its legitimacy from its impartiality, which requires that parties should not be obstructed when presenting their arguments and submitting evidence”<sup>368</sup>. However, under the current system private parties could have to overcome three major obstacles: immunity of archives enjoyed by the Bank, any limitation of access to the borrower documents, and the lack of accessibility to the Bank and borrowers' communications.

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<sup>366</sup> For more details on burden of proof and evidence see Section 2.1 of this Chapter.

<sup>367</sup> See Arrowsmith, Linarelli and Wallace, (2000), Chapter 12 and Reich, (1999). In the EC procurement context see discussion over the effectiveness of complaints brought to the attention of the Commission. See Pachnou (2005) (b) and Delsaux (2004).

<sup>368</sup> Page 126-127.

The charter of the Bank provides that the archives of the institution “shall be inviolable”. This rule aims to protect the internal information owned by the international organisation and to protect it from any undue interference in its functioning and independence<sup>369</sup>. The immunity of the archives is also independent from the waiver of the immunity from legal process provided in the same charter. This means that the waiver, even if interpreted widely, will not necessarily imply an open access to the institution’s archives. Therefore, private parties’ complainants might be deterred from having access to relevant procurement documents, especially those containing requirements and decisions taken by the Bank staff during procurement process.

The immunity established in the Bank’s constitutive agreement is not unique but most international organisations also enjoy the same immunity. However, the extent of the immunity granted must be subjected to the functionality restricted immunity concept, in which such rule is based. This argument was embraced by the European Court of Justice in J.J. Zwartveld, a case where a Dutch court asked the ECJ to order the Commission to produce evidence and permit Commission officials to testify in a national criminal proceeding<sup>370</sup>. There the Court rejected the formal provisions of the EC Privileges and Immunities Protocol of 1965 and stated that member states and the Community institutions had “duties of sincere co-operation” with each other. Based on such principles the Court said that the privileges and immunities granted to the communities have a “purely functional character, inasmuch as they are intended to avoid any interference with the functioning and independence of the Communities”<sup>371</sup>. By doing so the Court ordered the Commission to provide the evidence to the national court “unless it presents to the Court imperative reasons relating to the need to avoid any interference with the functioning and independence of the Communities justifying its refusal to do so”<sup>372</sup>. Although the Bank operates under a difference environment in the sense that its is not subject to the rulings of a central court, nor has it to follow a treaty which requires co-operation between member countries and the institution, it seems that there is a general duty for international organisations to facilitate the

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<sup>369</sup> J.J. Zwartveld and others, Case 2/88, ECJ, 13 July 1990, as reported in Reinisch,(2000), page 340.

<sup>370</sup> (1990) ECR I-3365 at 3372. Reinisch,(2000), page 340.

<sup>371</sup> Ibid.

<sup>372</sup> Ibid.

administration of justice regardless of the jurisdiction in which the evidence is needed<sup>373</sup>. Privileges and immunities should only serve to protect the interests of international institutions and their proper functioning, and not to prevent third parties from achieving the proper administration of justice.

After overcoming the obstacle of immunity of archives, private parties might still have to face difficulties imposed by national laws, especially if the case is heard under national jurisdiction of the borrowing country. As mentioned before, not all jurisdictions where procurement regulations are in place have a dispute settlement mechanism open to private parties. Procurement rules might be bound only to the administration and enforced only by internal proceedings. Moreover, even in jurisdictions where procurement documents are generally open to review by private parties, there could be national laws that protect some governmental documents from being disclosed to the public, for instance in strategic purchasing. In those cases, private parties could be deterred from having access to the documents leading to the final procurement decision.

The lack of access to the communications between the Bank and the borrower might also impose a significant obstacle to private parties, especially at the pre-litigation stage, where the claimant would have to determine the accountability for the wrongful act. The greater effect would be felt in prior review procedures where the Bank has to approve all major documents before the borrower is authorised to release them to the bidders. In those instances, it would be difficult to determine whether the borrower or the Bank has taken the decision that is being challenged. Another situation where it might be extremely difficult for private parties to ascertain accountability are cases where litigation arises at the start of the proceeding, where suppliers challenge the criteria set out in the bidding documents. Since the Bank and the borrower work together in the preparation of such documents, it is unlikely that private parties would be able to clearly determine who has to decide on the inclusion of a certain criteria.

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<sup>373</sup> Wellens (2002) page 126.

Despite the obstacles that limited access to the documents impose on private parties, it must be acknowledged that the Bank and the borrower should take care in disclosing information at their disposal not to harm the legitimate interests of other parties. Therefore, the adequate allocation of the burden of proof should rest with the party that is more likely to have access to the evidence needed. This means that if the Bank or the borrower is in a better position to prove the legality of the act being questioned, the burden of proof should be shifted and the claimants released from the obligation of providing evidence that is in the hands of the Bank or the borrower. The shift of the burden of proof in favour of the claimants would bring the necessary fairness to the review mechanism as not only would the inequality of the parties be taken into account, but also a reasonable and practical solution would be provided to the limitations imposed to private parties.

### **3.2 Who Could Bring a Claim?**

After establishing that private parties could have an important role in achieving procurement objectives, it is important to determine more precisely who should have the right to complain. In procurement procedures, not only the bidder will have interests in the results of a procurement process, but also the sub-contractor might be affected by the decision to reject a bid. Suppose for instance that during the procurement procedure for a complex project the primary bidder offers a proposal in which several sub-contractors are going to be engaged. Before making such an offer, sub-contractors form an agreement with the primary bidder that they would have to present all the necessary documents to fulfil the requirement imposed in the bidding documents. Under this scenario, suppose that the Bank or the borrower decides to disqualify the bid based on the wrongful assumption that one of the sub-contractors did not fulfil the requisites of the bidding documents. Such a decision might not only prevent the sub-contractor from engaging in the project, but also could cost them money, as the primary bidders might sue them for breach of their contract. Under circumstances like this, sub-contractors might have a genuine interest in launching a claim against the Bank, the borrower, or both, in order to recover their losses. However, should a complaint mechanism be open for them as well?

The problem of determining who should be able to bring a claim is not restricted to situations where sub-contractors could have an interest, as several other situations can be envisaged. The right to sue could in theory be granted to other interested parties such as citizens (who would have an interest in the proper application of the funds), trade associations (which could be triggered by a complaint from a bidder that wants to remain anonymous), or other suppliers that feel that they have been left out of the procedure because of an unlawful criteria or failure to advertise, etc<sup>374</sup>. However, the Bank and borrowers should be aware of the disruption that openness of the review mechanism to several persons could have on the procurement procedure. In fact, it has been suggested that if citizens and sub-contractors acquire the right to complain, this could have a negative impact on the economy and efficiency of the public purchasing<sup>375</sup>.

Therefore, it is unlikely that sub-contractors or other interested persons apart from bidders would have the right to pursue a claim under a complaint mechanism set under the World Bank Guidelines. Moreover, if a legal relationship between the Bank and bidders is already difficult to prove, other interested persons would stand even less chance of imposing liability upon the organisation. However, there is no impediment, at a national level, to governments setting up legislation allowing such persons to bring their complaint, provided that other mechanisms are in place to ensure the efficiency of the system.

### **3.3 Speed of the Proceedings**

The time taken by review bodies to reach a decision is vital in procurement proceedings. If a decision is not reached in a short period and no measures are imposed to suspend the procedure, the remedies to correct the breach could be significantly limited. As the contract is formally signed with one supplier and steps have been taken towards the fulfilment of such a contract, it could be very costly, if not practically impossible, to overturn the wrongful procurement decision. Moreover, suppliers would not necessarily have financial compensation

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<sup>374</sup> Arrowsmith, Linarelli and Wallace, (2000), page 772.

<sup>375</sup> Ibid. quoting United Nations, UNCITRAL Model Law on Procurements of Goods, Guide to Enactment to the UNCITRAL Model Law p. 100, 1995.

for their losses<sup>376</sup>, and therefore will not have an incentive to bring a claim if they know that their complaint will not be heard within the appropriate time.

Given the significance of maintaining the status quo before a decision is reached, most procurement enforcement mechanisms provide for interim measures, or suspensions, of the procedure while the claim is being decided<sup>377</sup>. This is granted by the organ responsible to hear the complaint in order to secure the award of the procedure or the implementation of the decision, before the settlement of the issue. The purpose of this measure is to stop the procedure from being continued until the final decision has been reached since, if no relief is granted, there is a risk that by the time the court expresses its findings, the contract would be already concluded and sometimes substantially performed. Many national systems that accept the adoption of interim measures establish some conditions for their implementation. There are three common considerations of review bodies when determining whether or not the procedure should be suspended<sup>378</sup>. Firstly, the claimant has to prove that he has *a prima facie* case; this means that by analysing only the facts and the legal issues presented by the claimant, the judge should be able to predict that the claim has a significant chance of success. Secondly, the claimant has to prove that if the measure is not granted, serious and irreparable damage can be caused to his right. If those first conditions are met, an analysis of the circumstances of the case will have to be made in order to determine the impact of the measure on the procedure. If the damage caused by the delay of the procedure is greater than that caused to the claimant, the interim measure will not be granted, but the claimant still keeps the right to ask for other remedies that might be available, such as damages. Although the nuances that are typical of such provisions will not be discussed in this paper<sup>379</sup>, it is worth mentioning that given the disruption those measures could cause in the procedures it is important to define a balance between keeping the business opportunity open for

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<sup>376</sup> As explained below, such a remedy is desirable but not necessary.

<sup>377</sup> For further information on enforcement mechanisms in the EC, the GPA and the UNCITRAL Model Law see Arrowsmith, Linarelli and Wallace, (2000), Chapter 12 (for specific consideration on length of the proceedings and time limits see subsection B, 1, at page 761).

<sup>378</sup> Idem.

<sup>379</sup> Under those provisions it is common to discuss for example the meaning of a “reasonable chance of success” or what “a serious and irreparable damage” is. For examples on how the application of the EC rules can vary in each EC member state see Arrowsmith, (1993).

suppliers and preventing the procurement procedure to be unduly stopped. The circumstances of each case presented should be analysed and interim measures applied in a cost-effective way, so that borrowers, the lender and suppliers would be able to benefit from a review mechanism without causing harm to the rights of other bidders, or to the public interest. Therefore, although interim measures could be used in different types of dispute settlement mechanisms, it is likely that the longer the procedure takes, the lower are the chances of an interim measure being granted.

Under the current enforcement system of the Guidelines it seems that an informal suspension of the procurement procedure might be determined by the Bank procurement staff when handling prior review procurement. The Bank-Financed Procurement Manual states in Section 5.2: ‘*when handling complaints staff does not: [...] give a “no objection” to a bid award recommendation until all outstanding complaints are addressed to the full satisfaction on the Bank*’’. However, the problem with that system lies in fact that complaints are not handled transparently and suppliers can never be sure that their claim will in fact be addressed.

### **3.4 Remedies**

As mentioned above, the mere existence of a complaint mechanism could make the procurement process much more effective<sup>380</sup>. The concerns that drive the authorities responsible for the decisions to objectively justify their choices is closely linked with the fear of being held responsible for the injury suffered by the complaining party, and having to pay for that. In this context, remedies are a strong incentive to prevent breaches, if well imposed. Moreover, it is worth recalling the importance of the remedy system as an incentive to suppliers to bring their complaints.

Many forms of remedies can be designed to punish officials who act unlawfully, such as criminal responsibility, administrative sanction (loss of the position or expulsion), etc. However, for the examination of such measures the internal rules of the Bank regarding the rights and

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<sup>380</sup> See example given by Pachnou (2005) (a) explaining that although Greek authorities usually consider unlikely to lose a case, the threats to sue sometime prompt authorities to correct breaches.

duties of the Bank's staff would have to be analysed. Moreover, each borrowing country would have its own national administrative rules and procedures that would have to be taken into account. This comprehensive study however, would depart from the intention of this work.

Settlement of disputes by out of the court arrangements can also be envisaged. Thus, for example, winning firms could offer excluded firms a cash payment or a benefit in exchange for dropping a protest<sup>381</sup>. Settlement of disputes involving public officials might also be possible. Under this mechanism, officials would offer excluded suppliers a cash payment or a future benefit (such as future contract) to settle the dispute<sup>382</sup>. If in some specific cases such conducts could be beneficial<sup>383</sup>, in general they are detrimental to the procurement process as they perpetuates breaches and brings a lack of transparency over the decisions. Thus, the possibility of adopting those measures under the World Bank system will not be considered.

Several measures could be determined by the review body to correct any breach of the rules<sup>384</sup>. There could be a declaration that a certain decision is unlawful and the procurement entity could be obliged to re-run the procedure from the point where the breach had occurred. Sometimes the entire procurement process might have to be annulled and a lawful one reset. In some national jurisdictions the review body might even substitute the unlawful decision with a correct one and determine the contract to be awarded to the claimant<sup>385</sup>. The legal force of those decisions, however, can vary and, while in some jurisdictions they will be binding in the procurement authority, in others they will be a recommendation of correction.

Under the Bank system, any formal review mechanism that is eventually set up will probably award decisions which have a recommendatory character. If on one had it is unlikely that the Bank would be prepared to accept a limitation on the independence of their decision, on

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<sup>381</sup> See interfirm settlement and its detrimental effect to procurement in Marshall, Meurer and Richard (1994).

<sup>382</sup> See Marshall, Meurer and Richard (1994). Also see Pachnou (2005) (a) who found this practice in European procurement.

<sup>383</sup> See Marshall, Meurer and Richard (1994) explaining that procurement officials may want to settle even if they were not found to be in breach so that the delays with protest do not interfere with other procurement concerns such as the timing of the project. In those cases and when beaches are not significant quick settlement might be beneficial to the procurement process.

<sup>384</sup> See examples given in Arrowsmith, Linarelli and Wallace, (2000) page 781.

<sup>385</sup> Ibid.

the other hand the borrower will also appeal to issues of sovereignty as a justification not to limit its freedom of awarding the contract to the chosen supplier. However, the power of such recommendations should not be underestimated. It should be always taken into account that the borrower will be willing to cooperate, since the disbursement of the funds will be tied to the conditions of following the rules strictly. Therefore, a recommendation against its decisions will trigger the threat of having a portion or the entire loan withdrawn. When a recommendation is issued against the Bank, pressure to comply will come from Executive Directors' representatives in the bidder's country of origin and also from the international community, as the credibility of the Bank's rules is put into question.

The possibility of recommending the suspension of the procurement decision, when this means the breach of a concluded contract, should be considered carefully. Even if it is accepted that an unlawful decision should be set aside, when it comes to challenging the validity of a signed contract, the review board will have to take into consideration the right of the original contractor, the stage of the performance, and any other method available, etc. Within the Bank's system, the Guidelines expressly state that the Bank will not finance contracts that have not been procured according to the Loan Agreement<sup>386</sup>. In this context the cancellation of contracts could be an incentive for bidders to try to monitor the performance of the contract, and report any breaches<sup>387</sup>. Moreover, the Bank, in its supervisory role, will scrutinise the contract and determine whether it will approve disbursement of the value referent to that expenditure. Therefore, the cancellation of concluded contracts that were not signed with the strict observance of the procurement regulations is a remedy that can be understood in harmony with the Bank's rules.

Another important remedy that should be available for complainants is a damages award. While corrective measures aim to improve the efficiency of the procedure and to ensure compliance with the rules, the award of damages aims to repair the harm caused to individual rights of suppliers and to provide the necessary incentive for bidders to bring their complaints.

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<sup>386</sup> Guidelines: Procurement under the IBRD and IDA Credits, rule 1.13.

<sup>387</sup> Reich, (1999), page 339.

While in some systems, the awarding of damages, constructed under the notion of ‘tort’ or ‘delict’, allows for claimants to be awarded loss profit, in others suppliers are only allowed to recover the expenses incurred to submit the bid. In the first alternative the bidder should be put in the position that he would have occupied had the breach not occurred. This means that if the rules had been followed and if, in this context, the claimant had won the contract, than he is entitled to receive all the lost profits that he would have gained. Although this notion seems very attractive to contractors, two main difficulties might also be felt; proof that the contractor would have won, and proof of the value of the lost profit. Those difficulties become even more apparent when the suppliers did not actually bid (either because there was a fault on the advertisement procedure or because they were excluded at an early stage). In those cases, the system will have to establish measures for the loss of the chance to bid in the procedure. Therefore, the mere recovery of the bidding cost might not provide an effective system and suppliers could feel unwilling to complain if this is the only remedy available. Nonetheless, for complex projects, where the value of the bid is significantly high, it is possible that complainants will seek redress for their concerns. This type of approach will also have a greater value when cumulated with other forms of remedies.

In the context of the World Bank it seems more likely that both the borrower and the Bank will seek to prioritise the efficiency of the procurement process rather than the rights of individual parties. Moreover, the award of damages for lost profit might trigger so many complaints from suppliers who are just seeking to take advantage of this possibility that procurement at the Bank could come to a standstill. Hence, a balance should be achieved in order to design remedies that will encourage complaints that could bring some improvement to the process, and not only the private concerns of bidders<sup>388</sup>. The review system could, for example,

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<sup>388</sup> It is interesting to note that the EC Directives and the GPA Agreement have a different purpose from the World Bank system. The former seeks to open the procurement market between member states in order to create commercial opportunities. In this context the commercial rights of private firms has a greater weight than in the Bank’s system.

allow for the award of damages limited to the expenses incurred and provide a fine for litigants that are found to have brought a complaint not in good faith<sup>389</sup>.

#### **4 Possible Ways to Set up a Review System**

Although many possible ways to set up a complaint mechanism could be envisaged, this work will focus on the advantages and disadvantages of three of them: a formal complaint mechanism within the Bank; access of private parties to national review mechanisms and; an international arbitration. In each of these mechanisms complainants would have to bear in mind that they will probably have to face two possible defendants, namely, the Bank and the borrower. Moreover, the relationship between the lender and the borrower might also need to be addressed and the accountability of each of them determined.

However, before starting to discuss alternative systems, it is worth evaluating the one that is already in place. As we have seen, the Guidelines establish that any dispute or doubts about the procedure should be addressed to the borrower. The way in which such complaints will be dealt with depends on the borrower's national legislation and the administrative structure of the government. However, suppliers may be surprised by the lack of such legislation in some national systems since in some countries private firms are not allowed to challenge governmental decisions. In those cases, the Guidelines are of no help, as they do not impose on the borrower the duty of having any complaint mechanism in place.

The rules in Appendix 4 of the Guideline allow suppliers who are unhappy with the borrower's response to their concerns, or who did not receive an answer from the borrower, to ask the Bank to address the issue. Through this informal system, the Bank keeps the freedom of whether to investigate the complaint or ask the borrower for more information on the matter. No correspondence will be exchanged between the Bank and the bidder and complainants will probably realise whether or not the issue is being solved by subsequent contacts with the procuring agency.

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<sup>389</sup> Note, however, that although this might deter frivolous complainants, fines might also reduce the deterrent effects of protests. See evidence on Marshall, Meurer and Richard (1994).

This informal system might have some advantages over a stricter legal approach. Firstly, the Bank can be aware of potential problems in the procedure before a contract is concluded or performance begins. Without any external pressure, the Bank and the borrower could negotiate a solution, which could be more appropriate to the efficiency of the procedure. Moreover, the complainant does not have to pay a costly litigation nor be involved with the complex issues that derive from the need to prove the breach of the rules. The borrower, in this circumstance, will suffer pressure to comply with the Guidelines by the threat of losing part of the loan, if not the whole amount. The Bank, in this context, will be pleased not to be involved in litigation and would keep the discretion of only perusing complaints that are significant to the adequate development of the procurement.

On the other hand, this system does not seem to guarantee to the suppliers any form of effective solution to their complaints or concerns. The lack of compromise of either the borrower or the Bank with the bidders does not give the latter the necessary incentive that they need to act. Even more importantly, in cases where the borrower and the Bank decided against what was pleaded, the complainant does not have alternative access to an impartial decision that can evaluate its rights and lawful expectations when entering the procedure. This could cause significant uncertainty in tendering.

Another drawback of the current system is the fact that the Bank does not acknowledge responsibility for the decisions it takes during the procedure. Therefore if in the course of following the Bank's recommendations, the borrower happens to cause harm to the suppliers' rights, neither can the supplier challenge the Bank's decision nor can the borrower be held responsible for the wrongdoing, since funds are only available for the procurement of goods and services carried out to the satisfaction of the Bank. Hence, although some advantages can be envisaged in the procedures in place, an alternative way should be available to private firms.

When developing an enforcement mechanism that will be imposed against different countries around the globe, we should bear in mind that this topic involves not just technical discussions but also some politically sensitive issues such as state sovereignty and control over internal policies. Some governments might be unwilling to subject themselves to the restrictions

that could eventually be imposed in an international dispute<sup>390</sup>. This is particularly true in the case of international agreements such as the GPA and the EC Directives. However, under the World Bank system, the borrower already agrees to follow different rules on procurement for that specific project. The use of the Guidelines instead of the national rules on procurement is in itself an act of sovereignty by which the government decides to limit its freedom of purchasing and follow the Bank's rules. Even if we consider that the use of the Guidelines is a condition imposed by the lending institution over which the borrower has no real choice, the fact that the borrower asks for a loan and that it agrees to submit to the Bank's rules is an act of sovereignty. Therefore, it seems that if the Bank and the borrower can envisage the benefits of having an enforcement mechanism available for private parties, the implementation of such a procedure through the Loan Agreement would not be a major problem. Moreover, having to deal with possible complaints can help the borrower to develop procurement skills, increasing, therefore, the chances of success of the project on a long-term basis.

#### **4.1      Review by Internal Organ of the Bank**

The first suggested alternative is a complaint mechanism whereby suppliers could have access to an independent body within the Bank. Such a body would be in charge not only to solve disputes and determine the responsibilities of the parties, but also to interpret unclear provisions of the Guidelines. The review body could be set at the regional level with appeal to a centralised body at the central level. The decisions related to procurement above a certain threshold would be submitted to the Board of Executive Directors, which would review them and evaluate their findings in order to improve the Guidelines.

The work of the review body would be similar to the work of the Inspection Panel<sup>391</sup>. This would be independent from the procurement officials responsible for supervising the procedure and would respond directly to the Board of Directors. Moreover, it should be allowed to investigate the complaint by having access to the procurement documents and other relevant

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<sup>390</sup> Reich (1999) p. 327.

<sup>391</sup> For comments of why procurement should not be included into the existing procedures of the Inspection Panel see page 19 and 30.

evidence. However, the speed of the procedure must differ significantly from the one adhered to by the Panel so that it meets the requirements for procurement. Moreover, as each region will have its own review board, the centralised body will only have to deal with appeal at major cases.

The decisions of the review board would be communicated to the borrower, who should comply with any alteration of the procedure determined by the board if the procurement is to be financed by the Bank. If it is too late and the performance of the contract has been concluded, or is in an advanced stage, the board would assess the responsibility of the Bank and the borrower towards the injured party and allocate damages accordingly.

The main advantages of such a procedure are the uniformity that it can bring to the interpretation of the Guidelines and the credibility that can be associated to it. When advertising its work and projects, the Bank invites firms to rely not on the procurement procedure according to the borrower's rules, but on the Bank's Guidelines. Hence, it would be expected that suppliers would be more willing to rely on a review board run by the Bank than a national review mechanism. As to the enforcement of the decision, the Bank enjoys a much stronger position and can impose the decision on the borrower.

However, several problems might be associated with this procedure. Firstly, the number of complaints that arise might be greater than the resources that the Bank has available. In this case, only major complaints will be selected for investigation and many suppliers could encounter difficulties in having their complaints addressed. The time taken to deal with the information received could also be an important factor. As we have seen, the complaints arising out of procurement issues seek quick decisions, otherwise the remedies available could be extremely limited. Therefore, if we consider that the Bank has a large number of ongoing projects all around the world, an efficient complaint mechanism can be costly and time consuming.

The enforcement of the decisions could also cause concern. If it is true that the Bank can threaten the borrower with suspension of the Loan Agreement if the latter does not comply with the Guidelines, it is unlikely that a decision on the weight of the responsibility attributed to the

borrower against a private firm could be bidding on a sovereign country<sup>392</sup>. Article IV, Section 10 of the Bank's Articles of Agreement expressly forbids any interference in political affairs of the member countries, and requires the Bank only to make decisions based on economic considerations. Therefore, damages awarded to private parties could not be imposed on the borrower, as this would deviate from the Bank's functions.

Finally, there could be concerns over the independence of the review body, especially when the accountability of the organisation has to be determined. Even if they are independent from the procurement personnel responsible for supervising the various stages of the procedure, the members of the review board will still have to respond to the Board of Executive Directors and might be constrained by the political character of that organ. The argument becomes clearer when compared with the results of the proceedings before the Inspection Panel. After having been established for ten years, the Panel received 33 formal requests for inspection, but only 30 were registered and processed by the Panel<sup>393</sup>. From those the Panel recommended for investigation 18 projects. In each of these projects, the Panel found that the potentially affected local population could be suffering harm caused by the lack of compliance by the Bank with its own policies and procedures<sup>394</sup>. For the 18 projects recommended for investigation, the Board accepted only 13, and in two of them the investigation was limited to a desk study<sup>395</sup>.

Therefore, it can be argued that although a review mechanism by an internal organ of the Bank might be a possible solution to address issues before the lender, it will not be an efficient mechanism to address complaints against the borrower. Moreover, the assessment of the lender's and the borrower's accountability might suffer significant interference from political concerns.

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<sup>392</sup> In the existing mechanism of the Inspection Panel, the review body ensures compliance with the Bank's procedures and does not impose sanctions on borrowers. For further information see Bradlow,(1994), discussing one of the proposes for the Inspections Panel that were rejected, page 167. Also see Shihata, (2000) (b). More generally on incorporating binding decisions of international organizations see Martin Martinez, (1996).

<sup>393</sup> For early cases see Umaña (ed.), (1998.) at page 317.

<sup>394</sup> Ibid.

<sup>395</sup> For cases until 2002 see The Inspection Panel Report 2002 available at the World Bank web site; for recent cases see Panel Reports available at <http://wbln018.worldbank.org/ipn/>

## **4.2 Review Mechanism under Domestic Legal System**

The second suggestion would be an enforcement mechanism through the national system of the borrowing country. In this case two possibilities might be available: a formal judicial system, or a system of complaints within the governmental administrative level. In the first case, the Guidelines could require the borrower to provide suppliers with access to a formal judicial review. As in international trade agreements, the Guidelines could establish some minimum requirements where certain remedies and enforcement measures were available. Moreover, there could be requirements over the independence of the decisions of the review bodies and the establishment of some other procedural rules.

On the administrative level, there could be a review body, which would be independent from the implementing agency and which would have sufficient power to enforce corrective measures. Such administrative proceedings could either be the sole review mechanism or act as a pre-litigation forum where any decision could be appealed to the judicial system.

The arguments for and against both review mechanisms will be further developed in the subsections below. However, there are some concerns that would apply to any review mechanism set under the national legal system of the borrowing countries.

The first concern with both types of procedures is to define the objectives and rules that would regulate a review mechanism. Although it is recognised that the primary objective of any enforcement mechanism would be compliance with the World Bank rules, each member country might face different problems with compliance that might need to be addressed in a particular way. While some borrowers might have to tackle corruption related issues; other member countries might be more concerned with implementing measures that prevent discrimination of suppliers. Considering that the use of a review mechanism to enforce the Guidelines has a transitional character, and that an institution used to review procurement decisions made under projects financed by the Bank will probably be maintained after the completion of the project, it is reasonable to argue that member countries would have to consider setting a review mechanism that would address their concerns in a long-term basis. In this context, the Bank could impose

some minimum requirements and give some freedom to the borrower to implement a review mechanism that would better fulfil its needs.

However, many borrowing countries might not be prepared to engage in internal political discussion about reform of the national review mechanism at the time of signing the Loan Agreement. Even to comply with a minimum set of requirements the borrower would probably have to pass new national legislation and invest in institutional infrastructure. Given the budget constraints that countries borrowing from the World Bank usually face, it is unlikely that those countries would be able to commit themselves to such requirements.

It is possible, on the other hand, that the borrowing country might already have an enforcement system in place, or that they are reforming their national enforcement system in order to comply with international agreements<sup>396</sup>. If, for example, the borrower is hoping to apply to the World Trade Government Procurement Agreement<sup>397</sup> or to be member of the European Community<sup>398</sup> it will have to establish a strict regulation on the availability of enforcement mechanisms to aggrieved parties. The GPA, for instance, requires a non-discriminatory, transparent and effective mechanism to be in place<sup>399</sup>. Complainants must have the possibility of being heard by an independent review body (not necessarily a judicial body), which after following strict procedural rules will reach an impartial decision. Such bodies are also required to have sufficient powers to award interim measures, to correct any breach encountered or to award compensation for loss or damage suffered. Such requirements do not significantly depart from what is established by the European Community Directive on remedies, although there are some slight differences<sup>400</sup>.

If reform is not being pursued to enter an international agreement on procurement, it is possible that some national governments will reform their procurement system in order to comply

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<sup>396</sup> This might be a regional agreement or a plurilateral agreement .

<sup>397</sup> For the full text of the GPA Agreement see [www.wto.org](http://www.wto.org)

<sup>398</sup> For full text of the European procurement Directives see <http://europa.eu.int>

<sup>399</sup> For further reference on the GPA enforcement system see Arrowsmith, (2002) (b) Chapter 14; Arrowsmith, (2002) (c); Arrowsmith, Linarelli and Wallace, (2002); Davis, (1997); Footer, (1995).

<sup>400</sup> There is extensive literature on the EU procurement Directives and on the enforcement mechanism under the European context. For a general overview and further reference see Arrowsmith, Linarelli and Wallace, (2000), Chapter 12. For more specific issues see Arrowsmith, (1999); Pachnou, (2000); Brown, (1998).

with a ‘governance agenda’. As previously mentioned, the Bank has supported the reform of national legal systems, and in particular of the procurement legislation, and, together with other multilateral institutions, is planning to increase reliance on satisfactory domestic procedures in aid-funded projects<sup>401</sup>. Some guiding principles for assessing domestic systems have been identified, and the presence of an ‘effective way to submit protests’ pertaining to contract awards is regarded as mandatory<sup>402</sup>. Moreover, it was agreed that such a review procedure should be open to aggrieved parties at any time and should be submitted to an independent entity. Regarding remedies, the agreed principles establish that complainants should have the right to have their protest analysed before the award of contract, and if protests are submitted after the award, bidders could claim compensatory damages for the cost of bid preparation<sup>403</sup>.

The reform of national procurement systems based on the UNCITRAL Model Law is also supported by the World Bank<sup>404</sup>. The Model Law provisions on remedies and enforcement (Articles 52 to 57) provide some options to states reforming their procurement regulations, such as a review by the contracting agency, the review by a superior administrative authority or a judicial review<sup>405</sup>. None of those options are mandatory and the Model Law does not specifically states that an independent review is desirable. It also provides for general rules on procedures and remedies but it leaves to national states to decide on the extent to which those rules should apply. The weakness of those rules has been justified based on the sensitivity of this issue<sup>406</sup>. Many states were not keen on opening a route for challenges under procurement procedures since this could limit their discretion for the award of contracts and might disrupt the procurement process. However, it has been argued that the Model Law should include more strict provisions, based on the GPA, on the independence of the review body, on procedure requirements and on remedies

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<sup>401</sup> See harmonisation efforts in Chapter III.

<sup>402</sup> OECD, (January 2003) (c), Annex A.

<sup>403</sup> Ibid.

<sup>404</sup> Although there is not an open policy such statement can inferred by the way the UNCITRAL Model Law is used by the World Bank under the Country Procurement Assessment Reports.

<sup>405</sup> For further reference on the UNCITRAL Model Law see Hunja, in Arrowsmith and Davis (eds), (1998); Arrowsmith, Linarelli and Wallace, (2002); Westring, (1994); Arrowsmith, (2004) (a); Dischendorfer, (2003).

<sup>406</sup> For discussion over the possibilities see Arrowsmith, Linarelli and Wallace, (2000), Chapter 12.

available, at least as a suggestion<sup>407</sup>. This would help countries interested in joining international agreements in setting up procurement provisions that are seen as compatible with the standard required by those regulations. Moreover, the draft of such provisions might also help countries in drafting satisfactory domestic procedures based on the principles agreed by multilateral development institutions. Given the importance of enforcement provisions and the wide recognition that a harmonisation effort should be made in order to ease the burden placed - especially on developing countries - on applying several models and standards, some changes to the provisions of the Model Law are currently being considered<sup>408</sup>.

Another concern is whether the member state has sufficient qualified staff to deal with procurement issues. This uncertainty might be especially great in countries that have no tradition of dealing with procurement rules<sup>409</sup>. Economies in transition are a particular example of countries with a lack of trained procurement experts<sup>410</sup>. In those countries, procurement issues are very new and government employees, judges and suppliers are not used to the nuances of such procedures. Problems may also occur in countries that already have a tradition of dealing with procurement, as it is likely that they would be unfamiliar with the Bank's Guidelines. Deciding cases based on national procurement principles will not always match the analysis of the Guidelines based on the objectives that those rules are trying to achieve.

Therefore, it is possible to have courts or administrative tribunals all over the world interpreting the rules in completely different ways. The lack of uniformity would certainly bring enormous uncertainty to the system and could be harmful to the Bank's credibility and to the efficiency of the procedure. Moreover, diversity in the remedies available might bring inequality as suppliers might or might not have access to certain corrective measures, depending on the part of the world in which they are bidding.

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<sup>407</sup> See Arrowsmith, (2004) (a).

<sup>408</sup> A/ CN.9/539/Add.1 UN General Assembly at its 36<sup>th</sup> session in July 2003.

<sup>409</sup> In the context of Africa see Karangizi (2005) for the deficiencies in the procurement systems.

<sup>410</sup> For difficulties encountered in applying procurement rules in economies in transition see Trepte, in Arrowsmith and Davies (eds.), (1998).

On the other hand, where a lack of experts is a problem, the setting of a complaint mechanism through the national system could help to develop procurement skills. Both the implementing agency and the review bodies will be exposed to a series of complaints and concerns brought by suppliers and will need to determine, according to procurement principles, the best way to settle the issue. Therefore, on a long-term basis a review mechanism could help to increase the chances of procurement success, not only in projects financed by the Bank, but also in national purchasing.

Another concern that could be identified is the vulnerability of national judicial and administrative systems to political pressure. If the Bank is implementing projects in a member country where there is strong opposition to its rules, there is a risk that review bodies will not decide objectively but will follow political beliefs. The uncertainty brought to the procedure by such behaviour would harm suppliers' confidence in the review mechanism. If suppliers do not trust that they could reach a positive result, they would not bring a claim and risk entering into costly litigation. Moreover, where the responsibility of the lender would have to be determined, the Bank might fear that pressure coming from particular groups, which disapprove of the role of the international lending institutions, could interfere with the decisions. In those instances, the Bank might not accept the waiver of immunity towards the borrower's jurisdiction and fight against illegal decisions.

However it should be noted that, in theory, the risk of having an impartial judge or administrative tribunal that unlawfully relies on its political beliefs instead of basing the decision on the facts and the rules is run by every plaintiff in any judicial system. Controls to such behaviour, therefore, must be in place to secure the legitimacy of the system. If the system is recognised as having basic principles of independence and freedom of the decisions, there should be no argument against the reliability of its verdicts.

Concerns should also be directed at the legal cost of bringing a procedure. In fact, there is evidence that this might be one of the most important factors determining the decision of bidders

to bring a complaint<sup>411</sup>. If low costs could bring bidders to litigation even when they do not have a strong case; high cost could significantly deter bidders from bringing a breach to the attention of the relevant authority. Under the World Bank system, determining the right balance will pose a significant challenge since significant disparities might occur among member countries.

Finally, one last concern that should be dealt with is the perception of suppliers and other interested parties in the review mechanism. If bidders and potential bidders do not trust the system, either because of cultural beliefs that governmental institutions would necessarily be engaged in corrupt practices, or because of fear of being blacklisted, the whole process might not work as expected. Although perceptions and cultural beliefs are not always based on fact, they do influence the behaviour of the parties and any review mechanism needs to take them into account in order to be effective<sup>412</sup>.

#### 4.2.1 *Judicial Review*

The complaint mechanism based on a judicial system has the advantage of being already set up, at least most of the time. Neither the Bank nor the borrower would have to bear the costs of setting a new review body. The judicial system already in place would be used, with the provision that supplier would be guaranteed access to it. If this provision could mean an increase in the number of processes in the courts, it is unlikely that such an increase would significantly disturb the normal operation of the courts since they are usually designed to be able to deal with a significant number of cases.

However, one great concern over submitting procurement complaints to national courts is the amount of time taken to reach a decision. As the importance of timely decisions on procurement issues has been discussed above, it is worth mentioning that long delays in court decisions is one of the problems frequently identified in several countries<sup>413</sup>. Courts usually take

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<sup>411</sup> See finding on Pachnou (2005) (a).

<sup>412</sup> See Pachnou (2005) (a) referring to cultural legal practices as a factor influencing bidders decision to bring a complaint.

<sup>413</sup> Note for example that as mentioned above, many countries were concerned with the inclusion of judicial review mechanisms in the UNCITRAL Model Law, since it was argued that those could severely disrupt the procurement process. Arrowsmith, Linarelli and Wallace, Chapter 12. In order to minimise such disruption the Model Law imposes strict limits on review provisions. See Article 54.

several months, or even years, to come to a final decision. Studies undertaken in Latin American countries, for example, show that the average duration of commercial cases is two years, and it is not uncommon for complex commercial cases to take more than five years.<sup>414</sup> In Ecuador the average case takes almost eight years to reach a verdict<sup>415</sup>. The time for enforcement of judicial decisions may also vary significantly among countries. In a study carried out by the World Bank in 109 countries, it was identified that while in the richest quartile of countries it takes on average 64 days to enforce a decision on small debt collection, in the poorest quartile the average is 192 days, with some countries taking more than a year to enforce those judgements (450 days in Senegal)<sup>416</sup>.

If difficulties can arise from the lack of independence and credibility of the verdicts of review tribunals generally, such problems could be made worse by the way judicial decisions are reached in different jurisdictions. While in some countries a legal dispute might be dealt with by professional judges, in another country a similar dispute might be handled by a public official, who is not a judge or a lawyer, and in other cases by a jury of unpaid volunteers who lack any legal qualification<sup>417</sup>. Therefore, procurement decisions are not guaranteed to be heard by experts, or even by people interested in developing procurement skills, but could be decided by ordinary people who do not fully understand the complexity of the issues being raised.

A problem might also arise when attempts are made to enforce decisions against the borrower and the organisation. If damages are imposed, for example, it is possible that national mechanisms will be in place to enforce the decision against the borrower (being either the government or public or private enterprises). However, it is unlikely that national courts would have mechanisms in place to enforce the decisions against the Bank. If the Bank does not comply with the decision and there are no assets within the court jurisdiction, it is possible that the

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<sup>414</sup> Maria Dakolias, *The Judicial Sector in Latin America and the Caribbean: Elements of Reform*, World Bank Technical Paper No 319. World Bank, Washington, D.C. (1996) as cited in World Bank Development Report 2002, *Building Institutions for Markets*, page 120.

<sup>415</sup> Ibid.

<sup>416</sup> World Bank Development Report 2002, page 123.

<sup>417</sup> See the difficulty encountered by the World Bank study in classifying the word ‘judge’ in several member countries. World Bank, Washington, D.C. (1996) as cited in World Bank Development Report 2002, page 120.

decision will have to be enforced in foreign courts. If that is the case the plaintiff might have to try the case again and issues of immunity might be pleaded one more time<sup>418</sup>. Furthermore, the Bank's assets and governmental property might be subjected to immunity from seizure, making it hard, if not impossible, to enforce national judgements against their will<sup>419</sup>.

Probably a compromising solution would be to determine that review bodies would just to make recommendations. Those recommendations could be binding within the local administration and also enforceable towards private parties in the borrowing country. As to the lender, the recommendations issued by the review body might not be enforceable. However, their value should not be underestimated as they could bring accountability. In fact, the more open analysis of the procurement procedure by the external review body with specific powers to do it will expose the lender institution and its rules to an evaluation, and might even be able to prevent any deviations.

#### *4.2.2 Administrative Review*

Administrative tribunals have the advantage of being a quicker and less costly method of solving disputes. If a complaint is brought during the procedure or just after the award of the contract, an administrative tribunal could easily stop the procedure and investigate the complaint. This would make the system much more effective, increasing the chances of the government signing a profitable contract. Moreover, this kind of procedure can be settled to deal with a great number of complaints (which could eventually include sub-contractors complaints, if it is felt appropriate). In this context, a significant number of cases could help to develop procurement skills within the borrowing country, allowing governments to understand better the market expectations and demands.

Nevertheless, there are some difficulties with this system as well. Firstly, it is doubtful that in some countries an administrative body could have enough independence in its decisions. The Bank and suppliers could certainly fear the interference of the government in those agencies, creating, therefore, a lack of credibility in the decisions taken. A suggestion to overcome this

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<sup>418</sup> For an example of possible problems raised when enforcing foreign decisions see Zimbler, (1986).

<sup>419</sup> IBRD Articles of Agreement, article VII, Section 3. For analysis of this provision, see Chapter II.

problem is the introduction of Guidelines' provisions determining the functions and composition of the review body<sup>420</sup>. The review body could be established specifically to deal with complaints brought under procurement procedures financed by the Bank. Moreover, the Bank could be called to appoint some member of the tribunal (even if it is done from a list of names of government officials negotiated with the borrower). The interference from the Bank in the rules and requirements to be followed by the tribunal could bring the necessary credibility to the procedure. Moreover, as the review body would be set just to deal with complaints brought under the Guidelines, it would be assumed that people with reasonable experience in procurement financed by development institutions would be called to occupy a chair on the tribunal.

A second problem associated with an administrative tribunal is the enforceability of the decisions. As administrative tribunals will probably be composed of government employees, it is unlikely that such bodies would have the power to apportion the responsibilities of the borrower and Bank. However, administrative tribunals could work at the pre-litigation stage and their decisions could be revised either by national judicial bodies or by arbitration tribunals. In this context, the importance of administrative tribunals would be to deal with day-to-day complaints and enquiries about the legality of the requirements set in the procurement documents. Any breach could be rapidly corrected and if damages are due, the administrative verdict could be brought to judicial courts for enforcement or taken to arbitrators for the appropriate allocation of liability.

Finally, it is interesting to note that because the World Bank procurement system follows its especial rules those agencies might be needed only temporarily. Therefore, two considerations might be relevant: the length of time for which this agency should be available to hear complaints, and the use of the resources after they are no longer needed. The decision over the first issue has to consider that breaches of the rules might happen long after the contract has been concluded. The winning bid could change, for example, the material to be used in the construction to one of lower quality and price. Another example is the collusion of bidders and borrower

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<sup>420</sup> Note that it only applies to countries where no satisfactory review system is in place.

agents, where the contract is awarded to the lowest bid, but after the conclusion of the contract there is a readjustment of the price. In this context, excluded bidders might feel that their rights were harmed because their bids were excluded when compared with the criteria set up in the winning bid, without taking into account the new concessions. Therefore, it is probably worth leaving open the opportunity to bring a complaint for some time after the conclusion of the contract. The exact length of time, however, will have to be decided according to the complexity of the procedure (off the shelf products would need a review mechanism to be in place for less time than construction works).

The use of the resources when the agency is no longer needed will depend on the borrower's policy, but it is suggested that the establishment of competent and experienced procurement officials should be taken as a long term investment. This means that skills gained in those agencies could be extremely useful for governments in understanding the market and developing new and more adequate rules for the national procurement system.

To sum up, it is argued that national review procedures might be an important mechanism to address complaints against the borrower's conduct. However, at the moment there is evidence that national judicial and administrative enforcement mechanisms, especially in developing countries, are not prepared to deal efficiently with procurement complaints. The Bank is supporting the reform of such mechanisms and is willing to increase reliance on them, provided that they are effective. Therefore if such a mechanism is in place, bidders could have an independent and reliable system to bring actions against the borrower. Nonetheless, if during the analysis of the complaint, there is a need to address the responsibility of the Bank and to determine the accountability of the lender and the borrower, a national review mechanism will not be able to address these issues in a satisfactory way.

#### *4.2.3 Foreign National Courts*

Apart from the possibility of submitting a claim to the judicial or administrative system of the borrowing country, the Guidelines could determine that claims will have to be brought in a determined national court. Such provision is not uncommon in commercial contracts where

parties can decide to submit their claim to a pre-determined forum. In international projects financed by private parties, for example, the loan contract is often subject to the law and forum of either New York or Britain. Such a choice is not surprising as major creditors are usually banks based in New York or London and would put pressure on the borrower to accept the agreement being based within a system of law and forum which is familiar to them<sup>421</sup>.

In the procurement context, the Guidelines could determine that the law and forum of a particular member state, where public procurement principles have been applied for a long time, should be used to decide any complaints. This choice would solve some of the problems explained above. Firstly, the Bank, borrowers and suppliers would have confidence that the judgement would be pronounced by courts with experience in deciding procurement issues. The jurisprudence formed during the process would provide some certainty and predictability over the decisions and therefore claimants could more easily assess their chances when starting a proceeding. Moreover, courts in a foreign jurisdiction will not be subject to political pressures, as would the courts in borrowing countries. This would provide security to the parties over the independence of the court decisions.

However, other issues would have to be considered in those situations. The first concern is over the costs of bringing a claim. The World Bank finances projects around the globe and one of the objectives of its procurement rules is to develop the domestic industries of borrowing countries. Incipient firms will be lucky if they can afford the costs of bidding in a World Bank project. To provide for a review mechanism where claims would have to be brought in the courts of another country would be unfair on small and medium sized domestic suppliers who will not be able to afford the procedure.

There are some measures that could be taken to minimise the effect of foreign litigation. The Bank, for example, could expand the list of parties allowed to bring complaints to embrace trade associations, which would institute a complaint on the behalf of their associates. Moreover, if the resort to foreign courts is only part of a structured review mechanism where the complaint

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<sup>421</sup> Zimbler (1986) and Park, (1998).

has to go through several instances on the national level before being brought to the foreign court, than it is likely that only a few suppliers would feel the need to litigate elsewhere.

Another concern is towards domestic rules of the court where the case is being decided. Although most courts would accept jurisdiction to try the case if the parties have lawfully agreed to submit the dispute to that jurisdiction, some courts will have to follow national principles of *forum non conveniens*. Under the *forum non conveniens* doctrine, courts can decline jurisdiction when there is a clearly more appropriate forum to try the case. The fundament of the doctrine is to give jurisdiction to the forum that best suits the interests of the parties and the ends of justice<sup>422</sup>. Therefore, courts could decline to try the case even if there is a clear agreement determining the forum for the dispute.

Finally, it is possible that the decisions taken by a foreign court will have to be enforced in the borrowing country and/or by the courts of other countries. When the award has to be enforced by other courts, each jurisdiction will apply its own rules on recognition and enforcement<sup>423</sup>. Often such rules will require the fulfilment of certain conditions such as competence of the court of origin, fair trial, and the decision should be final and conclusive, etc<sup>424</sup>. Moreover, both foreign courts and the courts of the borrowing country will probably require the decision not to be in conflict with the idea of public policy or *ordre public*<sup>425</sup>.

Therefore, if the decision rendered cannot be enforced within the jurisdiction of the court where

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<sup>422</sup> Under English law, for example, the *forum non-conveniens* doctrine is adopted, for cases where the Brussels Convention on Recognition and Enforcement of Foreign Judgements does not apply. The highest authority for forum *non-conveniens* cases under English law can be found in *Spiliada Maritime Corp v. Consulex Ltd*, the *Spiliada* case (1986) 3 All ER 843. For cases where as time-barred, unfair trial due to political or ideological divergences, or long delay were regarded as factors against the ends of justice see the *Spiliada* case and *Oppenheimer v. Louis Rosenthal & Co AG* (1937) 1 All ER 23. For further explanation of the doctrine see Fawcett, (1995).

<sup>423</sup> There is a technical difference between recognition and enforcement. When courts recognise a foreign judgement this means that the case can no longer be litigated (*res judicata*) but it does not necessarily mean that the positive action determined in the judgement will be fulfilled. Enforcement will involve taking the necessary steps to fulfil the foreign judgement. Here we are more concerned with enforcement of foreign judgements.

<sup>424</sup> For detailed explanation of the nuances of each requirement see Wood, (1980); North and Fawcett, (1999); Hill, (1997); Collins in *Dicey & Morris in the Conflict of Laws* (2000).

<sup>425</sup> As an example, Article 17 of the Brazilian LICC provides that “the law, official acts and judgements of another country, as well as any declaration of intent, shall have no effect in Brazil when they are offensive to national sovereignty, public order and accepted customs”.

the case had been decided, there is a great chance that the costs of further enforcement proceedings will be a barrier to some complainants.

### **4.3 Arbitration Proceeding under International Legal System**

The third method suggested is an independent system where disputes are settled by arbitration. Some clear advantages of arbitration awards have been identified in the literature, namely, the finality of the decisions<sup>426</sup>, expert adjudication<sup>427</sup>, reduction of costs<sup>428</sup>, and flexibility of the procedures<sup>429</sup>. Lelewel also adds, “[n]ot political persuasion or coercion through the use of power in whatever form, but the application of legal principles in a judicial manner is the strength of international arbitration”<sup>430</sup>. Nonetheless, it should be considered whether those advantages will be relevant for disputes arising on procurement procedures.

Decisions granted by arbitrators are usually final and not subject to review. In procurement cases, where it is desirable to have a final decision as soon as possible so that the procedure could be continued, such a characteristic is a practical advantage. Borrowers, the Bank, and suppliers will be better off with a speedy award that cannot be litigated again than to be subjected to lengthy appeals.

As decisions on procurement issues demand experts who are experienced with the principles and objectives that public procurement rules aims to achieve, the formation of arbitral tribunals allows the Bank, borrowers and suppliers to rely on expert opinions over the claim. Moreover, considering the fact that the arbitration panel will be set up to deal exclusively with issues arising from the Bank’s Guidelines, it is possible that previous decisions on the interpretation of such rules will be taken into account, allowing uniformity and certainty to grow.

The choice of arbitration as a method to solve complaints can also be less expensive than some of the alternatives mentioned previously. In fact, commercial and insurance disputes have

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<sup>426</sup> Wood (1980), §3.4 (1).

<sup>427</sup> Ibid.

<sup>428</sup> Park (1998).

<sup>429</sup> Wood (1980), §3.4 (1).

<sup>430</sup> Lelewel, (1989) citing Carlson, *The Role of Arbitration in International Law* 264 (1946), reprinted in 1 The International Arbitral Process: Public & Private 5 (J.Wetter ed. 1979).

long been referred to arbitration as the parties consider that arbitration tends to reduce litigation costs<sup>431</sup>. Therefore, although costs would be still high for incipient firms of borrowing countries, it would be nonetheless, lower than litigation in some foreign courts<sup>432</sup>.

Generally, procedural rules established by arbitration tribunals are less complex than court proceedings and can be adapted to the particular requirements of procurement process. Wood, however, points out that speedy resolutions can be blocked if one of the parties is not prepared to co-operate<sup>433</sup>. In the context of World Bank procurement such an argument is of great magnitude since decisions against the Bank or the borrower can trigger sensitive political issues. However, arbitration can level the playing field so that parties do not feel they are being subjected to the other ‘hometown’ justice. Hence, decisions are more likely to be accepted and followed.

Arbitration, however, is not a mechanism free of problems. The greatest concern is towards the enforcement of arbitration decision either in the borrowing country or in other jurisdictions. To illustrate the complexity of this issue, Delaume provides an interesting example. When the Libyan American Oil Co. tried to enforce and award against Libya (Socialist People’s Libyan Arab Jamahiriya) in France, the United States, Switzerland and Sweden, each court provided a different finding. “In France the award was recognized, but attachments of Libyan assets in France were vacated for reasons of immunity from execution. In the United States, it was held that by consenting to arbitration, Libya has waived its immunity and that the court had jurisdiction to give recognition to the award. However, the court refused to exercise jurisdiction on the basis of the act of the state doctrine. In Switzerland, the Federal Tribunal, consistent with Swiss precedents, declined to exercise jurisdiction on the grounds that the sole contact between

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<sup>431</sup> Park (1998). Also see rules on International Trade disputes under the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules of 1976, the Rules of Conciliation and Arbitration of the International Chamber of Commerce (ICC), the Rules of the London Court of International Arbitration or the Rules of Arbitration Institute of the Stockholm Chamber of Commerce. Moreover, see the Convention on the Settlement of Investment Disputes between States and National of Other States (ICSID Convention), and correspondent literature including Delaume, (1988); Hirsch, (1993); Soley (1985), and Vuylsteke, (1974).

<sup>432</sup> Even in developed countries, there is evidence that the high cost of bringing procedures tends to prevent suppliers from complaining Pachnou (2005) (a).

<sup>433</sup> Wood (1980), §3.4 (1).

the transaction and Switzerland was that the seat of arbitration was located in Geneva, which was deemed insufficient to found jurisdiction. Finally, in Sweden, the Court of Appeal of Stockholm held that, by consenting to arbitration, Libya has waived its immunity from suit and execution”<sup>434</sup>.

Despite the controversies demonstrated in the example above, there are a number of bilateral and multilateral treaties now in force, which try to guarantee the enforcement of arbitration awards<sup>435</sup>. The most notable example of such treaties is the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Arbitration Convention)<sup>436</sup>, which requires the courts of member states to enforce written arbitration agreements and the resulting awards, subject only to a limited number of defences<sup>437</sup>. Since this convention has over one hundred contracting parties it is likely that borrowers, especially those signatories of arbitration conventions, would not oppose the enforcement of awards within their jurisdiction.

Although arbitration proceedings could be brought against both the Bank and national governments implementing the procurement, in practice, the arbitration decision against the Bank might encounter some difficulties. Firstly, it is worth remembering that the Bank is an international institution formed by both wealthy member countries (usually lenders) and poor ones (usually the borrower). Moreover, the Bank will frequently turn to the private capital market to raise fund for lending. Therefore, although the borrower will be willing to share the responsibilities with the Bank towards the winning complainants, the Bank will suffer pressure from other members and from lenders not to accept responsibility for failures in procurement procedures, as this will mean that money invested in the Bank could be used to pay damages to private parties. On the other hand, suppliers might exhort counter pressure through their member

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<sup>434</sup> Delaume, (1985).

<sup>435</sup> For example, the Inter-American Convention on International Commercial Arbitration (Panama Convention), 1975, 14 I.L.M. 336, the *Convention on the Settlement of Investment Disputes between States and National of Other States* (ICSID Convention) 1965, 575 U.N.T.S. 159, European Convention on International Commercial Arbitration, 1968, 484 U.N.T.S. 349.

<sup>436</sup> 1958, 330 U.N.T.S 3

<sup>437</sup> Those defences are related to procedural measures such as validity of the arbitration agreement, the opportunity to be heard and the limits of the arbitral jurisdiction. See Park (1998).

countries, since fair procurement opportunities could mean returning the capital invested in the Bank. Mediation for this conflict could be the limitation of liability of the Bank to a level that will reconcile the demands of the private capital market and the effective addressing of suppliers' complaints.

Summing up, arbitration seems to be an efficient way to address complaints since it allows complainants to bring actions against both the Bank and the borrower. Moreover, the arbitration tribunal could have the power to address the inter-relationship between the defendants. Nonetheless, given the increased emphasis that the Bank has been placing on developing efficient national enforcement systems in the borrowing counties and the difficulty in organising suppliers all around the world to lobby for an alternative mechanism such as arbitration, it might not seem realistic to believe that the Bank and borrowers will be willing to submit to an arbitral tribunal.

## **5 Conciliatory Suggestion**

No wholly satisfactory mechanism exists by which procurement decisions can be effectively reviewed. All mechanisms present advantages and disadvantages and the choice of which one should be implemented will be based on political reasons rather than legal ones. However, a suggestion can be advanced here taking into consideration the elements analysed in this work.

The actual system provides an informal mean to address complaints. Although such a mechanism presents some advantages, such as flexibility, it fails to address transparently and effectively all complaints and concerns that private parties might have regarding the Guidelines' provisions. Despite the supervisory role of the Bank, it is acknowledged that they might not be aware of individual incidents and violations which are experienced by suppliers in the course of the procurement procedure. This information is held by bidders unless they have the appropriate incentive to bring them into light. If it is considered that the procurement rules are aimed at achieving an economic and efficient contract, setting a complaint mechanism where violations can be corrected can improve the chances of the borrower to get a better contract. As Reich correctly points out, by providing sufficient incentive to participants in the procurement process,

“it can turn them into the most effective supervisors and potential enforcers and create a general deterrent effect that would dissuade bidders and agencies from infringing the rules”<sup>438</sup>. Therefore, given the important role that private parties can have in strengthening the enforcement of the Bank procurement procedures it is suggested that a formal review mechanism should be open to them.

In ascertaining which system should be used one would have to consider the possible defendant, the Bank, the borrower or both, and the relationship between them. It is also important to determine which factors should have priority. We have seen that time, cost, independence of the court, credibility and enforcement are some of the factors that might influence the decision. In this context, it is suggested that the review mechanism set by the Guidelines could submit complaints not to one, but to several review mechanisms, maximising the advantages that each of them could bring.

Firstly, suppliers could retain the right to address their concerns directly to the Bank in order to trigger the lender supervisory role. The Bank at its discretion could decide whether it should investigate the complaint. This would keep the line of negotiation between the lender and the borrower open and would provide suppliers, who are not prepared to litigate, with a means of review.

To bidders who could benefit from a formal review, the Guidelines should provide for a review panel. Such a panel would be constituted of nationals of the borrowing country and Bank staff. The members of the panel should be independent from the implementing agency and supervisory group. The presence of the Bank in the decisions and the independence of the panel would bring credibility to the decisions and would keep it away from internal political pressures. The involvement of nationals of the borrowing country, on the other hand, will help to develop procurement expertise within the country.

The decisions reached by the panel will not be binding on the parties but will serve as a means to correct mistakes. The panel will recommend any amendments necessary to make the

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<sup>438</sup> Reich (1999)

procedure comply with the Guidelines. If the borrower decides not to consider the recommendations, the panel could recommend that projects are not financed by the lender. The panel would not have attribution either to award damages to injured supplier or to attribute liability to the Bank or to the borrower, but to determine whether the rules have been followed. If the complainant does not agree with the decision, or if no corrective measures are still available under a conciliatory agreement, the matter could be taken to a national review mechanism if one is available.

A similar review mechanism is place under the European Community's external aid cooperation and procurement of technical assistance, services, goods and public work. Under that regime, dissatisfied tenders, contractors and promoters of development project can submit their grievances and claims to the European Ombudsman, denouncing the Commission's attitude as "maladministration"<sup>439</sup>. The European Ombudsman is not part of the European Judiciary but an independent body which is issued with the mission to detect and investigate reported cases of maladministration, and to correct them if possible. It does not make binding decisions, but after investigating the issue recommends corrections as appropriate and tries to settle the dispute amicably<sup>440</sup>. If instances of maladministration are found the EO makes a "formal finding of maladministration with a critical remark or issues a decision together with a draft recommendation to the Commission, formally inviting it to amend its practices and settle the case in line with his recommendation"<sup>441</sup>. Although the EO does not have the power to overturn the Commission's decisions or to order the suspension of contract award procedure or to impose interim measures, it has proved to be very helpful in instances where conciliatory settlement is still possible<sup>442</sup>.

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<sup>439</sup> The claimant must be a citizen of the Union or any natural or legal person residing or having a registered Office in a member State. Article 21 TEU and 195 TEC (Amsterdam Treaty).

<sup>440</sup> On the meaning of maladministration and for further information on the system operated by the EO see Kalbe, (2003). For general information on powers, function and procedures of the European Ombudsman see Peters (2005).

<sup>441</sup> Kalbe (2003).

<sup>442</sup> See cases examined by Kalbe (2003).

The European Ombudsman example shows that the importance of not-binding decisions should not be underestimated. In fact, the choice of bringing a complaint to a formal review body offers tenders and contractors an uncomplicated and inexpensive alternative. Even if it is possible to bring procurement complaints to courts in the borrowing countries, the settlement of a formal review body that aims to investigate complaints in the particular instances of procurement financed by the World Bank would bring much more certainty and credibility to the procedure. Moreover, any departure from the rules could be more easily detected and corrected in due time.

The way to implement this mechanism should be through the incorporation of the review panel mechanism into the Guidelines. This would legally relate the Bank and the borrower when they sign the Loan Agreement and subsequently link those two with the bidders through the bidding documents. To avoid problems of interpretation about the responsibilities of the Bank, it is better to determine clearly which decisions of the Bank could be challenged and the limit up to which liability will be accepted. Although it is accepted that the panel will not make binding decisions, it is important to allow it to issue formally reasoned findings and to make recommendations for corrections as appropriate.

As to the remedies available, the panel could have the power to recommend on a preliminary basis the suspension of the procurement procedure or even the holding of a non-objection notice before the investigation is completed. This would be different from the European example. However, this departure is justified since the Bank states that it will not finance goods, works or services that are procured without the observation of the Guidelines. However, it should be noted that the panel will carefully analyse the circumstances of each case so that the procedure will not be seriously impaired. The panel would not have the power to award damages or to set aside contracts

Apart from establishing a review panel, it is also suggested that the Bank should continue to provide incentives to borrowers to build into their national system some form of addressing

complaints<sup>443</sup>. The adoption of such a policy would help the borrower to develop skills to deal with future proceedings and to understand better the demands of the market. Moreover, an efficient enforcement mechanism might help to increase certainty that the rules will be followed at a national level. This, in the future, might lead to a market friendly environment where private investment could start to flow.

As an immediate consequence, an efficient national system could be an alternative to tenders, contractors and other creditors that feel that their claim would be better addressed at a national level, whether because wider remedies are in place or because their rights to sue are readily recognised (say for example that national law permits actions brought by sub-contractors). Moreover, for those cases where the recommendations of the panel were not followed, complainants would still have the alternative of having a formal complaint mechanism at a national level. It is important to note that in those cases the claimant will bring action against the borrower only.

However, it is recognised that many borrowing countries do not at present have adequate national systems. In order to implement those, governments might have to overcome internal political pressures and be able to gather wide consent so that new national legislation could be approved. Given the difficulties of achieving such reforms it is supposed that weak systems will still remain for some time. If in the future the vast majority of borrowing countries are to have an efficient national system it can be envisaged that a different approach for the enforcement of the Guidelines might need to be considered, and a greater emphasis placed on addressing the accountability of the lender.

To sum up, it can be said that although the implementation of a dispute settlement at a national level could be extremely beneficial, at the moment it should not be a substitute for the panel review set by the Guidelines, but an alternative. The parallel running of those two types of mechanism will, on one hand, improve the system actually in place by increasing the confidence

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<sup>443</sup> In fact, as commented before, the Bank, under its good governance agenda, has insisted on the establishment of a review mechanism when providing funds for the reform of national procurement systems.

of suppliers and, on the other hand, help to develop a sustainable national procurement system to the future. In this context, the creation of an enforcement system in the procurement field will help to improve the role of the Bank as a financial institution concerned with the development of its members, since it will offer lower risks to the opportunities opened to private firms as well as better quality of government contract. Moreover, the mere existence of an enforcement mechanism will reduce corruption and bad procurement practices in the borrower country, therefore increasing confidence in the market.

## **CHAPTER VI – SECONDARY POLICIES IN PUBLIC PROCUREMENT – AN OVERVIEW**

### **1 Introduction**

When regulating public procurement, national governments might seek to achieve several objectives. Some of those objectives might have a commercial justification, such as getting the most advantageous contract for the lowest possible price, or an efficient system that provides timely and cost effective responses for its needs<sup>444</sup>. However, not only economic concerns will come into play when preparing a national public procurement system. Public procurement practices, as opposed to procurement in the private sector, are often seen as an instrument to achieve public policies<sup>445</sup>. Given the great size of the procurement market, expressed by percentage of GDP, some governments might use procurement to address other concerns, such as to promote the development of businesses owned by disadvantaged groups, or the industrial development of a particular region, the implementation of environmentally friendly practices, etc<sup>446</sup>. All those policies might be seen as legitimate since commercial objectives are being sacrificed in order to achieve other important targets.

This Chapter will present some examples of secondary policies and methods of implementation commonly used by national governments. The Chapter also discusses the effectiveness of the use of such policies and the alleged justifications underlying some of those policies. The need for setting standards of control, such as the need to have a transparent system

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<sup>444</sup> For a deeper analysis of procurement objectives see Arrowsmith, Linarelli and Wallace, (2000), Chapter 2. Also see Schooner (2002). For specific objectives see Brown, (1999) comments on APEC non-binding principles of value for money and open and effective competition; on probity see Westring (1996); Anechiarico and Jacobs (1996); Rose Ackerman (1999); Wittig (2001); for transparency concerns see Kelman (1990); Schooner (2001); Arrowsmith (1998) (b); OECD (2003) (b); for concerns on corruption and transparency in developing countries see DeAses (2005) among others.

<sup>445</sup> There is extensive literature on the use of secondary policies in procurement. For particular examination and comments on this issue see Arrowsmith, Linarelli and Wallace, (2000), Chapter 5; Arrowsmith, Meyer and Trybus, (2000); Arrowsmith, (2002) (b) Chapter 13, McCrudden, (1998), ch. 12 in Arrowsmith and Davies (eds.); McCrudden, (2004); Bovis, (1998); McCrudden, (1999); Nielsen, (1995); Kunzlik, (2003) (a) and (b); Carrier (1997) (a) among others.

<sup>446</sup> For an analysis of the procurement market see Audet, (2002). In the European context also see *Green Paper on Public Procurement in the European Union: Exploring the way forward* (European Commission, 1996).

that can be evaluated and enforced will also be considered. The control exerted over the freedom of national governments in setting secondary policies into the procurement rules imposed by international agreements will also be looked at. A brief exam of the UNICITRAL Model Law will also be carried out, since it has been used as the starting point of by some national governments in formulating or reviewing their procurement systems.

It is important to note that this Chapter will not aim to carry out an extensive analysis of the different policies and methods of implementation, or to give a full account of the international rules as a means of limiting national regulations. The objective here is merely to provide some examples taken from the literature on how different procurement regulations have responded to secondary policies issues<sup>447</sup>. It is expected that this first part will provide the basic framework for the analysis carried out in later Chapters, where the possibility of applying such polices under financed projects will be explored.

## **2 Secondary Objectives in Public Procurement – National Policies:**

Governments might seek to implement several policies through procurement regulation. Such policies could reflect a development policy, an environmental or a social agenda, or any other governmental concern<sup>448</sup>. This section will explore some examples of substantive policies commonly promoted through public procurement, and the consideration behind them.

### **2.1 Industrial policies**

#### *2.1.1 General discriminatory policies to favour domestic industry*

Many developed and developing countries adopt protectionist policies directed at promoting national industrial objectives<sup>449</sup>. Such policies might have several objectives. Firstly, they might be aimed at protecting the national industries in general against foreign competition. In those cases states usually adopt measures that will displace the natural advantage of the

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<sup>447</sup> Arrowsmith, Linarelli and Wallace (2000) has provided some of the examples referred in this Chapter and was seen as a starting point for many of the considerations drafted here.

<sup>448</sup> For an example of other policies pursued by procurement regulation see Priess and Pitschas, (2000) (a).

<sup>449</sup> For a deeper explanation on such policies see Arrowsmith (2002) (a) and Arrowsmith, Linarelli and Wallace (2000).

foreign bidder and shift the contract towards national competitors. Examples of such policies could be found under a number of procurement regulations. An example of protectionist measures taken strictly can be found in the Chinese procurement regulation, where government shall buy nationally unless goods, construction and services are not available or cannot be acquired at reasonable commercial terms and conditions<sup>450</sup>. On the other hand, more liberal procurement regulations will provide for preference to national producers, but only if it incurs no additional cost for the government. In Brazil, for example, the procurement regulation establishes that under equal conditions, as an untied clause, preference must be given to goods and services produced in Brazil or, produced or rendered by Brazilian firms<sup>451</sup>. Other states adopt quite a complex set of regulations providing for a variety of methods for protecting domestic industries. The United States, for example, under the “Buy American” legislation, uses procurement to protect the domestic industry by setting aside some contracts, by restricting the origin of some products purchased by federal agencies, or by allowing foreign bids to be rejected on the basis of national interest or national security, etc<sup>452</sup>.

The justification for such policies is usually based on the increased domestic employment opportunities and profits to the national industry<sup>453</sup>. Moreover, governments might be subjected to political pressures by national industries which would lose a relatively large economic support<sup>454</sup>. However, liberal economic theory shows that such policies might be detrimental not only to global welfare, by shifting the resources away from the industry that has a comparative advantage, but also to the domestic economy of the country applying such measures<sup>455</sup>. The effect of such policies is that governments will pay higher prices and shift resources to the private

<sup>450</sup> For a general explanation of the Chinese procurement law see Wang (2004).

<sup>451</sup> Federal Law 8666/93 article 3 § 2º. For comments on the Brazilian public procurement legislation see Levy (2001).

<sup>452</sup> For US policies see Golub and Fenske (1987); Arrowsmith, Meyer and Trybus (2000); Wittie (2002); Eyester (2002). Also see below for US discriminatory policies in favour of particular groups.

<sup>453</sup> On this respect see comments on Carrier (1997) (a).

<sup>454</sup> See Hoekman and Kostecki (1995) and Deltas and Evenett in Hoekman and Mavroidis (1997).

<sup>455</sup> For comparative advantage theory, see Jackson (1997), Sykes (1998), Trebilcock and Howse, (1999) and Lowenfeld (2002). Also see Schuman (1994) and McGinnis and Movsesian (2000) for different view on the impact of trade liberalisation at a local level. For explanation of the economic theory on the context of public procurement see Arrowsmith (2002) (b) and Arrowsmith, Linarelli and Wallace (2000).

sector and, in many instances, such policies might also fail to achieve their alleged objective<sup>456</sup>. On a long term basis, this support might even have an adverse effect since industries which are not exposed to competition will not be stimulated to improve their production methods.

### *2.1.2 Protection of a particular industry or sector*

Discriminatory policies based on industrial development might also be drafted to promote the development of a particular industry or sector. For example, the small business sector is often seen as important to economic growth and therefore governments use procurement policies to help such firms in bidding for contracts<sup>457</sup>. The alleged objective of such policies is to give the opportunity to potentially competitive suppliers to finance the development of their industry, which would not otherwise be available in imperfect markets<sup>458</sup>. Policies protecting a particular industry might also be justified by the amount of investment needed and the historical strength enjoyed by some competitors. This is the case for example with the effort made by the Airbus Consortium to compete with Boeing<sup>459</sup>. Such industries are seen as key to the development of the domestic industry and governments might wish to sacrifice economic objectives in order to guarantee the market for the goods produced during the first few years<sup>460</sup>.

The protection of particular industries is often defended by developing countries on the grounds of support of ‘infant industries’. Economists, however, have doubted the efficiency of trade restrictions as a policy to enhance the development of new industries<sup>461</sup> for several reasons. Firstly, governments are usually not prone to choose a winning sector to support but might more easily bend over the lobby of non-competitive industries<sup>462</sup>. Determining the period of time when the industry should receive the benefit might also be a problem since industries might claim infancy for longer than they actually need. Moreover, the imposition of discriminatory measures might trigger other trade partners to impose restrictions on the access of their markets, a cost that

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<sup>456</sup> Trionfetti (1997) and Mattoo (1996).

<sup>457</sup> Clark and Moutray (2004).

<sup>458</sup> Krugman (1987).

<sup>459</sup> See McIntyre (1992).

<sup>460</sup> Arrowsmith, Linarelli and Wallace (2000) also refer to this example at page 246.

<sup>461</sup> See argument of “infant industry” as explained by Jackson (1997).

<sup>462</sup> On the tension between domestic interests and free trade Shuman (1994) and McGinnis and Movsesian (2000).

would be felt not only by the developing industry, but also by other domestic competitive industries<sup>463</sup>. Finally, help granted by other methods such as training and subsidies might be more efficient than protection from competition<sup>464</sup>. Moreover, such methods might be seen as more transparent as direct cash is going to the protected industry<sup>465</sup>.

The same line of reasoning can be used for measures applied as safeguards against the free trade effects suffered by some specific industries<sup>466</sup>. In those instances the government might want to help national industries which are suffering significant decline because of international competition, but which could still make reforms in the process of becoming competitive. Those measures are also, in theory, limited in time since it is expected that the elected industry will eventually recover.

One particular industry that often receives protection is the defence industry<sup>467</sup>. Governments usually advocate that for reasons of national security defence procurement should be restricted. Although this could be seen by trade partners as a legitimate concern<sup>468</sup>, there is a risk of over restricting the market<sup>469</sup> and having a lot of public money shifting to private hands through defence procurement contracts. The limit of what should be regarded as national security is not precisely drafted in many jurisdictions and the lack of transparency on those choices might bring further problems<sup>470</sup>.

### *2.1.3 Supporting the development of a particular region*

The development of a particular region is also another industrial policy commonly pursued by national governments. In Italy, for example, the government seeks to support a declining region called Mezzogiorno by imposing on all public bodies and authorities the

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<sup>463</sup> See the imposition of procurement trade restrictions as a bargain tool for trade negotiations in Arrowsmith, Linarelli and Wallace (2000) and Arrowsmith (2002) (b).

<sup>464</sup> See Jackson (1997).

<sup>465</sup> See McGinnis and Movsesian (2000).

<sup>466</sup> For the legality of safeguard measures in the context of free trade see Jackson (1997).

<sup>467</sup> For exclusion of national security concerns from the free trade theory see Kenen (1985).

<sup>468</sup> Defence procurement have been largely excluded from many trade agreements including the GPA and the European procurement directives. For more information see the relevant section in this Chapter.

<sup>469</sup> Carrier (1997) (a) has noted that in a strict approach a number of industries and services could be seen as important to national security.

<sup>470</sup> For defence procurement in the EC see Trybus (2000) and (2002).

obligation of buying 30% of their supplies from agricultural undertakings and small business established in that region<sup>471</sup>. Although this policy was found to be in conflict with the EC Treaty, policies such as this are not uncommon in other jurisdictions<sup>472</sup>.

The alleged objective of such policies is the improvement of welfare distribution throughout the country<sup>473</sup>. Moreover, it could be used to improve the standard of living and income of citizens of declining regions<sup>474</sup>. However, there is doubt over the use of such procurement to achieve such objectives since other forms of economic interference such as direct investment, tax incentives, training for low-skilled people, etc. could have a much more longstanding effect.

#### *2.1.4 Other discriminatory measures*

Procurement measures could be taken in order to pursue a number of industrial objectives. Governments might impose discriminatory measures alleging balance of payments problems<sup>475</sup> or using restriction as a means of putting pressure on trade partners to open up their markets<sup>476</sup>. Several other policies and explanations could be drawn from a number of jurisdictions. However, there are great controversies over the efficiency of the use of procurement in pursuing those policies<sup>477</sup>. Could those interests not be better served by the imposition of tariffs, the granting of subsidies, tax relief, grants for research etc? Moreover, even if those are seen as legitimate policies, do they really produce a trade effect that justifies the costs of running such policies? The answer to those questions is not clear in the literature, but what is certain is that a number of states systematically include discriminatory provisions in their procurement regulations alleging industrial concerns.

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<sup>471</sup> Case 31/88, Du Pont de Nemours Italiana v. Unita Sanitaria Locale No. 2 di Carrara [1990] ECR I-889.

<sup>472</sup> The United States also have policies directed at “labour surplus areas”. See Federal Acquisition regulation (FAR), Part 20. For comments see Arrowsmith, Meyer and Trybus (2000).

<sup>473</sup> Schooner (2002) citing wealth distribution as one common procurement objective.

<sup>474</sup> For historical reference on the schemes in the European context see Bovis (1999).

<sup>475</sup> For trade restrictive measures based on balance of payment problems under the WTO see Jackson (1997).

<sup>476</sup> See Arrowsmith (2002) and Arrowsmith, Linarelli and Wallace (2000).

<sup>477</sup> See Arrowsmith (1995); Arrowsmith (2002) (a).

## 2.2 Environmental policies

### 2.2.1 Policies associating government purchasing with best practices

In recent years a number of governments have established policies that are drafted to ensure that goods, works and services purchased are, as far as possible, the least damaging to the environment<sup>478</sup>. Such policies would include among many others restrictions on the level of pollution to air, water and land, protection of animal life, protection of forests, restrictions on the levels of noise pollution etc. In the US, for example, federal procuring authorities are required to take into account some environmental policies, such as use of recovered material, reduction of hazardous waste, etc, when designing product and services specifications<sup>479</sup>. In European procurement, environmental criteria could be used in the selection of bids if they relate to the subject matter of the contract<sup>480</sup>.

As will be discussed further below, policies could be implemented through several methods. They might, for example, be directed at the goods, works or services being purchased by establishing an environmental requirement at the specification stage, or impose a number of contracts being directed to the purchasing of environmentally friendly products. Moreover, environmental requirements could be imposed generally on contractors by restricting access to government contracts to firms that comply with certain environmental standards. Environmental requirement could also be imposed on the production methods by determining that governments will only buy products that have been produced by a certain method that least damages the environment<sup>481</sup>. Many states also impose environmental requirements that should be met during

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<sup>478</sup> For examples on domestic social and environmental policies see Arrowsmith, Meyer and Tribus (2000). For examples on the possibility of using procurement to address environment under international trade agreements see Kunzlik (2003) (a).

<sup>479</sup> See for example, US EPA 2001. Environmentally preferable purchasing guide: greening your purchase of electronics. EPA 742-B-01-005. On US environmental policies see case study by Li and Geiser (2005).

<sup>480</sup> See case law on *Concordia Buses Case C-513/99, Concordia Bus Finland v. Helsinki*, [2002] ECR I-7213, which will be further explored below. For more recent development of the EU legislation see Arrosmith (2004) (b) and Arnould (2004).

<sup>481</sup> See below for discussion on the impact of such policies on foreign government policies.

the performance of the contract<sup>482</sup>. Under those polices contractors are obliged, for example, to achieve a low level of pollution or to keep noise to a certain level.

The adoption of policies directed at the protection of the environment could be justified on several grounds. Firstly, there could be national and international political pressure for improving environmental practices in some countries<sup>483</sup>. Environmentalists, civil society and industries that have already invested in environmentally friendly practices might demand the inclusion of environmental requirements in government purchasing since this might create a price disadvantage for them<sup>484</sup>. Secondly, governments might realise that there could be future economic costs if best practices are not taken into account<sup>485</sup>. For example, not buying recycled goods might incur the future cost of having to deal with more waste. Buying goods that are produced by a certain method whereby chemical waste is dumped into rivers might bring with it the future cost of having to clear contaminated rivers. In this context, the adoption of environmental requirements in procurement is seen as a means to support and stimulate suppliers to change to more environmentally friendly techniques. Moreover, in jurisdictions where a great emphasis is placed on the moral effect that governmental behaviour might have on the private sector, governments might not want to be seen to be entering into a contract with a supplier known to have a poor record for environmental performance, or seeking to buy goods that are not environmentally friendly. The belief that governments should set an example might have an important political effect and the benefits in the long term might be worthwhile<sup>486</sup>.

There are, however, potential costs for the implementation of such policies. Those costs will include not only the possibility of paying higher prices for goods with the same performance,

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<sup>482</sup> See European Commission view that environmental measures relating to the execution of works and services can be taken into account. Commission of the European Communities, *Commission interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement*, COM(2001)274 Final July 4 2001.

<sup>483</sup> *Environmentally Preferable Procurement Meeting*, Co-sponsored by World Bank, Asian Development Bank, United Nations Environmental Programme, United Nations Development Programme, Consumer's Choice and Global Ecolabeling Network available at <http://www.consumerscouncil.org/green/procurement.html>. Melser and Robertson (2005); Chapman (1998); Eyester (2002); Sands (1998).

<sup>484</sup> See Jackson (1997) for trade restrictions based on environmental factors.

<sup>485</sup> For analysis of win-win situation see Marron (2003).

<sup>486</sup> For impact of green public procurement in the market see Marron (2003).

but there could also be the hidden cost of restricting access, or discouraging potentially good suppliers from bidding. If strict environmental requirements are set, suppliers that do not adopt the required technology will not be allowed to bid, despite their overall environmental performance. In the international arena it could potentially restrict trade from foreign suppliers which are not prepared for the standards applied by the purchasing country<sup>487</sup>. Moreover, governments will have to take into account the costs of running and enforcing the policy. This might be particularly difficult if production is carried out in a foreign country. As will be explored further below, the balance of the costs versus the benefits of such policies will vary significantly depending on the method used for their implementation. For example, by imposing a standards method of production, governments might lose the possibility of having the private sector working to provide innovative ideas for the protection of the environment. Thus, the less open is the method, the greater is the cost of the policy.

### *2.2.2 Protection of the national environment vs. Transnational policies*

Another sensitive implication of such policies is the fact that they might interfere with the environmental policies of another government and impose additional burdens on suppliers<sup>488</sup>. Say, for example, that a major purchaser of coal decides that it will only use coal produced with a lower level of noxious smoke emissions. This might significantly influence the overall production of another country which exports coal. Moreover, suppliers will have to go through a certification procedure in order to ascertain that the coal being sold meets the requirements. Are those policies legitimate, or do they reflect a discrimination not necessarily related to an environmental or health concern<sup>489</sup>?

The EU regulation, for example, restricts this kind of qualification conditions and establishes that environmental conditions must relate to the subject matter of the contract<sup>490</sup>.

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<sup>487</sup> See OECD (2000) (b) for comments on outdated standards. Also see further below for discussion on technical standards under international agreements.

<sup>488</sup> For addition comments and examples see the GPA section on the extra-territorial effect.

<sup>489</sup> See comments on the debate over the effect of pollution and regulation of the manufacturing process in Jackson (1997) at 235.

<sup>490</sup> The limits of such measure under the European regulatory regime will be discussed.

Under the GPA, however, the issue is not settled and conditions related to the delivery or production methods might be taken into account, provided that they are not discriminatory.<sup>491</sup>

The difficulty with environmental policies lies in the fact that many measures will have an effect, not just nationally, but also internationally. If we think of a simple example such as buying recycled paper, we can see that locally this could benefit the community by, for example, diminishing the waste being dumped, lowering the emissions of methanol, and therefore lowering the risk of explosions in dump sites, etc. International benefits will also be felt since this will, for example, lower the greenhouse effect and prevent more forests from being cut. Therefore it is difficult to establish the costs and benefits of such policies and the impact they could have on world practices.

It is interesting to note that such policies sometimes do not impose additional requirements for procurement contracts, but just reflect other existing domestic legislation. Thus, for instance, suppliers caught engaging in unlawful environmental conduct might be excluded from government contracts. Such exclusions are not necessarily linked to the ability of the contractor to perform the contract and might impose a punishment for environmental breaches. Those policies might be applied without having any trade restricting effect, provided that foreign bidders do not have to prove that they comply with the standards set by the national regulation of the procuring country.

### **2.3 Social Policies**

Public procurement is also used under many jurisdictions as a means of implementing a wide variety of social policies. This will often be directed at minority or disadvantaged groups in order to promote business opportunities at favoured conditions. This is, for example, a major objective of the procurement policy in South Africa which uses procurement to promote the development of groups who before the end of the apartheid system were discriminated against<sup>492</sup>. Some policies are also directed at the protection of human rights, not only in the domestic sphere,

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<sup>491</sup> See discussion under the GPA sections 3.2.5 and 3.2.10.

<sup>492</sup> See note 515 for more information on the South African system.

but also internationally. In the US, for example, the state of Massachusetts included in its procurement regulation restrictions to firms doing business with Myanmar/Burma given this country's poor human rights record<sup>493</sup>. Social concerns will also include gender equality policies<sup>494</sup>.

Social requirements are also usually associated with certain policies directed at the promotion or guarantee of labour standards<sup>495</sup>. Those could either be directed at the conditions of labour during the performance of the contract or the workforce used in the implementation of the contract. Moreover it might include some of the elements of the policies mentioned above and be directed at the contractors' general behaviour by, for example, improving the employment conditions of particular groups or requiring that contractors in general follow human rights standards<sup>496</sup>. Moreover, they could go beyond general legal requirement and require that contractors pay fair wages either to workers directly involved with the contract, or else have a general fair wages policy.

As with environmental policies, social policies are implemented by means of several methods. The South African system mentioned above, for example, was originally implemented mainly through preferences in contract awards but now has increasingly used set asides, as discussed further below. Set aside have also been part of the procurement policy of the US, which permits some portion of government contracts to go to small business owned by ethnic

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<sup>493</sup> Act Regulating Contracts with Firms Business with or in Burma (Myanmar), ch. 130, 1996 Session Laws, Mass. Gen. Laws Ann., ch.7 223 (west 1997). The European Community and Japan questioned this measure under the WTO/GPA Agreement see *United States – Measures Affecting Government Procurement – Constitution of the Panel Established at the Request of the European Communities and Japan* (21 October 1998, WT/DS88/4, WT/DS95/4). However, the law was considered unconstitutional by the US Supreme Court (*Crosby v. National Foreign Trade Council* 120 S.Ct.2288, 2000) and the panel never gave its ruling. For discussion on this case see Linarelli, (2001) (a). For discussion on the WTO *Burma/Massachusetts* case see McCrudden (1998), McCrudden (1999), Oram, (1998), Priess and Pitschas, (2000) (b), Moritsugu, (2002), Hellwig (2000), Cleveland (2001), Baker (2000).

<sup>494</sup> For a discussion of gender policies under the European context see Tobler (2000).

<sup>495</sup> See discussion on labour conditions and international trade in McCrudden (2000) and (2004); Bovis (1998) (a); Nielsen (1995).

<sup>496</sup> The US for example has 'affirmative action' requirements which are implemented through contract compliance. Under the affirmative action policy contracts are required to take a series of steps to adopt policies related to the employment of people from the target group. See Moris (1998) and a review of recent developments in Fatterman (2004). Also see below for restriction brought by the Supreme Court Decision in the *Adarand* case.

minorities<sup>497</sup>. Contract compliance is also another method of adopting secondary policies directed at social objectives. In the US, for example, an affirmative action policy applied through contract compliance has been subjected to wide debate<sup>498</sup>. Also under EC law, the application of social criteria as a contract condition has been accepted by the Court of Justice, and more recently has been incorporated into the new European procurement directives<sup>499</sup>.

Reasons behind social policies sometimes coincide with some of the justifications for the implementation of environmental policies. States' desire to promote higher standards, to be associated with best practices, to encourage others by example, are some of examples of legitimate reasons<sup>500</sup>. Moreover, the behaviour of one state could influence the practices in other countries which are trade partners and therefore contribute to the improvement of human rights and labour conditions in the world<sup>501</sup>. In addition, states might be concerned that bw prices should not be paid at the expense of environmental deterioration or poor labour practices.

The successful implementation of social polices, however, might encounter several difficulties. For instances, preferential treatment given to a particular disadvantaged group might delay its integration into the competitive market, or else might trigger even more tension among ethnic groups. Moreover, disadvantaged groups could be used as tokens and their development could be retarded by strong economic rivals. Following this debate, the US Supreme Court, for example, has imposed a significant limitation on the affirmative policy mentioned above by decreeing that any such policy has to be evaluated and justified<sup>502</sup>. If the general economic rule of giving all interested suppliers a fair opportunity to compete will not apply there should be a direct

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<sup>497</sup> See Small Business Act of 1953, § 201, 15 U.S.C. § 631.

<sup>498</sup> Government contract requirements have suffered significant review after the *Adarand* case in which the Supreme Court stated that any such requirement was subject to "strict scrutiny". *Adarand Constructors, Inc. v. Pena* 515 U.S. 200, 237 (1995). This case have been commented and cited by a great number for legal papers, see for example, Eades (1996). For a more recent review of the legal battle and debate over race-based requirements see Fetterman (2004) and Sabin (2004).

<sup>499</sup> See decision of the European Court of Justice in *Beentjes* case. For a brief outline of the new Directives see Arrowsmith (2004) (b) and Arnould (2004). For discussion on the inclusion of other social polices such as gender related clauses in the European procurement directives see Tobler (2000).

<sup>500</sup> See Priess and Pitschas (2000) (b)

<sup>501</sup> See discussion on the *Burma/Massashussets* case mentioned above in particular McCrudden (1999) and Cleveland (2001).

<sup>502</sup> See *Adarand Constructors v. Pena*, 115 S.Ct. 2097 (1995). For comments see Eades, (1996). For more recent debate over the Court ruling see Fetterman (2004), Weeden (2002).

effect on the discriminatory effect of the policy and the social outcome that it is aiming to achieve. In this context, a systematic evaluation of the policy could minimise the risk of failure, but it should be noted that many jurisdictions do not provide for a robust evaluation scheme<sup>503</sup>.

## 2.4 Other policies

Procurement is commonly used by many states to enforce a series of other policies. It is used to combat crime, to combat corruption, to impose tax and social security legislation, etc. The policies enforced through public procurement could be based on national legislation or international obligations. The EC, for example, decided with the new procurement directive to require member states to exclude from participation firms convicted of participation in criminal organisations, corruption, fraud and money laundering<sup>504</sup>, although each member state will have some discretion on the implementation of such requirement. The same piece of legislation also foresees that the lack of payment of tax duties might disqualify firms from competition.

It is difficult to measure whether or not the enforcement effect pursued by such policies is in fact being achieved<sup>505</sup>. If the policy is directed at combating corruption, for example, it will have to define whether only firms or persons themselves convicted of corrupt practices would be excluded, or whether any firms associated with them would also be excluded. If an extensive analysis is required it is possible that good suppliers might not be willing to participate in the bidding process since the cost of the documentation to be produced will be high. If, on the other hand, a more simplistic analysis is made, the risk of having an ineffective policy to combat corruption will increase. The same could happen with policies aiming to secure social security legislation since in theory contractors might subcontract the workforce for the contract. It is, therefore, more realistic to expect that the enforcement of such secondary policies through procurement will have more of a moral effect than an effective impact on the alleged objective.

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<sup>503</sup> See Arrowsmith, Meyer and Tribus (2000). Also see difficulties found by Siemens (2003).

<sup>504</sup> Article 45 (1) New Public Sector Directive. For comments see Arrowsmith (2004) (b) and Arnould (2004). For more detailed information on the EC system see Arrowsmith (2005).

<sup>505</sup> See this argument as explained in Arrowsmith (2004) (b) in the context of the EC Directives.

## **2.5 Methods of implementation**

There are several ways to implement secondary policies in public procurement. Different procurement systems will choose to adopt one or more of the methods indicated below, depending on the objectives of the system and the weight attached to the policy to be pursued. Each method of implementation will have its advantages and disadvantages<sup>506</sup>. The right choice will depend on how much of its commercial objectives the government is prepared to commit.

### *2.5.1 Set-aside*

Governments might set aside some of their contracts or some portion of the value of the procurement to the target objective. For example, the procurement regulation might determine that the contracting agency must reserve a percentage of its contracts for disadvantaged minorities, or restrict the competition to firms owned by the targeted group. This method can also be used to achieve industrial objectives by setting aside a portion of contracts to national firms or to firms situated in underdeveloped regions.

It is important to note that the ability of the contractor to compete on procurement proceedings will be analysed at the qualification stage. However, set- aside policies differ from the qualification condition since in the latter, the contractor is able to adapt its behaviour to meet the requirement, while in the former, policies are directed at a particular group, leaving other competitors with no possible means to compete.

Implementation through ‘set-aside’ policies is usually adopted when the government wants to show the results of the policy quickly. By separating a portion of contracts it is easier to show how much money is being disbursed to the target group or in favour of the target objective. Despite the doubts over its efficiency, set-asides are commonly used in many jurisdictions. In the United States, for example, under the Small Business Act<sup>507</sup>, a portion of federal government

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<sup>506</sup> For further explanation on the advantages and disadvantages of each method see Arrowsmith, Meyer and Tribus, (2000), Arrowsmith Linarelli and Wallace (2000) for implementation of environmental concerns see Kunzlik (2003).

<sup>507</sup> Small Business Act of 1953, § 201, 15 U.S.C. § 631.

contracts might be set aside for small business owned by eligible disadvantaged groups<sup>508</sup>.

Although this policy has been subject to controversy and significant restrictions over the last ten years following the Supreme Court decisions on the *Adarand* case<sup>509</sup> the relevant legislation is still in place. Under the new European legislation the directive provides for the possibility of reserving contracts for sheltered workshops or reserving the granting of the contracts to the context of sheltered employment programmes for handicapped persons<sup>510</sup>.

However, the reservation of contracts in favour of a particular group might not only have negative effects on the economic value of the contract, but also might be counter-productive to the development of the targeted group. Firstly, the government might base competition, and a potentially better contract. Secondly, the fact that a particular group is being protected by a government policy might lead to inefficiency, since the target group will be subject to less pressure to deliver a better product for the best possible price. Thirdly, it is possible that the targeted group could be used as a token, when in fact a non-beneficiary group will ultimately reap the benefits. Finally, when the government defines the policy and establishes rules on how the minority group should be involved, it does not give the market the chance of including the minority group in the most efficient way. Moreover, since government choices are most of the time a political issue, the chances are that the government will not choose the policy framework based on the market reality and therefore, when it decides to terminate the policy and leave those firms to compete, most of them will not be able to stay in the market.

### 2.5.2 *Technical specifications*

When government contracts are open to free competition, secondary policies are often implemented by technical specifications. By describing the goods, works or services that are being procured, contracting authorities might establish specific requirements that are aimed to reach the target objective. The implementation of secondary policies through this method is very common for environmental policies, although it is possible to address social and industrial

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<sup>508</sup> See in particular section 8 (a).

<sup>509</sup> See note 502.

<sup>510</sup> Article 19 of the new public sector Directive and Art. 28 of the new utilities Directive.

concerns by the same means. If, for example, a government is concerned with environmental matters it could state that it will only buy recycled goods. If on the other hand, if it is concerned with unemployment rates, it could state that a particular work being procured must use labour intensive practices.

Of course, some requirements might not increase the price paid or the overall cost of the contract. For example, when the procuring entity seeks to buy an energy efficient machine, that might mean that it will help reduce the greenhouse effect, but also that the energy cost of the entity will be reduced. On the other hand, the entity might help the environment without paying more for it in the long term.

When drafting specifications, contracting authorities could establish not only requirements that are directly related to the contract, but also requirements for the way in which the supplier produces its product. The requirements which relate to the contract might be directed at the goods or at the way the contract is performed. For example, contracting authorities might define in the procurement of machinery that they will buy products that produce a certain level of noise. On the other hand, in the procurement of services, authorities might say for example that the service must be performed with a low level of noise. When the requirement does not relate to the subject of the contract, it usually relates to the way the good is produced. For example, it could state that it will buy non-recycled paper produced by industries that use wood from reforestation sites.

When introducing secondary policies on the description of the product to be procured, procurement authorities take the risk of applying a strict approach that will stop potentially good suppliers from bidding. If for example, they establish that the goods must be produced by means of a certain method which is known to reduce the emission of carbon monoxide, they will lose the chance of giving suppliers the challenge of bringing innovations that will increase the protection of the primary objective, which is the reduction of the greenhouse effect<sup>511</sup>. Moreover,

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<sup>511</sup> A possible way out would be to apply performance specifications. See South African example of drafting specifications based on performance which are particularly keen on maximising quality and engineer innovation in Mitchell, Verhaeghe and Ackermann (2002).

if the description applies a domestic standard, there is a risk of discrimination against foreign suppliers which could provide equivalent products, but which might not be able to prove compliance with the required standard. For this reason the procurement regulation of many jurisdictions requires that, when the contracting authority refers to a certain standard, it should try to use international standards and use the words “or equivalent” in order to avoid unnecessary restrictions<sup>512</sup>.

Another risk run by procuring agencies is to overlook the hidden costs of this kind of implementation method. Since the secondary policy is implemented in the draft of the specifications, only firms that can comply with the specified condition will present a proposal. Thus it will be difficult to accurately determine the additional cost paid by the inclusion of the policy. An alternative would be to seek offers with and without the requirement, and then attribute a level of preference to the offers that comply with the requirement.

### 2.5.3 *Qualification conditions*

Under procurement regulations suppliers are usually analysed at the qualification stage for their technical and financial capacity to perform the contract. However, when governments implement secondary policies through qualification conditions, suppliers that could provide for the product being procured are excluded from the competition if they cannot meet the requirement being set by the policy. For example, a contracting authority could determine that only firms that follow a non-discriminatory policy for hiring employees can compete for the contract. This kind of requirement does not relate to the ability of the firm to perform the contract, but is a means of enforcing the legislation (if there is legislation already in place) or of providing incentives (if the policy is applied only through procurement) to firms to adopt a non-discriminatory policy. In this context, qualification conditions could be seen as a sanction to firms that fail to comply with the relevant requirement, or a means of excluding firms that do not meet the required standard<sup>513</sup>.

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<sup>512</sup> See for example, Article 23 of the new EC Public Sector Directive, Article 16 (3) of the UNCITRAL Model Law, Article VI (3).

<sup>513</sup> See difference from set aside policies above.

Qualification conditions could also include requirements that implement industrial and environmental policies. Moreover, policies could either have a direct effect on the targeted objective, such as only qualifying firms that have a set number of national employees, or promote the secondary objective in an indirect form. For example, in evaluating the capacity of bidders, contracting agencies might require previous experience in the country where the contract will be performed. This might place local firms in a better position, although in theory any firm could compete.

As with the methods mentioned above, secondary policies implemented through qualification clauses will also potentially exclude good contractors from the competition. This might lead to the government having to pay a higher price for the contract and, since competition is restricted, it will not be easy to measure the excess in the price paid. If the government applies a strict policy by, for example, only considering contractors whose workforce is comprised primarily by a minority group, it might end up restricting the competition to only a few bidders and gaining a false impression of market prices.

While strict clauses might severely damage some of the economic objectives of the procurement process, it is common for governments to require that firms at least comply with national laws and regulations. The exclusion of firms for evading tax law, for violating criminal law, or for not complying with environmental and social legislation (such as payment of national minimum wages) is very common in many jurisdictions. In the EU, for example, member states are free to impose such requirements on the procurement covered by the Directives. Moreover, as seen above, the new European procurement legislation requires members to establish policies directed at the exclusion of firms convicted of participation in a criminal organisation, corruption, fraud and money laundering.

It is also interesting to note that qualification conditions used to enforce secondary legislation might in some cases have an effect on the primary objectives of procurement. For example, firms which have tax and social security debts to be resolved, or which have a criminal record might have problems in fulfilling the contract. However, when governments impose those secondary policies they are not necessarily concerned with the performance of the contract. The

aim of the policy is to reflect a moral stance and to set an example for the national, and sometimes for the international communities<sup>514</sup>.

#### *2.5.4 Award criteria*

Usually when evaluating the bidding offers, the procuring agency will look for price and for the technical quality of the proposal. However, when secondary policies are implemented at the award stage, additional criteria are included in the analysis. Such criteria could be aimed at the implementation of industrial, environmental, social or any other policy. For example, the contracting agency could determine that a margin preference will be given to national firms or to products produced nationally. Thus, if the offer of the protected group is, for instance, up to 15% higher than the offer from other suppliers, it will be awarded the contract. As will be seen in Chapter VII, the World Bank guidelines do provide for this kind of preference mechanism under procurement for financed projects.

The way in which the preference is applied will depend on the willingness of the government to pay for the additional costs. When the procurement legislation states a fixed amount to all firms that qualify for the price preference, it might end up paying more where there is no need for it. For example, a national firm, which could compete on price and technical quality with international suppliers, might use the preference granted to increase the offered price. Moreover, there is no incentive to national firms to increase their efficiency if they can count on governmental protection. In this context, the additional price paid by the government will not reap the benefit of developing the national industry. In international competition, if the margin of preference is significant there is also the risk of having foreign firms associating with national firms in order to be granted preference, but without the correspondent benefit to the national supplier. For, example, on a 15% price preference, foreign suppliers might pay 5% to the national firm to bid, increase their price by 10% and still win the contract.

The advantage of this kind of mechanism is that the government clearly states the limit that it is willing to pay for the secondary policy. Unlike implementation through set-asides or

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<sup>514</sup> On whether those policies are or should be linked to performance under national rules of European member states see Piselli (2000) and Priess and Pitschas (2000) (a).

qualification conditions, competition is open to all suppliers and the government can see more clearly how much more it is paying to run the policy. This will provide transparency for the system and governments will be able to determine whether the amount of money being spent is justified. However, since there is the risk of awarding the contract to firms that do not fulfil the requirements, governments might understand that the importance of some policies will outweigh the discussion of cost. For example, if the government does not want its contract to be associated with firms that are known to have poor human rights records or that use techniques that are known to damage the environment, it might want to exclude those firms at the previous stage and not grant a margin of preference to the ones that are not involved in such conducts.

There are other ways to implement a preference mechanism, other than by a fixed price preference. Governments might, for example, award preferences not based on a fixed amount granted to the group that fulfils a particular requirement, but might leave contractors to innovate and bring solutions to the problem, and weigh them accordingly. For example, when establishing a system of preferences for environmental reasons, governments might not establish beforehand that preference will be given to the contractor that uses a certain method of production that the government finds less damaging to the environment. The most effective method would be to leave the contractors to determine which method they will use to make their production less damaging and weight each method according to objective criteria (for instance the amount of harmful gases released by the process). On a system of preference the government could eventually award the contract not to the contractor who presents the best possible solution for the environment, but to the contractor who presents the best trade-off between commercial objectives and the target policy.

A practical example of this approach was adopted by South Africa in order to foster the development of the groups discriminated against during the apartheid regime<sup>515</sup>. Under the

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<sup>515</sup> For more information on the South Africa procurement policy; Watermeyer, (2000) (a summary of the article can also be found at the [www.pwdprocure.gov.za](http://www.pwdprocure.gov.za) entitled *An Introduction to Targeted Procurement*); Arrowsmith, Linarelli and Wallace (2000) pages 265-280; Letchmiah, (1999), and Arrowsmith Meyer and Trybus, (2000). Also see Watermeyer,(2005) for the national standards produced in South Africa more recently. For an informal overlook of the policy passed in 2003 see Clarke (2005).

‘Targeted Procurement System’, which was a system developed mainly under the auspices of construction procurement, an offer was analysed both for its economic aspects and for the extent to which it contributed towards the secondary objective of involving societal groups disadvantaged under the apartheid system. It is for the bidders to propose in their offer whether, and to what extent, these disadvantaged groups will become involved in the contract. A system of points is then used to measure the development objectives. While price will count for 90 points, the involvement of the targeted group could reach up to 10 points. Although this system has evolved and expanded over the years, there is still room for the preference mechanism established by the Targeted Procurement System<sup>516</sup>.

The risk inherent in such policies is that it might leave a margin of discretion to the purchaser, and if limits are not strictly defined by the legislation, a loss in transparency and an increase in corruption could follow. Moreover, governments will have to take into account the time and effort that contractors will take to understand and comply with the system, and the possibility of losing interesting contractors since some might think that the benefits are not worth the cost<sup>517</sup>.

When governments are not prepared to pay an additional price for the contract, secondary policies could still be implemented by giving priority to bidders who comply with the policy,

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<sup>516</sup> The framework of the policy is set out in the following legislation: Constitution of South Africa section 217 and section 146, Preferential Procurement Policy Framework Act 2002, Act 5 – 2000, Republic of South Africa Government Gazette, volume 416, Public Finance Management Act , Act 1 of 1999 amended by Act 29 of 1999, Preferential Procurement Regulations, 2001; White Paper, *Creating and Enabling Environment for Reconstruction Growth and Development in the Construction Industry*, [www.pwdprocure.gov.za](http://www.pwdprocure.gov.za) , and interpretation on the legislation given by the High Court of South Africa, *Grinaker v Tender Board*, judgment of 5/12/01. Also, the policy that was first developed by the Department of Public Works has now evolved and expanded to other sectors. With the new legislation namely Broad Based Black Economic Empowerment Act 2003, esp. 4 and 5, the room for preferential procurement has gained impulse both in the public and private sectors, and other methods of implementation, such as set aside, has been used. The new legislation is aimed at using preferential procurement to increment the redistribution of wealth and eliminate economic inequality, by ensuring that more goods and services are bought from black suppliers. The legislation also include clauses to guarantee that ownership is not fake by establishing a minimum percentage of black owners and requiring that they have exercisable voting rights. Also the preferential procurement policy is now embodied in a series of standards of the South Africa Construction Industry Development Board that can be used by any public bodies (SANS 1914-1 to 1914-5 (2002) and SANS 10396 (2003). For those standards see Watermeyer, (2005). Documents on the South Africa Target Procurement system can be obtained in the Department of Public Work, South Africa, Targeted Procurement home page at <http://pwdprocure.gov.za>.

<sup>517</sup> For potential problems with a preference system see Wittie, (2002), which focus particularly on the US system of preferences.

provided that their price and quality match the winning bid. Thus the policy is implemented as a tie-break condition between otherwise equal bids<sup>518</sup>. This is the case, for example, with Brazilian public procurement law, where in relation to foreign contractors, the law provides for departure from the general equality principle in order to favour domestic firms. It establishes that if the proposals are equal, as a tie-break condition, preference must be given to goods and services produced in Brazil, or produced or rendered by Brazilian firms<sup>519</sup>. It is worth noting that even such policies are not cost free since the contracting agency still has to administer the policy and check for compliance.

### 2.5.5 *Contract conditions*

Secondary requirements imposed by specifications, under qualification conditions or as an award criterion, will most invariably be reflected under the contract finally signed between the government and the winning bidder. For example, when a margin of preference is given to products that are nationally produced, the contract will require the delivery of a national product. Also if the bidder has been chosen because it has agreed to subcontract part of the contract to a particular group, this will be stated in the contract as a contract condition. However, contract conditions can also be the only form of implementing secondary policies. The contracting agency could accept and compare bids during the procurement process without regard to secondary concerns, but nevertheless include in the contract a condition related to a secondary objective. For example, under the European procurement directives, because of the limitations on the criteria used at the qualification stage it is not possible to exclude contractors who cannot comply with an unemployment policy. However, it might be possible to require under the contract that the contractor comply with such policy<sup>520</sup>.

Contract conditions might be related only to the contract being awarded, or could require a more general behaviour from the contractor. Thus, the conditions could state that in performing the contract the contractor will limit its pollution emissions to a certain level, or that the

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<sup>518</sup> Although this is difficult to find in practice.

<sup>519</sup> Federal Law 8666/93 article 3 § 2°.

<sup>520</sup> See discussion on the Beetjes case below. On this issue also see Arrowsmith (2004) (b), McCrudden (1998), Arrowsmith, Linarelli and Wallace (2000).

contractor must adhere to low emission policy in its business as a whole. Although contract conditions have mainly been used to promote social, labour and environmental policies<sup>521</sup>, they could also be used to implement industrial objectives, by for example requiring that a portion of the contract is performed by national labour with the correspondent transfer of technology<sup>522</sup>.

One of the main advantages of implementation through contract conditions is that it does not exclude contractors from the bidding process. However, there could be significant hidden costs of the running this policy. When bidding, firms will have to include in their price the cost of complying with a policy that they are not used to. The government might, for example, impose certain environmental standards that are stricter than those required by law and therefore, contractors will incur extra expenditure in order to comply with the contract condition. The same will happen if the government imposes labour conditions or wages that are not those practiced by the market. Apart from the increase in price, the government will have to spend a lot of money in monitoring compliance. The implementation through contract compliance might also limit the remedies available since, for example, cancellation of the contract for non-compliance might be costly.

#### *2.5.6 Other methods*

It should be noted that the methods explained above are just some examples of common ways to implement secondary policies. However, secondary policies could be implemented through different methods, by a combination of several methods, or by the application of one of the aforementioned methods with certain variations.

Other examples of implementation methods would include policies of assisting the targeted group to understand and compete for public contracts by, for example, providing training or advertising more directly to the targeted group; breaking larger contracts into smaller units in order to attract bidders from the targeted group; lowering the level of documents and guarantees

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<sup>521</sup> See for example, South Africa uses contract conditions to support the social policies pursued during the procurement proceedings; in the U.S. affirmative action requirements are incorporated into the contract and enforced by contractual measures. Contract conditions are also used for example by some European governments to implement environmental, social and labour related policies see Arrowsmith, Meyer and Trybus.

<sup>522</sup> See Arrowsmith, Linarelli and Wallace (2000).

required so that the targeted group could more easily comply, etc<sup>523</sup>. Also, several variations of the methods explained above could be implemented. For example, preference could be given to the targeted group not at the awarding stage, but at the short listing stage (where a shortlist is required). At the award stage, as a variation of the preference given as a tie-break condition, contracting authorities could establish that the best bid from the targeted group could be given the chance of being awarded the contract if they can match the winning bid (the “offering back” approach)<sup>524</sup>.

## 2.6 Evaluation and Enforcement

The adoption of social, industrial or environmental objectives, as opposed to commercial objectives, will be far from costless. In fact, apart from the direct cost incurred by governments in signing more expensive contracts or in losing potentially more attractive deals, governments will have to take into account the costs of managing the policy, including: training for procurement authorities, verifying compliance, imposing of sanctions for non-compliance, establishing an effective system of complaints (if this is not in place), etc.

Furthermore, a systematic evaluation of the policy, which can clearly show if its objective is being achieved, seems to be the key to an effective implementation. It is important for governments to know not only how much is being spent, but also if the final goal is in fact being affected by the relevant policy. However, it seems that governments usually pay little or no attention to the implementation of an evaluation system. Even in countries with longstanding procurement systems, there seems to be little evidence of an effective evaluation procedure in place. In the US for example, the requirement imposed by the Supreme Court for justifying the discriminatory behaviour of the government in favour of minorities has shaken the entire

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<sup>523</sup> See Tucker’s (2001) comments regarding the heavy burden of documentation and the aggregation process in financed projects. Lowering the number documents and grantees required could attract local bidders and thus enhance not only the secondary objective of developing the national industry but also the primary objective of procurement which is best value for money. See the same issue being discussed and exemplified by Hughes (2000). For further comments of financed projects see Chapters below.

<sup>524</sup> For a more detailed explanation of different methods of implementation in different jurisdictions see Arrowsmith, Meyer and Trybus (2000), Arrowsmith, Lianrelli and Wallace (2000), Kunzlik (2003), For a historical approach see Mc Crudden (2004).

structure of implementing social policies through public procurement, and has driven contracting authorities to start evaluating their policies<sup>525</sup>.

It might be argued that in some secondary policies the moral importance of the rule should not be weighed against the costs of its implementation. This for example would be the case with rules applying human rights standards or labour standards to firms that are engaged in business with the government<sup>526</sup>. However, even under such a policy there should be an evaluation system that can tell if the rights of the people who the government is trying to protect are in fact being respected as an effect of the implemented policy. It might be the case that no alteration is being felt, or that conditions have actually improved, but as a result of improvements in the market as a whole. In both cases governments might have to rethink their policies and redefine goals and measures used to achieve their objective. This was the case in South Africa, for example, where evaluation procedures have helped the government to reshape the procurement regulation in order to make the policy of empowering black businesses more effective. There it was felt that previous legislation allowed too much emphasis to be put on price and that a more pro-active approach was needed to enhance black economic empowerment<sup>527</sup>.

In evaluating the effectiveness of the policy, governments should also take into account the choice of using procurement as a mean by which to achieve the target objective. Industrial, social and environmental objectives might also be achieved through other policies, such as subsidies. Governments could help small businesses or businesses run by minority groups by opening new lines of credit. They could also provide tax relief or even training and equipment to achieve the target objective. Therefore, it is important to evaluate and define the importance that procurement should have in implementing the policy<sup>528</sup>.

Another condition that will affect the success of the implementation of secondary policies is the presence of an enforcement mechanism. It is vital to determine firstly, whether the contracting authorities are in fact implementing the policy correctly; secondly, whether the bids

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<sup>525</sup> See the conclusions of the United States review of its policies in Federal Register vol.61 No.101.

<sup>526</sup> See discussion on the *Burma/Myanmar* case referred above.

<sup>527</sup> See declaration of a spokesman from the South Africa Department for Trade Industry on Clarke (2005).

<sup>528</sup> On the use of procurement see Arrowsmith (1995).

are in fact responsive to the procurement conditions; and thirdly, if after the award of the contract the contractor complies with the contractual requirements. If deficiencies are detected in any of the three levels the efficacy of the policy could be at risk. Enforcement measures should be in place so that such deficiencies are identified early on and corrected, therefore maximising the chances of success.

As seen in previous Chapters, several enforcement measures might help to ensure compliance. In order to deter breaches at the first level, rules should be clear and contracting authorities should be well trained and capable of implementing the policy. As explained below, transparency and objectivity could also help deter breaches, no matter which method of implementation is being used. Another helpful measure would be the review of procurement proceedings above a determined threshold and a review on a random basis for smaller contracts. Moreover, auditing might have to take place on a certain number of contracts to ensure compliance with the policy requirements. In addition, procurement authorities should be prepared to listen and address complaints by affected parties. Remedies must also be in place to correct any breach<sup>529</sup>.

## 2.7 The need for transparency

Transparency is an important procurement objective in many jurisdictions<sup>530</sup>. It is also one of the four pillars of the World Bank procurement guidelines<sup>531</sup>. Moreover, international efforts to increase transparency in public procurement have proliferated dramatically over the last few years and countries which have reformed their procurement regimes have included transparency as one of the main goals<sup>532</sup>.

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<sup>529</sup> For further explanation on the need for an enforcement mechanism see Chapters IV and V.

<sup>530</sup> For transparency as a procurement objective see Schooner (2002); Kelman (1990); Arrowsmith (1998) (b); Arrowsmith, Linarelli and Wallace (2000).

<sup>531</sup> For procurement objectives of the World Bank Guidelines see Chapter III.

<sup>532</sup> See transparency as an objective of the EC Treaty, the Government Procurement Agreement, the public procurement UNCITRAL Model law, procurement provisions on the North America Free Trade Agreement (NAFTA). Also see transparency efforts in the Asia Pacific Co-operation Forum, Government Procurement Experts Group, *Non-binding Principles on Government Procurement: Transparency* at [http://www.apsecsec.org.sg/committee/gov\\_non\\_binding.html](http://www.apsecsec.org.sg/committee/gov_non_binding.html) and under the WTO see Working Group in Government procurement transparency in [http://www.wto.org/english/tratop\\_e/gproc\\_e/gptran\\_e.htm](http://www.wto.org/english/tratop_e/gproc_e/gptran_e.htm).

To have a transparent procurement regime is not only to have clear rules, but also to state that those rules must be open and known by competitors before the proceedings start<sup>533</sup>. They must also provide accountability and include means by which to verify that they were in fact followed<sup>534</sup>. Moreover, contractors should be made aware of contract opportunities and of any qualification or award criteria in advance and with enough time to prepare compliant bids<sup>535</sup>.

When such a great emphasis is placed on transparency, the contracting authority usually loses much of its discretionary power<sup>536</sup>. In a transparent system decisions are taken based on objective criteria which are set in advance and must be followed during the procedure. Moreover, documentation is usually kept so that procedures could eventually be scrutinised. Thus, transparency is often seen as an important means by which to deter corruption and any other abuse<sup>537</sup>. In addition, a transparent system provides confidence in the procurement process and might stimulate potential suppliers to bid, adding therefore the chances of getting a better contract<sup>538</sup>. Ultimately transparency can bring more efficiency, fairness and legitimacy to a government procurement system<sup>539</sup>.

On the other hand, it is also important to mention that there are also considerable costs involved in setting up a transparent system<sup>540</sup>. Costs will derive from resources spent on implementing transparency rules (such as having to keep records or analysing a greater number of bids), from the loss of discretion imposed on efficient contract authorities (which would have to advertise the contract and apply objective criteria and could not settle a good deal on the spot) and eventually, if too great a burden is imposed on bidders (such as the presentation of a great number of documents) some potentially good contractors might be discouraged from entering the

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<sup>533</sup> See Arrowsmith (1998) (b).

<sup>534</sup> See definition of transparency by Westring and Jadoun (1996).

<sup>535</sup> Arrowsmith (1998) (b).

<sup>536</sup> For a more commercial approach to government purchasing see US example in Schooner (2001), Vacketta (2002). For balance between transparency and commercial behaviour see Schooner (2003).

<sup>537</sup> See Wittig (2001) and Allen (2002).

<sup>538</sup> OECD (2003) (b), Kinsey (2004). On market access see Linarelli (2001) (b), Kinsey (2004), Arrowsmith (2003), Evenett and Hoekmann (2004).

<sup>539</sup> Kinsey (2004).

<sup>540</sup> See evaluation made by the UK HM Treasury Review of Civil Procurement in Central Government (April 1999) available at <http://www.hm-treasury.gov.uk/1999/pgfinalr.html> between the cost of public procurement and procurement in the private sector.

competition<sup>541</sup>. Depending on the environment found in each particular country, the cost of transparency objectives should be weighed against the benefits it could bring to the procedure. Thus in countries where there is a high risk of corruption, where procurement officials are not experienced and well trained to obtain good value contracts, transparent rules might lead to better procurement practices<sup>542</sup>.

The implementation of secondary policies through public procurement brings an additional dimension to transparency concerns. Arrowsmith alerts that in implementing secondary policies through procurement, the choices of groups and policies to be adopted, traditionally, depend on political choices rather than on economic analysis<sup>543</sup>. She also points out the danger of a loss on transparency by the increase of discretion given to contracting authorities in implementing secondary policies<sup>544</sup>. She suggests that when secondary policies are in fact pursued through public procurement any requirement should be set in advance and that policies should be precise and objective. Moreover, to minimise the any risk of abuse, policies not set in the other existing legal norms should be referred to a procuring entity other than the contracting agency, and/or be subjected to advance approval for application in particular cases. The process to take such decisions must also be transparent and would be further improved if right to review are open to contractors<sup>545</sup>.

To sum up, it could be said that transparency in implementing secondary policies is important since it will bring to the procurement procedure not only a desirable sense of predictability and fairness, but also accountability. Bidders will be more willing to compete for government contracts if they can foresee how their proposals will be evaluated and that competition will be fair. Therefore it is important that, if governments decide to use procurement as a method of implementing their policies, this should be clearly stated in their procurement legislation and bidders should be aware of the criteria used at the earliest opportunity.

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<sup>541</sup> Arrowsmith (1998).

<sup>542</sup> OECD (2003) (b) and DeAses (2005).

<sup>543</sup> Arrowsmith, Linarelli and Wallace, (2000) at page 252.

<sup>544</sup> Ibid at pages 298-301.

<sup>545</sup> For the importance of a complaint mechanism see Chapter V.

Procurement authorities should also be controlled by limiting the amount of discretion, and insisting on the maintenance of procurement records of those decisions so that they could be eventually reviewed by the appropriate mechanism. This should reduce the chances of corrupt practices and increase the accountability of the system.

Although this Chapter has concentrated on describing the use of secondary policies generally in different procurement regulations, it is worth emphasising that transparency and equal competition among bidders are also some of the objectives of the World Bank procurement regulation. The Bank has insisted in several procurement rules that no corrupt practices or unfair treatment to bidders will be tolerated. Moreover, the Bank is so keen to establishing transparent procedures that it is sometimes prepared to receive complaints for excessive documentation and bureaucracy. For the Bank, transparent activities will bring accountability for the Bank's investments and will please member states and the international community. Therefore, if secondary objectives are to be part of the Bank's procurement regulations, or if the Bank is ever to allow member countries to use their policies on financed projects, those must be transparent.

### **3 The influence of international instruments on the application of secondary policies**

Over the years many international instruments have regulated public procurement. Agreements have been reached to provide models for countries reforming their national procurement system<sup>546</sup>; international financing institutions have established procurement rules for financed projects<sup>547</sup>; and countries have gathered to establish procurement rules that focus on opening up procurement market at a regional or global level<sup>548</sup>. A common feature of those instruments is that they are all part of a global movement of acceptance of the liberal economic theory which states that free trade practices maximise overall welfare<sup>549</sup>. The opening of public procurement markets is seen in this context as an important step in removing barriers to

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<sup>546</sup> See UNCITRAL Model Law below.

<sup>547</sup> See rules and harmonisation efforts of MBDs in Chapter III.

<sup>548</sup> See GPA and EC Directives below. Also see other efforts referred at notes 582and 583.

<sup>549</sup> There is an extensive literature on international trade. Some examples would included Trebilcock and Howse (1999), Jackson (1997), Lowenfeld (2002), Hoekman and Kostecki (2001), Sykes (1998).

international trade<sup>550</sup>. Thus, states have either unilaterally reformed their procurement rules to make room for new developments, or driven by reciprocal agreements, have decided to open up to trade partners<sup>551</sup>. Since the objective of those agreements is precisely the opening of procurement regimes for foreign competition, it is natural that they will prohibit (or limit) discrimination in favour of national firms and will establish an equal ground for competition. In this context, the inclusion of secondary concerns in drafting the procurement system might encounter a series of barriers, especially if they relate to the protection of the national industry<sup>552</sup>. Also, as mentioned in the previous Chapter, even those states which are not part of international agreements and which have not unilaterally opened their procurement system might have to make room for international competition if for example they seek financing from international institutions such as the World Bank<sup>553</sup>.

However, despite the wide acceptance of the liberal theory, many countries are not prepared to completely drop their protectionist policies, probably because of political reasons. International instruments might have to take this behaviour into account, although limiting the extent of protectionist policies, if it aims to gain wide acceptance<sup>554</sup>. In addition, measures for the protection of the environment and directed at social concerns have also gained force over the years and the balance between those concerns and trade objectives have become an important issue for many jurisdictions<sup>555</sup>. Moreover, since the main objective is to open up procurement to foreign competition, international instruments might also try to accommodate secondary policies which are not discriminatory<sup>556</sup>. However, even when legitimate reasons drive the application of

<sup>550</sup> For procurement related discussion see Arrowsmith (2002) (b), Reich (1999), Hoekman and Mavroidis (eds) (1997), Arrowsmith, Linarelli and Wallace (2000). Also see Evenett and Hoekman (2004).

<sup>551</sup> See examples in Schnitzer (2005).

<sup>552</sup> For an analysis of the arguments that could justify the use of domestic preferences see Jackson (1997) Mougeot and Naegelen, (2005).

<sup>553</sup> See Chapter III on the use of ICB procedures.

<sup>554</sup> See discussion on widening the GPA membership below.

<sup>555</sup> There are a number of secondary materials covering this tension under the WTO system. See for example, Desmedt, (2001); Motaal, (2001); McCrudden and Davies, (2000); Powell, (2004); Jackson (1997). For considerations under international law see for example Chapman, (1998)and Sands, (1998). For procurement related discussion see for example, Nielsen, (1995); McCrudden, (1998), (1999) and (2000); Arrowsmith Meyer and Trybus (2000); Arrowsmith, Linareli and Wallace (2000); Priess and Pitschas (2000) (a) and (b); Arrowsmith (2002) (b) and (d); Kunzlik, (2003) (a) and (b).

<sup>556</sup> See risks of having an open requirement in Arrowsmith, Linarelli and Wallace (2000).

secondary concerns into procurement regulations, states might have to weigh the impact of such policies against their market closing effect, the possible cost of running the policy, and the concrete benefits they might bring (see the evaluation section above).

This section will aim to discuss briefly how some of those international instruments have dealt with secondary concerns and the limits imposed on the adoption of such policies. Since there is an extensive literature on the instruments mentioned below, the objective of the following parts is to provide a summary of the position on those regimes, which could provide useful material when drafting considerations regarding the World Bank procurement system.

### **3.1 UNCITRAL model law**

The balance of interest between the relevance of secondary policies, especially regarding the promotion of national industries and social benefits, and the pressure for liberalisation, was considered by the UNCITRAL Model Law on Government Procurement. The agreement was negotiated in order to help developing countries and economies in transition to set procurement legislation or to reform their existing laws according to a liberal approach. The objective was to help countries drafting their new legislation and opening up procurement markets through competition, including international competition<sup>557</sup>. However, during negotiations, while some countries were keen on keeping some of their protectionist policies, others were opposed to the inclusion of protectionist clauses, given the difficulties of making those policies effective<sup>558</sup>. Thus, some scope for using secondary criteria, especially industrial policies, on procurement proceedings were included, but with limited reach.

Regulation of policies directed at social and environmental objectives were largely left out of the Model Law concerns. It is supposed that the lack of such provisions was based on the assumption that states should not apply such policies. However, the increased use of procurement as an instrument to pursue such policies has led to commentators advocating the inclusion of

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<sup>557</sup> For a deeper examination of the Model Law see Arrowsmith, Linarelli and Wallace, (2000), Wallace (1994); Westering (1994); Hunja, in Arrowsmith and Davis (1998); Dischendorfer, (2003) and Arrowsmith, (2004) (a).

<sup>558</sup> See Travaux préparatoires – Summary record of the 497<sup>th</sup> meeting – [A/CN.9/ SR 497] available at <http://www.uncitral.org/pdf/english/yearbooks/yb-1993-e/vol24-p343-414-e.pdf>.

provisions establishing the parameters for such use<sup>559</sup>. It is better to acknowledge the use of those policies and to regulate them in a transparent and effective way than to leave the issue unresolved. In this regard it must be said that the Model Law does have transparency requirements. The implementation of secondary policies through qualification conditions<sup>560</sup>, as award criteria<sup>561</sup>, or through set aside<sup>562</sup> must be disclosed to bidders in advance, and records of the decision allowing the implementation of the policy must be kept, so that they can eventually be reviewed by a superior authority<sup>563</sup>.

### *3.1.1 General prohibition on discrimination*

In the pre-amble, the Model Law states clearly that one of its objectives is to deter discrimination based on nationality. Moreover it suggests that procurement should be open to firms from all nationalities<sup>564</sup> and that bidders should compete on an equal basis. However, the Model Law also contemplates exceptions to this general rule, provided that those exceptions are defined in the procurement regulation or other relevant law<sup>565</sup>. In the Guide to Enactment it is explained that the Model Law recognises that “enacting States may wish in some cases to restrict foreign participation with a view in particular to protecting certain vital economic sectors of their national industrial capacity against deleterious effects of unbridled foreign competition”<sup>566</sup>. The Guide also notes that such restriction should be based only on grounds specified in the procurement regulations, or should be pursuant to other provisions of law so that transparency and limitations of arbitrary discrimination can be protected. Thus, the provision suggests that countries should in principle have a procurement system open to foreign competition and that any restriction should be limited and transparent.

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<sup>559</sup> See Arrowsmith (2004).

<sup>560</sup> See Article 6.

<sup>561</sup> See Article 34 (4) (a).

<sup>562</sup> See Article 8 (1). Also see Guide to Enactment Paragraph 25 explaining that this requirement is meant to promote transparency and to prevent arbitrary and excessive resort to restriction of foreign competition.

<sup>563</sup> See Article 8 (2) and Article 34 (4) (d).

<sup>564</sup> Model Law, Article 8.

<sup>565</sup> Idem.

<sup>566</sup> Guide to Enactment paragraph 25.

The provision also takes into consideration the needs of national states to restrict tendering based on the bidder's nationality in cases such as tied aid, regional economic integration groupings and on restrictions arising from economic sanctions imposed by the UN Security Council<sup>567</sup> by referring to Article 3, which provides for the possibility of international agreements to prevail over the Law. This will also be relevant for developing countries receiving money through international financing institutions, such as the World Bank, which require the use of their own procurement rules in financed projects.

### *3.1.2 Specification*

The Model Law states that in drafting specifications contracting authorities should not impose obstacles to the participation, including obstacles based on nationality<sup>568</sup>. Moreover it suggests that any specifications, plans, drawings, designs and requirements or descriptions of goods, construction or services shall be based on the relevant objective technical and quality characteristics of the goods, construction or services to be procured<sup>569</sup> and that standardised features should be used in drafting the specifications with the addition of the expression "or equivalent"<sup>570</sup>. Such provisions aim at guaranteeing that discrimination in favour of national suppliers or products will not be disguised by specification conditions, such as a requirement that products are made with raw materials that are nationally produced. The wording of the provision also suggests that any technical specifications should relate to the subject matter of the contract.

### *3.1.3 Qualification conditions*

Article 6 defines the criteria for qualifying suppliers and states that contracting authorities should take into account their technical and financial capacity as well as their capacity to enter legal contracts. Exclusions could be made either on failing to meet financial standards or failing to comply with secondary legislation such as tax and security obligations<sup>571</sup>. Moreover,

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<sup>567</sup> Idem. Note that in the latter case such contractors are not excluded only from the procurement market but from the country private market as well.

<sup>568</sup> Article 16 (1).

<sup>569</sup> Article 16 (2).

<sup>570</sup> Article 16 (3).

<sup>571</sup> Article 6 (1) (iv).

firms could be disqualified based on a criminal conviction of the firm or of its administrators, or based on misrepresentation<sup>572</sup>. Moreover, in order to provide transparency in the qualification of bidders, any requirement must be set out in advance<sup>573</sup>.

Paragraph 5 clearly states that ‘subject to articles 8 (1), 34 (4) (d) and 39 (2), the procuring entity shall establish no criterion, requirement or procedure with respect to the qualifications of suppliers or contractors that discriminates against or among suppliers or contractors or against categories thereof on the basis of nationality, or that is not objectively justifiable’. The provision excludes any discriminatory policy based on nationality, with exception made for cases stated in the national procurement law. In addition paragraph 3 suggests that a procuring entity shall impose no criterion, requirement or procedure with respect to the qualifications of suppliers or contractors other than those provided for in this article. The strict approach taken by the Model Law entails the emphasis placed on having an open and transparent competition where contractors are not excluded on non-objective criteria.

### *3.1.4 Award criteria*

In order to accommodate industrial discriminatory policies, the Model Law foresees that states could establish a system of preference in evaluating bids, provided that it is authorised by the procurement legislation, approved by the relevant authority and predisclosed in the solicitation documents<sup>574</sup>. The provision includes an extensive list of criteria that could be used in determining the lowest evaluated offer<sup>575</sup>. This is not a comprehensive list, as states could add their own criteria, but the examples set out in the list seem to include only industrial criteria (although there is no express limitation for the use of environmental and social criteria). Moreover, Article 34 (4) (d) expressly states that agencies could state a margin of preference for the benefit of domestic contractors or domestically produced goods, always subject to

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<sup>572</sup> Article 6 (1) (v).

<sup>573</sup> Article 6 (3).

<sup>574</sup> In the evaluation of bids through the ‘lowest evaluated tender’ the procurement agency could take into account specified industrial criteria. See article 34 (4) (c) (iii). The letter of the article does leave room for a wide range of policies to be included under this system of preferences but the situations enumerated in there suggests that only industrial policies can be pursued.

<sup>575</sup> Model Law Article 34 (4) (c) (iii).

authorisation by the law and superior administrative authority. According to the Guide “by way of this technique, the Model Law provides the enacting State with a mechanism for balancing the objectives of international participation in procurement proceedings and fostering national industrial capacity, without resorting to purely domestic procurement”<sup>576</sup>. The adoption of a preference mechanism, as mentioned above, is preferable compared with other methods of discrimination since it provides an incentive to firms to improve their performance. Moreover, it allows the government to calculate the costs of the policy more accurately as it provides more transparency for the additional price being paid.

### *3.1.5 Set-asides*

There are two cases where the Model Law allows restrictive tendering. According to the Model Law, restriction to foreign suppliers can be imposed on low value procurement where it is unlikely that international suppliers would be willing to participate<sup>577</sup>. Moreover, the Model Law also suggests that in limited circumstances, single sourcing procurement can be used such as in urgent cases, for standard purposes, if only one contractor has the exclusive rights, etc<sup>578</sup>.

In addition, it is important to note that the Model Law does not apply to national defence procurement or to other kinds of procurements defined by the national legislation unless the procurement law expressly declares it to be applied<sup>579</sup>. Moreover, provisions of national procurement regulations based on the Model Law might be overruled by international agreements<sup>580</sup>.

### *3.1.6 Contract Conditions*

Despite the use of this method in some jurisdictions, such as the example cited above, there is no provision in the Model Law contemplating the use of contract compliance as a means to implement secondary policies. However, since implementation through contract conditions does not generally restrict competition during the procurement process, and is a method that

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<sup>576</sup> Guide to Enactment paragraph 26.

<sup>577</sup> Article 21.

<sup>578</sup> Model Law, Article 22 (2).

<sup>579</sup> Article 1 (3).

<sup>580</sup> Article 3.

could potentially be used under some international agreements<sup>581</sup>, it might be the chosen method of countries reforming their system. Therefore, the Model Law should provide some guidance on its implementation, especially regarding social and environmental policies.

### 3.2 GPA

International agreements on public procurement have been formed on several levels. There have been bilateral agreements among trade partners<sup>582</sup>, regional agreements among members of an open market<sup>583</sup> and multilateral agreements open to a wide range of countries<sup>584</sup>. Perhaps one of the most significant examples of those international agreements is the World Trade Organisation Agreement on Government Procurement, the GPA (Government Procurement Agreement)<sup>585</sup>. The GPA is a plurilateral agreement which operates under the WTO system<sup>586</sup>. Signature of the GPA is not mandatory for all WTO members and in fact, the agreement has limited membership as compared with the number of members of the WTO<sup>587</sup>, as most developing countries have not signed it. However, the countries which are part of the GPA account for a significant portion of the world trade. Moreover, since the GPA is an agreement open for participation from countries with a wide diversity of legal cultures, its content has to accommodate different policy requirements.

For those countries that have signed the GPA the provisions of the Agreement are mandatory. This rule-based approach is an important feature of the agreement since not all international agreements in public procurement have this characteristic. As mentioned above, the

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<sup>581</sup> See discussion below on the possibility of applying contract conditions under the GPA and the EC Directives.

<sup>582</sup> For example, the Australia and New Zealand Government Procurement Agreement [http://www.dfat.gov.au/geo/new\\_zealand/anz\\_cer/anzcerta\\_1997revised\\_npa.pdf](http://www.dfat.gov.au/geo/new_zealand/anz_cer/anzcerta_1997revised_npa.pdf). For a review of the agreements between the EU and other nations see Schnitzer (2005).

<sup>583</sup> For example, the EU Directives on Public Procurement, the procurement provisions on the North America Free Trade Agreement (NAFTA), the Common Market for Easter and Southern Africa (COMESA) principles on government procurement, the Common Market of the Southern Cone (MERCOSUR) Public Procurement Protocol.

<sup>584</sup> For example APEC *Non-binding Principles on Government Procurement: Transparency* at [http://www.apecsec.org.sg/committee/gov\\_non\\_binding.html](http://www.apecsec.org.sg/committee/gov_non_binding.html) and the GPA.

<sup>585</sup> For a comprehensive analysis of the Government Procurement Agreement see Arrowsmith, (2002) (b). Also see Reich (1999), Arrowsmith, Linarelli and Wallace (2000) and Hoekman and Mavroidis (1997).

<sup>586</sup> For procurement under the WTO also see Hoekman and Mavroidis, (1995), Reich, (1997); Dischendorfer, (2000).

<sup>587</sup> The WTO has 148 members on 16<sup>th</sup> February 2005, while the GPA has 28 members.

Model Law, for example, provides just a guide for states that want to reform or establish a procurement system, and states could depart from the provisions of the Model Law as they wish. Moreover, other international agreements such as the APEC agreement on public procurement provide just non-binding principles<sup>588</sup>. An important consequence of the approach taken by the GPA is the fact that it contains provisions for the enforcement of the agreement<sup>589</sup>.

### 3.2.1 Coverage

An important characteristic of the GPA is that it does not have general provisions on coverage. In fact, coverage under the GPA is a complex matter since each member state negotiates coverage upon accession<sup>590</sup>. Thus, there are wide differences on the entities covered, the contracts covered, and the thresholds at which the Agreement applies. The precise scope of coverage will basically depend on the “offers” of coverage made by each party, and will differ from state to state<sup>591</sup>. Moreover, even for contracts that would otherwise be covered by the GPA, states are allowed have derogation based on reciprocity. Thus each state party might insert specific derogations to exempt them from applying parts of the Agreement to other parties which do not offer reciprocal coverage<sup>592</sup>.

Another important derogation from coverage relates to the pursuit of secondary policies. The United States and Canada, for example, have included specific derogations to allow them to pursue specific industrial and social programmes, which might be incompatible with the GPA provisions<sup>593</sup>. Coverage is also restricted by the type of product being procured, for example, military equipment.

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<sup>588</sup> For APEC see Arrowsmith, (1996), (1997) and Brown (1999). Also see *Non-binding Principles on Government Procurement: Transparency* at [http://www.apecsec.org.sg/committee/gov\\_non\\_binding.html](http://www.apecsec.org.sg/committee/gov_non_binding.html).

<sup>589</sup> Article XX. For GPA discussion see Arrowsmith (2002) (b).

<sup>590</sup> For coverage discussion see Arrowsmith (2002) (b). Also see Bronckers, (1996); Olivera, (1997), Priess and Pitschas, (2000) (c); Davies, (2001); Kinsey, (2004).

<sup>591</sup> The precise scope of coverage for each party is set out in Appendix I to the GPA.

<sup>592</sup> Derogations based on reciprocity must be express otherwise the Most Favored Nation (MFN) principles would apply and concession made to one party would be extended to all members.

<sup>593</sup> Canada and the US states that the GPA will not apply to procurement in relation set-asides for small and minority businesses (Appendix I Canada General Notes 1 (d) and US General Notes 1). Canada will also exclude from GPA agricultural products made in furtherance of agricultural support programs or human feeding programs. (Appendix I, Canada General Notes 1 (e)).

The flexibility allowed for coverage reflects precisely the difficulties on finding a general consensus on the precise limits of entities and sectors that should be covered. Sectors that could raise sovereignty discussions, such as the inclusion of the energy sector<sup>594</sup>, oil purchase and strategic reserves<sup>595</sup>, etc have been left out of the agreement by some states. Moreover, derogation from coverage also shows the difficulties that states have to abdicate to use procurement as an instrument in pursuit of public policies.

### 3.2.2 *General prohibition on discrimination*

As is the case with other WTO agreements, the GPA is guided by the rules on non-discrimination and Most Favoured Nation. Under the non-discrimination principle, members are not allowed to discriminate, either *de jure* or *de facto*, between domestic and foreign products, services and suppliers<sup>596</sup>. This rule will also apply in relation to discriminatory measures relating to subcontractors and others further down the supply chain<sup>597</sup>. The MFN rule provides that members cannot discriminate among GPA parties and that concessions given to one member should be extended to all<sup>598</sup>. However, as mentioned above, this rule is significantly affected by coverage since derogations based on reciprocity are allowed, provided that they are expressed in Appendix I.

Those rules establish a significant limitation for members to adopt secondary policies. Any discriminatory measures are prohibited and could only be applicable under the derogations, or if they are justified under Article XXIII, which provides for departure from the non-discrimination rule in some limited circumstances (see below).

The GPA also contains provisions on the prohibition of “offsets”, which are measures used to improve “local development” or the balance of payment account<sup>599</sup>. Generally, members are prohibited from imposing, seeking, or considering their use, except for developing countries,

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<sup>594</sup> See Japan’s coverage.

<sup>595</sup> See Canada General Notes.

<sup>596</sup> GPA Article III (1) (a).

<sup>597</sup> GPA Article I.(3).

<sup>598</sup> GPA Article III.

<sup>599</sup> GPA Article XVI.

where offsets are allowed if conditions are negotiated at the time of accession<sup>600</sup>. The precise scope of this rule is, however, not well defined. Since discriminatory measures are caught by prohibition in Article III, and the provisions on offsets probably covers non-discriminatory measures aimed at improving local development or balance of payment problems.

A significant departure from the non-discrimination principle is set for developing countries<sup>601</sup>. The GPA states that members should take into account the development, financial and trade needs of developing countries. In this context, regard should be given to their need to safeguard their balance of payment and level of reserves<sup>602</sup>. In addition, policies aimed at domestic industrial development could be pursued under some circumstances<sup>603</sup>. Moreover, coverage derogation could be requested after entering the agreement in the light of its participation in regional or global arrangements, or by reason of any development, financial and trade need covered by Article V<sup>604</sup>. Although not stated in the text, it has been argued that the world “development” could also include social policies such as the one aimed at promotion of gender or racial equality<sup>605</sup>.

### 3.2.3 Derogation

Another significant departure from the non-discrimination principle can be found in Article XXIII. Under this provision, both discriminatory and non-discriminatory measures might be justified. This means that states might use the provision set out in Article XXIII to justify the use of secondary policies under the GPA. The interests covered by the Article are public morals, order or safety, human animal or plant life or health, intellectual property, or the products or services of handicapped persons, philanthropic institutions or prison labour<sup>606</sup>.

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<sup>600</sup> GPA Article XVI (2).

<sup>601</sup> GPA Article V.

<sup>602</sup> Article V (a).

<sup>603</sup> Article V (b) and (c).

<sup>604</sup> Article V (d).

<sup>605</sup> Arrowsmith (2002) (b) Chapter 13.

<sup>606</sup> The interpretation of derogation provision in the GPA might be linked to the derogations provided in the GATT Article XX, which cover similar interests. On the jurisprudence of the GATT in interpreting the derogation provisions see *United States - Restrictions of Imports of Tuna from Mexico* (Panel Report unadopted, circulated on 3 September 1991); *United States - Restrictions on Imports of Tuna* (Panel report unadopted, circulated on 16 June 1994); *United States – Standards for Reformulated and Conventional*

It is possible to note from the interests protected by the provisions that industrial objectives designed to protect national industries will not generally be allowed. This is not surprising since the GPA is an agreement specifically drafted with the aim of open public procurement to international trade. However, the limits of using this provision to implement other secondary policies such as social, environmental and labour policies<sup>607</sup> are uncertain. Discussions have been held for example over the precise definition of the meaning of the expression “public morals” and “public order”<sup>608</sup>. Does this cover human rights and labour issues? Can this provision justify the use of discriminatory conditions directed at readdressing inequalities between individuals<sup>609</sup>? The answer is not clear. Nonetheless, Arrowsmith has accurately pointed out that probably the best approach would be to require all policies (discriminatory and non-discriminatory) to be justified, but to remove limitations on the possible types of public interest justifications<sup>610</sup>.

### 3.2.4 Set-asides

As mentioned above, discriminatory measures are generally prohibited under the GPA. Thus, set-asides cannot generally be used. For countries that want to reserve part of their procurement to implement secondary policies, the legal path is to limit coverage of the agreement. An exception, however, should be made to the provision on Article XXIII (1), which states that any party should be prevented from “taking any action or not disclosing any information which it considers necessary for the protection of its essential security interests relating to the procurement of arms, ammunition or war materials, or to procurement indispensable for national

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*Gasoline* (Panel and Appellate Body Reports Adopted 20 May 1996, WT/DS2/9; *United States – Import Prohibition on Certain Shrimp and Shrimp products* (Appellate Body Report Adopted 6 April 1998, WT/DS58/AB/R).

<sup>607</sup> For discussion on the meaning of such provisions see Hellwig (2000); Priess and Pitschas (2000) (b); Arrowsmith (2002) (b) McCrudden (1999). For application of this provision regarding environmental concerns see Kunzlik (2003) (a).

<sup>608</sup> See Charnowitz (1998) and Feddersen (1998).

<sup>609</sup> In some countries, for example, tensions between ethnic groups might be an important issue for public order. In those countries governments might want to use procurement to ease the tensions between those groups.

<sup>610</sup> Arrowsmith (2002) (b) and (d). Her argument follows from the fact that implementing secondary concerns through public procurement might not have concrete effects in redressing social and other problems. However, for cases where the policy can be effective countries should be allowed to pursue them even if they are discriminatory (such as those to promote the development of disadvantageous groups).

security or for national defence purposes". Thus it is possible for example to justify the set-aside of a portion of the defence procurement (that would otherwise be caught by the GPA) to national suppliers, arguing that the maintenance of such suppliers are vital to national security.

### 3.2.5 *Drafting specifications*

Since specifications that are discriminatory are generally prohibited, it is important to establish whether non-discriminatory policies could be implemented through the draft of specifications. Firstly, it should be noted by purchasing authorities that when designing contract specifications they must not create unnecessary obstacles to international trade, which means that contractors must not be excluded if they can provide the good, work or service adequately<sup>611</sup>. The agreement states that technical specifications prescribed by procuring entities shall be in terms of performance rather than design or descriptive characteristics; and be based on international standards.

Since the GPA is part of the WTO system, a distinction has been made between conditions that relate to the characteristics of the products, construction or service being procured and those that relate to their methods of production<sup>612</sup>. Under the GATT the second type of restriction is generally prohibited<sup>613</sup> and thus the GPA might be interpreted in the same way. However, there is nothing in the GPA that supports this argument, and indeed Arrowsmith seems to be right when advocating that the GPA must be interpreted as not affecting the application of non-discriminatory conditions concerning delivery or production methods<sup>614</sup>.

### 3.2.6 *Qualification conditions*

There are significant uncertainties on the legality of the implementation of secondary policies through qualification conditions. The GPA states that entities must establish only

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<sup>611</sup> GPA Article VI 1.

<sup>612</sup> Arrowsmith (2002) (b).

<sup>613</sup> Report of the panel in *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, report of 6 April 1998 at 7.17. Also see discussion on extra territorial effect of procurement regulation below.

<sup>614</sup> Arrowsmith (2002) (b). Also see Kunzlik (2003) (a) for discussion on the relation between the GATT provision and the technical specifications requirements of the GPA.

conditions that are “essential to ensure the firm’s capability to fulfil the contract”<sup>615</sup>. However the precise limits of what could be regarded as a condition related to the capability of the supplier is not clear. For example, is it possible for contracting authorities to impose a contractual requirement relating to the working conditions or composition of the workforce, and thus exclude suppliers that cannot meet such requirements? Are conditions related to the suppliers’ recruitment policy or environmental policy covered by the provision? What if those conditions do not specifically relate to the contract? Can they relate to past performance, or only to future behaviour?<sup>616</sup> The only express provisions state that firms could be excluded for bankruptcy or false declarations, provided that such an action is consistent with the national treatment and non-discrimination provisions<sup>617</sup>.

Many of the uncertainties regarding the use of secondary policies have been raised by EU and Japan in a complaint against the US (the *Myanmar/Massachusetts* case)<sup>618</sup>. In this instance, the state of Massachusetts adopted a law excluding firms doing business with Myanmar from the procurement procedures. In some limited circumstances, when competition would be otherwise inadequate firms were allowed to compete but a price preference was imposed against them. This policy was adopted in protest against Myanmar’s record on human rights, but was considered unconstitutional by US Supreme Court<sup>619</sup> and the complaint before the dispute settlement body of the WTO allowed to lapse<sup>620</sup>. Therefore no guidance on the precise limits of the provisions has been given so far.

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<sup>615</sup> Article III (b).

<sup>616</sup> Kunzlik (2003) (a) advocate for the possibility of including past performance. McCrudden (1999) also support the use of secondary provisions that are not directly related to the contract. Arrowsmith (2002) (b) explains the uncertainties related both to conditions related to the contract and to conditions that are not contract specific.

<sup>617</sup> Article VIII (h).

<sup>618</sup> United States – Measures Affecting Government Procurement – Constitution of the Panel Established at the Request of the European Communities and Japan (21 October 1998, WT/DS88/4, WT/DS95/4. On the legal issues see further Oram, (1998); McCrudden, (1999); Priess and Pitschas, (2000) (b); Moritsugu, (2002); Hellwig, (2000).

<sup>619</sup> *Crosby v National Foreign Trade Council* 120 S.Ct.2288 (2000). Also see Linarelli, (2001) (a).

<sup>620</sup> United States – Measures Affecting Government Procurement – Lapse of the Authority for the Establishment of the Panel – Note by the Secretariat (11 February 2000, WT/DS88/6, WT/DS95/6) available at [http://www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_subjects\\_index\\_e.htm#bkmk54](http://www.wto.org/english/tratop_e/dispu_e/dispu_subjects_index_e.htm#bkmk54).

### *3.2.7 Award criteria*

The GPA is also not clear on the possibility of establishing social, environmental and industrial objectives at the award stage. It has been mentioned that any discriminatory policy is forbidden, and so are offsets. However, contracting authorities might want to implement non-discriminatory provisions such as a price preference to bids offering products that achieve certain environmental standards. The GPA Article XIII 4(a) allows entities to award the contract to the “most advantageous” offer. However, it does not provide any limits to the kind of criteria to be used<sup>621</sup>. Thus, secondary criteria might probably be used to determine the winning offer<sup>622</sup>. The only limitation imposed by the GPA is that any factors other than price that are to be considered in the evaluation of tenders must be published in advance<sup>623</sup>.

### *3.2.8 Contract Conditions*

As mentioned above, there are many uncertainties over the legality of the application of conditions that relate to the characteristics of the product, construction or service that is being procured, or conditions relating to the production process or delivery method. The GPA is not clear but it is possible that such conditions, if not discriminatory, can be used as a means to pursue secondary concerns.

A greater difficulty lies in the general measures imposed as contract conditions relating to the working conditions or composition of the workforce. If, for example, the contracting authority establishes that contractors must use disadvantaged persons (such as those from an ethnic minority) as part of their workforce in performing the contracts, could this criterion be challenged under the GPA? As discussed above, such a criterion might be caught by the prohibition of offsets if it aims to improve local development. Moreover, contractors probably might not be excluded at the qualification stage since compliance with such a condition might not

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<sup>621</sup> Unlike the provisions in other trade agreements such as the EU directives, the GPA does not bring an illustrative list which might impose a limitation to criteria relating to the delivery of products, construction and services.

<sup>622</sup> Arrowsmith (2002) (b) Chapter 13. Also see her discussion with McCrudden’s argument on the existence of a “purity principle”. Regarding the use of environmental obligations see Kunzlik (2003) (a).

<sup>623</sup> GPA Article XII (2) (h).

affect their capacity to fulfil the contract.<sup>624</sup>. However, there is no other limitation under the GPA on inserting such criteria into the contract. According to Arrowsmith, one solution that could set a compromise between the discretion allowed under the GPA and the transparency requirement, would be to prohibit the exclusion, but allow measures for breach of contract if the secondary policy is not implemented. Nonetheless, she also recognises that implementation in such a way might affect the ability of the contracting agency to implement its policy effectively. Another possibility might be to include as contract conditions only those requirements which are set out in other legislation (national or international)<sup>625</sup>.

### 3.2.9 Transparency

The implementation of secondary policies, either through discriminatory or non-discriminatory measures, is subjected to rules on transparency. First, it should be noted that even for procurement not subjected to the GPA, any WTO member is subject to the transparency obligations of the GATT and the GATS (which are multilateral agreements establishing general rules on trade of goods and services). The rules on transparency in those multilateral agreements refer generally to the need to publish national legislation and administrative measures affecting sale imports. This probably also covers public procurement measures, and thus general legalisation and measures must be published.

The provisions of the GPA provide more strict obligations on member states. Firstly, Article XIX requires parties to publish any law, regulation, judicial decision, administrative ruling of general application, and any procedure (including standard contract clauses) regarding government procurement covered by the Agreement (Article XIX (1)). This certainly includes any rules on the implementation of secondary criteria in procurement awards. Moreover, the article requires governments to be prepared, upon request, to explain its procurement procedures

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<sup>624</sup> The interpretation of the meaning of “capability to perform the contract” under GPA Article VIII (b) is not clear. A narrower interpretation would be that it relates only to the actual delivery of goods, works and services and not workforce matters. A broad view would be that being capable to perform would include this sort of requirement. Arrowsmith (2002) (b) Chapter 13, adopts a broader view although her own opinion on this matter has evolved over the years see Arrowsmith, (1995).

<sup>625</sup> Thus, for example, government could be allowed to use the provisions of the ILO convention as contract conditions. See McCrudden (1999).

to any other party and to give any “available” information on procurement by covered entities and on specific contracts award issued by them. (Article XIX(3)). The obligation to provide prompt information on procurement practices and procedures is also extended to the covered entities themselves (Article XVIII (2) (a)). Thus, probably any measure, even if it falls under the derogations of the agreement, has to be explained (although it might not have to be justified) to other parties upon request.

Regarding the award of specific contracts, the GPA lays down some detailed procedural rules, which are designed to ensure transparent award procedures, and to guarantee the actual application of principles of fair competition and non-discrimination, and to give contractors from all member states real access to the procurement contracts covered by the Agreement. Thus, the GPA requires for example that procurement contracts are advertised in publications listed in Appendix II, and that entities maintaining a permanent list of qualified suppliers publish annually a notice with the conditions to be fulfilled by suppliers with a view to their inscription on those lists, and the methods according to which each of those conditions will be verified by the entity concerned (Article IX). In this context, if the secondary criteria are to be used as qualification requirement, for example, they must be clearly stated to other parties.

### *3.2.10 GPA and the extra-territorial effect of national policies*

One important consequence of the interaction between international trade and domestic policy is the possibility that domestic policies will have an *extra-territorial effect*<sup>626</sup>. This means that, as in the *Myanmar/Massachusetts* case, governments might adopt measures directed at changing the policies of foreign governments, or policies that are directed at the way suppliers conduct their business in foreign jurisdictions. The legality of such measures under the WTO system is controversial and arguments have been advanced under the GATT/WTO law to limit the application of such measures<sup>627</sup>.

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<sup>626</sup> See comments on extra-territorial effects of GATTS rules in Shuman (1994).

<sup>627</sup> Extra-territorial effects of trade measure have being considered in the first and second *Tuna/Dolphin* case. The first case which resulted in the United States - *Restrictions of Imports of Tuna from Mexico* (Panel Report unadopted, circulated on 3 September 1991), it was argued that the derogations provide by GATT Article XX could not be invoked to protect environmental interest outside a state's own jurisdiction.

However, there has been some support for the admission of procurement measures that support accepted international norms, such as the International Labour Organization labour standards<sup>628</sup>. The ILO Convention No. 94 provides for the insertion of labour clauses into contracts between private parties and central public authorities and requires that wages, hours of working and other conditions of work under those contracts are not less favourable than those established for work of the same character in the trade industry concerned, in the district where the work is carried out<sup>629</sup>. Despite the extra-territorial effect that the insertion of such requirements in procurement would have, such a measure might probably be allowed under the GPA for several reasons. Firstly, it is not discriminatory as all suppliers are referred to an international standard rather than a standard set-up by the implementing state. Secondly, provided that suppliers are told in advance about the requirement, the rule can be regarded as transparent and enforceable since conditions of labour force are usually set out in rules and regulations which are external from the procurement legal framework.

### 3.3 EC Directives

From the perspective of international public procurement, another important set of rules can be found in the context of the European Community. The regulatory regime in public procurement from the European perspective is aimed to support greater trade integration among member countries<sup>630</sup>. For that purpose, the EC has drafted specific procurement directives that must be applied by all member states for central and local government contracts above the defined threshold<sup>631</sup>. The importance of the tension between national procurement policies directed at secondary objectives and the effort of the Community Law in liberalising the

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On the second case *United States - Restrictions on Imports of Tuna* (Panel report unadopted, circulated on 16 June 1994) the panel ruled that although extra-territorial effect could in principle be justified it was not possible to apply measures that would have the effect of forcing other states to change their policies.

<sup>628</sup> See McCrudden (1999). For the tension between labour rights and international trade agreements see McCrudden and Davies, (2000). For the inclusion of ILO provisions on World Bank projects see comments made by AID WATCH, in [www.aidwatch.org.au/news/13/index.htm on 22/02/02](http://www.aidwatch.org.au/news/13/index.htm on 22/02/02).

<sup>629</sup> Article 2 (1) of the ILO Convention No. 94. On the application of the ILO convention on procurement also see Nielsen, (1995); McCrudden (1999); McCrudden (2004).

<sup>630</sup> For procurement and trade integration see Bovis (1998) (b), Madsen (2002), Trionfetti (2001).

<sup>631</sup> For more information on the European procurement directives see Arrowsmith, (2005); Bovis (2005) (a); Arrowsmith (1993); Medhurst (1997); Fernandez Martin (1996); Trepte (1993) among others. For a more general overview of the European regulatory system see Verdaux, (2003).

procurement market becomes evident in some of the cases brought to the European Court of Justice<sup>632</sup> and in the relevance of the theme on the European Commission procurement documents<sup>633</sup>. More recently the need to accommodate those interests has been reflected in the New Procurement Directives published in 2004, and that will need to be implemented in member states no later than 31 January 2006<sup>634</sup>.

### 3.3.1 Treaty Principles

Before defining the provisions of the procurement-specific legislation, it must be said that government contracts will be affected by the general rules defined in the E.C. Treaty<sup>635</sup>. Thus, even for contracts that do not fall within the scope of the directives (because for example, their values falls below the threshold limit), there are treaty principles that will apply<sup>636</sup>. Those principles include equal treatment for suppliers from all member countries, free movement of goods, services and persons, and transparency requirements, among others<sup>637</sup>. The fulfilment of the obligations stated by the Treaty might require both positive and negative actions<sup>638</sup>. In this

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<sup>632</sup> See for example, Case 31/87, *Gebroeders Beentjes B.V. v The Netherlands* [1988]ECR 4635; Case C360/89, *Commission v Italy*, [1992]ECR I-3415; Case C243/89 *Commission v Denmark* [1993] ECR I-3353; Case C-225/98 Commission V. France, judgment of 26 September 2000 and Case -513/99 Concordia Bus Finland Oy Ab (formerly Stagecoach Finland) v. City of Helsinki and HKL-Bussiliikenne, judgment of 17 September 2002.

<sup>633</sup> The European Commission Green Paper, *Public Procurement in the European Union: Exploring the Way Forward* (1996) COM 583 pp 39-42. The European Commission Communication, *Public Procurement in the European Union* COM (98) 143 sections 4.3-4.4. European Communities, Commission interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating social considerations in public procurement, COM (2001) 566 final October 15 2001; European Communities, Commission interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating environmental considerations in public procurement, COM (2001) 274 final July 4 2001.

<sup>634</sup> For an in depth analysis of the European procurement directives see Arrowsmith (2005); For specific comments on the changes brought by the new directives see Arrowsmith (2004) (b), Arnould (2004), Williams (2004), and Bovis (2005) (b). On the tension of national policies and community law also see Arrowsmith, (1999), Arrowsmith, (2002) (a) Priess and Pitschas, (2000) (a); McCrudden (1998); Kunzlik, (1998); Boris, (1998) (a); Tobler (2000), Arrowsmith, Meyer and Trybus (2000), Piselli (2000), Kruger, Nielsen and Brunn (1998).

<sup>635</sup> The most important are Article 28 EC on free movement of goods, Article 49 EC on freedom to provide services and Article 43 on freedom of establishment.

<sup>636</sup> For application of treaty principles in government contracts see Braun (2000); Krügner (2003); Neumayr (2002) and Arrowsmith (2005).

<sup>637</sup> The principles of equal treatment, transparency and non-discrimination should guide the application of the procurement directives. See Case C-243/89, *Commission v Denmark* [1993] ECR I-3353 (Storebaelt) and Case C-87/94, *Commission v Belgium* [1996] ECR I-2043 (Walloon Buses). Also see Treumer, (1999). The new directives bring those principles on Article 2.

<sup>638</sup> European Commission, *Interpretative Communication on Concessions under Community Law* [2000] O.J. C121/2, explaining how European law regulates procurement in the form of concession contracts. For

context, entities are not only generally prohibited from discriminating against suppliers from other member countries, but must ensure that all suppliers have access to public procurement contracts by, for example, advertising such contracts<sup>639</sup>. Derogations and limitations to the treaty principles do exist, such as those concerning military equipment, but they are very limited in scope<sup>640</sup>. Thus, it can be said that under European legislation, the pursuit of industrial policies, such as those aiming at the development of a particular industry or region, or policies protecting the national industry as a whole, are not allowed.

### 3.3.2 Coverage

The EC currently has two groups of directives: the public sector directives, which include contracts for supply<sup>641</sup>, works<sup>642</sup> and services<sup>643</sup> issued by public bodies in general, and the utilities directives<sup>644</sup> which regulate contracts issued by bodies engaged in certain activities in the sectors of water, transport, energy and telecommunications. In both groups there is also a directive covering remedies<sup>645</sup>.

Coverage of the EC procurement directives is much wider than in the GPA and is not subject to negotiation or reciprocity requirements. Article 1 (b) of the ‘Works’, ‘Supply’ and ‘Services’ Directive gives a uniform definition of the term ‘contracting authorities’. It states that the state, regional or local authorities, bodies governed by public law and associations formed by

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the requirement of positive actions in Braun (2000); Krügner (2003); Neumayr (2002) and Arrowsmith (2005).

<sup>639</sup> See *Consorzio Aziende Metano (CoNaMe) v Comune di Cingia de Botti* (C231/03) (Unreported, July 21, 2005) (ECJ) and comments by Brown (2005).

<sup>640</sup> Article 296(1)(b) of the Treaty. For defence procurement in the EC, see Trybus (2000).

<sup>641</sup> **Council Directive 93/36/EEC** of 9.8.1993, [1993] O.J. L199/1 as amended by **Council Directive 97/52**, [1997] O.J.L328/1.

<sup>642</sup> **Council Directive 93/37/EEC** of 9.8.1993, [1993] O.J. L199/54 as amended by **Council Directive 97/52**, [1997] O.J.L328/1.

<sup>643</sup> **Council Directive 92/50/EEC** of 18.6.1992, [1992] O.J. L209/1 as amended by **Council Directive 97/52**, [1997] O.J.L328/1. After January 2006 the public sector will be covered by the **Directive 2004/18/EC** (Official Journal L 134 , 30/04/2004).

<sup>644</sup> **Council Directive 93/38/EEC** of 9/8/1993, [1993] O.J. L199/84 (as amended by **Council Directive 94/50/EC**, [1994] O.J. L164/3) also amended by **Council Directive 98/4/EC**, [1998] O.J. L101/1. After January 2006 the Utilities sector will be covered by the Directive 2004/17/EC (Official Journal L 134 , 30/04/2004).

<sup>645</sup> **Council Directive 89/665/EEC** of 21.12.1989, [1989] O.J. L395/33 and **Council Directive 92/13/EEC**, [1992] O.J. L76/7.

one or several of those authorities should be regarded as ‘contracting authorities’<sup>646</sup>. The Utilities Directive, Article 2 (1), identifies three types of entities covered: public authorities, which has the same definition as contracting authorities under the public sector Directives; public undertakings<sup>647</sup>; and bodies that are not public authorities or public undertakings but operate one of the activities covered on the basis of special or exclusive rights granted by a competent authority of a member state.

In addition, Article 1 (a) of each Directive provides that the regulation will generally apply to all contracts to the supply, work or service, which is for pecuniary interest and is concluded in writing. The exceptions made to this provision are limited and include contracts such as those declared secret, or the execution of which must be accompanied by special security measures<sup>648</sup>. However, member states cannot exclude contracts from the application of the Directives in order to pursue secondary policies.

### 3.3.3 Set-aside

As mentioned before, the European procurement directives aim to provide greater trade integration among member states. Thus, measures that exclude suppliers from another member country either expressly, or that have a trade restrictive effect are not generally permitted. A significant exception is made for military equipment, although even for such contracts, there has been a move within the European community to liberalise defence procurement<sup>649</sup>. Thus, states are generally allowed to award contracts for the acquisition of, for example, military tanks to national firms.

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<sup>646</sup> The Directives also bring some criteria on the meaning of ‘a body governed by public law’. For interpretation given by the European Court of Justice on covered entities see Case C-380/98, *R v HM Treasury ex parte University of Cambridge*, [2000] ECR I-8035; Case C-237/99, *Commission v French Republic* [2001] E.C.R. I-0939; Case C-373/00, *Adolf Truley v Bestattung Wien*, ECJ judgment of 27 February 2003; Case C-360/96, *Gemeente Arnhem v BFI Holding BV*, [1998] E.C.R. I-6821; Joined Cases C-223/99 and C-260/99, *Agora v Ente Autonomo Fiera Internazionale di Milan*, [2001] ECR I-3605. For discussion on the precise meaning of the provision see Arrowsmith (2004) (c), Papangeli, (2000), Williams (1998); Bennett and Cirelli (1993) and Arrowsmith (2005).

<sup>647</sup> Article 1 (2) - ‘undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it’.

<sup>648</sup> Article 2 of the supply Directive. There is also number of exceptions for specific contracts, for example, in the services directives. Moreover, purchasing from other contracting authorities might also be excluded. For a detail on the application of the directives see Arrowsmith (2005).

<sup>649</sup> Trybus (2004); Trybus (2002); Trybus (2000); Georgopoulos (2005).

Another significant departure from the application of the general principles of non-discrimination and equality among bidders in order to implement secondary concerns is provided in the new procurement directives. The directives provide that "Member States may reserve the right to participate in public contract award procedures to sheltered workshops or provide for such contracts to be performed in the context of sheltered employment programmes where most of the employees concerned are handicapped persons who, by reason of the nature or the seriousness of their disabilities, cannot carry on occupations under normal conditions"<sup>650</sup>. Although a primary interpretation of the provision could seem to authorise contracting authorities to award contracts to specific entities<sup>651</sup> a better view is that competition among firms from the protected group is required<sup>652</sup>.

### 3.3.4 Technical specifications

In drafting technical specifications, contracting authorities must be careful not to infringe the Treaty principles. Thus, specifications must not discriminate either directly or indirectly among suppliers from other member countries<sup>653</sup>. Thus industrial objectives are generally ruled out.

In order to guarantee transparency and equal treatment among bidders the directives also have specific provisions on drafting specifications. Contracting authorities are required, for example, to refer to the performance and functionality of the product, rather than to give a detailed description of the product characteristics<sup>654</sup>. If, however, reference to a specific characteristic is unavoidable, it must be stated expressly that products which are "equivalent" will be accepted<sup>655</sup>. When standards are used, contracting authorities should avoid reference to national standards since this might cause limitations to foreign contractors who do not normally

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<sup>650</sup> Article 19 of the new public sector directive and Article 28 of the new utilities directive.

<sup>651</sup> Arrowsmith (2004) (b).

<sup>652</sup> Arrosmith has changed her view and explains her position in Arrowsmith (2005).

<sup>653</sup> See Case 45/87, *Commission v Ireland* [1988] ECR 4929 (*Dundalk* case).

<sup>654</sup> See Articles 8 of the supply Directive, Article 14 of the service Directive and Article 10 of the works Directive. Under the New Public Sector Directive Article 23 states the rule of specifications.

<sup>655</sup> See Case C-359/93, *Commission v Netherlands* [1995] ECR I-157 (*UNIX* case).

have their products evaluated against the standards of another country<sup>656</sup>. Moreover, when there is a European standard for the product being procured, purchasers must refer to it unless it falls within the limited exceptions drafted in the directives, such as where their use would involve incompatibility with existing equipment or disproportionate cost<sup>657</sup>.

The new Directives expressly state that when drafting specifications purchasers can include environmental characteristics as one of the functional requirements of the product. Thus energy efficiency features of a product may be considered despite the costs involved in such a choice<sup>658</sup>. This would also apply for works and services being procured. So purchasers could probably stipulate that when opening a new road the contractor should keep disruption to minimum level. However, it should be noted that the criteria must relate to the subject matter of the contract, and thus it is not possible to insert criteria relating to the supplier's production method as a whole. Thus a requirement stating the product must be produced by a factory that keeps pollution levels to certain standard will not be admissible.

### 3.3.5 *Qualification criteria*

The inclusion of social and environmental requirements as qualification conditions, or as contract conditions but with judgment of the ability of the contractors to comply with them performed at the qualification stage, are limited by the directives provisions. The directives provide that contracting authorities can at the qualifications stage request evidence of the technical capacity, financial standing and the enrolment of bidders in professional or trade registers<sup>659</sup>. Moreover, any condition required must be related to the ability of the contractor to perform the contract. Thus, the directives bring a limited list of documents that can be required

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<sup>656</sup> See Case 120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung fur Branntwein*, [1979] ECR 649 (*Cassis de Dijon* case). For discussion on specifications see Arrowsmith (2005).

<sup>657</sup> Under the new directive purchaser could either draft the specifications based on standards (preferably European but national standard can also be used) or on performance and functionality of the product. Moreover, the new directive states clearly that purchasers can not insist on compliance with European standards but must accept other suitable products. Article 23.

<sup>658</sup> The fact that this might limit the number of suppliers that are able to provide the product is not necessarily regarded as a discriminatory provision. See *Concordia Bus Finland* case below.

<sup>659</sup> For financial stand see Works Directive Article 26; Supply Directive Article 22; Services Directive Article 31, for technical capacity see Works Directive Article 27; Supply Directive Article 23; Services Directive Article 32; for enrolment requirements see Works Directive Article 25; Supply Directive Article 21; Services Directive Article 30; Services Directive Article 32.

by the purchaser as proof of technical capacity<sup>660</sup>. In this context, only secondary concerns that can affect the bidders' capability to perform the contract might be included.

The directives also provide for a list of possible grounds for exclusion<sup>661</sup>. Bidders can be excluded on grounds of bankruptcy; if they are convicted of an offence concerning their professional conduct; if they have committed grave professional misconduct; if they have not fulfilled obligations relating to the payment of social security contributions; if they have not fulfilled obligations relating to the payment of taxes, or if they are found guilty of serious misrepresentation. This is a prescriptive list, and not an illustrative one. Thus contracting authorities cannot add any other grounds for exclusion. However, authorities might be able to use this provision to pursue social and environmental concerns if for example they were prescribed in other legislation, and failure to comply implies an offence relating to the business, or gross misconduct.

The new directives also bring new grounds for exclusion aimed at fighting crime and corruption. It is important to note that while under the old directives contracting authorities were free to decide whether or not to include any of the exclusion provisions, under the new directives, member states are obliged to implement this Community policy through the procurement regulation. The directives states that firms that were convicted of participation in a criminal organisation, corruption, fraud or money laundering should be excluded from participation in public procurement contracts governed by the directives<sup>662</sup>.

### *3.3.6 Award criteria*

In evaluating an offer the directives require that contracting authorities use either the lowest price or the "most economically advantageous" criteria. The directives also provide an illustrative list of criteria that can be used in evaluating the "most economically advantageous"

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<sup>660</sup> For Court ruling that this is a limited list see Case 76/81, S.A. Transporoute v Minister of Public Works [1982] E.C.R. 417; Joined cases 27-29/86, S.A. Construction et Entreprises Industrielles (CEI) and others v Societe Co-operative "Association Intercommunales pur les Autoroutes des Ardennes" ("CEI and Bellini") [1987] E.C.R. 3347; case C-71/92, Commission v Spain [1993] ECR I-5923.

<sup>661</sup> See Works Directive Article 25; Supply Directive Article 20; Services Directive Article 29. Article 45 (2) of the Directive 2004/18/ of 31 March 2004.

<sup>662</sup> Article 45 (1) of the Directive 2004/18/ of 31 March 2004. For comments on this provision see Arrowsmith (2004) (b).

offer. The list is not exhaustive and other criteria can be used in assessing an offer<sup>663</sup>. The legality of the use of environmental criteria as one of the criteria used at the award stage has been brought to the attention of the European Court<sup>664</sup>. In a procurement based on the most economically advantageous tender, the contracting agency determined that the operator's quality and environmental management was to be considered, and points should be awarded based on the level of nitrogen oxide emission and external noise levels. The Court decided that award criteria are not limited to criteria of "purely economic nature" and that in principle, criteria relating to the "preservation of the environment" could be used.

There were, however, some limitations to the discretion granted to contracting authorities. The criteria must relate to the contract's subject matter and must not give "unrestricted freedom of choice" to the contracting authority, but must be "specific" and "quantifiable"<sup>665</sup>. By setting those limits the Court has opened up the opportunity to accommodate environmental requirements into award criteria without compromising transparency and open trade objectives<sup>666</sup>. Although this case concerned environmental criteria, it is possible that these requirements also apply to social criteria<sup>667</sup>. The new directives expressly provide that the contracting authority can take environmental characteristics into account when awarding a contract under the "most advantageous offer", provided that they are linked to the subject matter of the contract and are precise<sup>668</sup>. They must be expressed on the contract notice and the contracting authority must establish a weighting or a priority system of evaluation<sup>669</sup>.

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<sup>663</sup> See Case C-19/00, SIAC Construction v County Council of the County of Mayo [2001] ECR I-7725.

<sup>664</sup> Case C-513/99, *Concordia Bus Finland v. Helsinki*, [2002] ECR I-7213.

<sup>665</sup> There are some uncertainties on the precise meaning of those words. See Arrowsmith (2004) (b). Also see decision of the Court of First Instance in the Case T-4/01, *Renco SpA v. Council* Court of First Instance; judgment of February 25, 2003.

<sup>666</sup> For a deeper analysis of the possibility to accommodate environmental requirement under the EC procurement context see Kunzlik, (2003) (a).

<sup>667</sup> There are however some discussion over the possibility of applying the ruling on this case for award criteria relating to "workforce issues", such a requirement to combat unemployment. However, this discussion is better placed at the analysis of contract conditions. See the *Commission v. France* case and the *Beentjes* case.

<sup>668</sup> New public Sector Directive Art. 53 (1) and utilities Directive Art. 55 (1). These provision confirm the ECJ ruling in the *Concordia Bus Finland* case and in the *EVN* case (C-448/01, *EVN AG, Wienstrom GmbH v Republik Österreich* [2003] E.C.R. I-14527).

<sup>669</sup> Article 53 of the Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004.

An important requirement for any criteria to be used in awarding contracts is that it must be disclosed to tenders in advance. In line with the Treaty principle of transparency, the directives require the authority to state in advance - in the contract notice or documents - precisely which factors it intends to consider, “where possible in descending order of importance”. However, under the old directives it did not seem to be necessary to detail precisely how those factors would be considered<sup>670</sup>. Under the new directives, contracting authorities are required to specify in the contract notice or in the contract documents the relative weighting which they give to each of the criteria chosen in order to determine the most economically advantageous tender<sup>671</sup>.

It is probably also important to mention that abnormally low bids can sometimes be rejected. The directives state that the contracting authority must seek explanations from the suppliers. However, it is not clear whether only commercial justifications could lead to a rejection, or whether the purchaser can reject an offer because, for example, the firm is receiving unlawful state aid. The new directives clarify that unlawful state aid can be regarded as grounds for rejecting an abnormal offer and sets out procedures in those instances<sup>672</sup>. It is interesting to note that lower environmental and social standards in some countries might lead to disparities on the value of offers. However, in order to comply with the treaty principle of equal treatment, suppliers from those countries cannot be rejected, provided that they comply with the regulations of the place where the work, service or supply is to be performed<sup>673</sup>.

### 3.3.7 *Contract Conditions*

The best authority on the position regarding the implementation of secondary policies through procurement contracts is found in the *Beentjes* case. In this case the Court had to decide about the legality of the exclusion of a contractor because the contracting authority did not think it could comply with a contract condition that obliged tenders to undertake to employ a quota of

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<sup>670</sup> See *Renco* case above and Case T-183/00, *Strabag Benelux NV v. Council of the European Union* Court of First Instance; judgment of February 25 2003. Also see Arrowsmith (2004) (b).

<sup>671</sup> Article 53 (2).

<sup>672</sup> Article 55. For comments on the provision of state aid in the procurement directives see Bovis (2004) and Doern (2004).

<sup>673</sup> In article 55 (1) (d) there is an express provision related to the workforce conditions.

long-term unemployed persons in performing the contract. The Court decided that contractors could not be excluded even if the authority thought it could not comply with the contract condition (only if their bids refused to accept such condition). However, the Court also ruled that in theory, contracting authorities were allowed to include such conditions in the contract. This reinforces what was mentioned earlier; that exclusions at the qualification stage are in fact very limited and, if entities want to include non-discriminatory secondary policies in the contract, they cannot exclude otherwise qualified suppliers and would have to rely on breach of contract measures if the contractor were to fail to meet the criteria.

Another important discussion on a policy to combat unemployment was based on the argument that entities could eventually implement those policies at the award stage. The ECJ, in a case where French authorities issued contract notices referring to the contractor's ability to combat local unemployment as an "award criterion", ruled that combating local unemployment could in principle be capable of being an "award criteria" provided it was not discriminatory<sup>674</sup>. However, such a decision has been criticised as it seems that the Court failed to distinguish between award criteria, and the previous analysis of whether a bid was compliant with the contract notice, and whether the contractor was capable of fulfilling a contract condition to adopt the local policy against unemployment<sup>675</sup>.

The recent procurement directives tried to settle the legal position by expressly allowing "special conditions relating to the performance of a contract, provided that these are compatible with Community law and are indicated in the contract notice or in the specifications. The conditions governing the performance of a contract may, in particular, concern social and environmental considerations<sup>676</sup>". It is important to note that the words "relating to the performance of a contract" imply that only conditions related to the subject matter of the contract can be included. Thus, policies such as affirmative action policies might not comply with the European procurement directives.

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<sup>674</sup> Case C-225/98 *Commission V. France*, judgment of 26 September 2000 (*Nord Pas de Calais*).

<sup>675</sup> See Kunzlik (2003) (a). Arrowsmith (2002) (a); Arrowsmith (2004) (b).

<sup>676</sup> Article 26.

Finally, it is important to emphasise that the European directives only apply to procurement over a certain threshold and therefore, governments might keep secondary policies not allowed under the directives for contracts below the threshold level. Nonetheless discriminatory and anti-competitive measures are ruled out by Treaty principles and cannot be applied to firms from other member states<sup>677</sup>. However, treaty principles would only apply in relation to contractors within the EU and competition in procurement procedures where firms from non-members are allowed to bid is not always free from discriminatory measures<sup>678</sup>.

#### **4 Conclusions**

As seen so far, despite the economic reasons for not including secondary policies in procurement regulations, political choices are usually stronger and procurement is commonly used as a tool to promote those policies, both in developing and developed countries. During the implementation several methods have been used and the choice in each case depends largely on the balance of economic objectives and the importance attributed to the policy being pursued.

Following this line, international agreements reflect the demand of states for discretion and limits, in one way or another, on the opening of procurement in order to accommodate the needs of their parties. The UNCITRAL Model Law, in providing guidance on the reform, or establishment of procurement systems also acknowledges such needs, although to a limited extent. Therefore it is natural that the agreements between the World Bank and borrowers will involve some degree of discussion on those matters, and thus it is worth analysing the extent to which the guidelines will allow, or should allow, for secondary policies to be implemented in procurement financed by the Bank.

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<sup>677</sup> See reference above.

<sup>678</sup> They might be covered by GPA rules if the contractor is from a GPA member.

# **CHAPTER VII – INDUSTRIAL, SOCIAL AND ENVIRONMENTAL POLICIES UNDER THE WORLD BANK PROCUREMENT GUIDELINES AND STANDARD BIDDING DOCUMENTS**

## **1 Introduction**

As explained in Chapter III, when procuring under financed projects national procurement regulations will generally be overruled by the World Bank Guidelines<sup>679</sup>. Thus, any secondary policy that is eventually in place might not apply to the procurement of goods, work and services financed by the Bank. Instead, the Guidelines will bring their own rules on secondary concerns, which will either be imposed in all procurement procedures or negotiated on a case by case basis. If the borrower wants to pursue any particular policy, such policy will be subjected to the limits imposed by the Guidelines and should be discussed with the lender. On the other hand, the lender may impose policies and methods which do not necessarily coincide with the borrower's usual procurement practice. Moreover, the Guidelines might have to accommodate other national and international obligations which are external from the procurement regulation but which have an effect on the procurement rules – for example, when exclusion of suppliers is based on UN resolutions imposing commercial sanctions on a certain country.

This Chapter will aim to examine the Guidelines in order to determine the extent to which secondary objectives could be pursued under financed projects. It will discuss not only the possibility of implementing policies which derive from the borrowers' concerns, but also policies which are pursued by the lender. The analysis will start with an assessment of the impact of the general principles guiding the World Bank operations and, more specifically, the procurement principles set by the Guidelines that are relevant for all methods of procurement under those Guidelines. Secondly, it will consider several issues that are relevant for all methods of procurement. These are, firstly, applicability of the Guidelines, which defines the scope for the

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<sup>679</sup> See discussion in Chapter II section 6.

use of such rules in financed projects; secondly eligibility, which concerns certain rules about which firms may participate, and which are relevant for all methods of procurement; thirdly, measures on fraud and corruption, which are measures imposed by the Bank and which might not coincide with the exclusions made by national governments; and finally procurement planning, where the possibility of the application of policies at a preliminary stage will be considered.

The Chapter will then turn to look at other aspects of the integration of secondary considerations, by looking in turn at the various different methods of procurement. Firstly, the Chapter will look in detail at International Competitive Bidding as this is the main procedure used for the procurement of goods, works and services under financed projects. Then, the Chapter will examine how other methods differ from the rules in the ICB and if they open new possibilities for the implementation of secondary policies. In the following section, the provisions for the procurement of consultant services which present some significant differences from the procurement of goods and works will be examined, and will provide additional scope for the use of secondary criteria.

## **2 General Principles**

As mentioned in Chapter II, the primary rule defining the World Bank operation is its charter, namely the Articles of Agreement. This international instrument defines the powers, scope and limits of all the Bank's activities. At this point we should return to the charter in order to determine whether some of the principles stated there might have an impact on the adoption of policies directed at promoting the industrial development, or raising the social and environmental standard of member countries.

Article I of the Articles of Agreement states that the one of the Bank's purposes is "to promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the **development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labour in their territories**" (emphasis

added).<sup>680</sup> Thus, the Bank must throughout its activities aim to promote the growth of international trade, but at the same time, help members to keep the equilibrium of their balance of payments. Moreover, it must stimulate investment directed at productive resources. The provision also requires that those activities have the result of raising the productivity of members and the living and working conditions for the people in their member countries<sup>681</sup>.

It is possible to foresee that the interpretation of such provision could in theory lead to the adoption of several policies directed to promotion of the industrial and non-industrial objectives in member countries. Since there is no precise definition of the words "development", "productive", and "resource", the scope of the provisions is wide enough to embrace policies directed at the promotion of labour standards, environmental standards, gender policies, human rights, etc. In fact, the provision urges the Bank to pursue policies which will have a direct positive impact on the lives of the people living in its member countries.

However, this primary interpretation should be tempered by the general provision on Article IV, Section 10, which forbids interference in the political affairs of any member and determines that *only economic considerations shall be taken into account*. More specifically, the provisions in Article III, Section 5, determine that the Bank must not predetermine in which member country the proceeds of a loan will be spent and that proceeds of any loan *are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations* (*emphasis added*). Thus any policy adopted by the Bank throughout its operation must have its economic effects and efficiency carefully considered and must not limit the access of the loan proceeds for particular members. Moreover, the Bank may only consider policies if they amount to an "economic consideration", which is distinguished from political interests<sup>682</sup>.

The provision also requires that the Bank refrain from considering political and other non-economical influences in carrying out its loan activities. However, as has been explained

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<sup>680</sup> Articles of Agreement, Article I (iii).

<sup>681</sup> For the Bank's purpose also see Chapter II, section 4.

<sup>682</sup> For discussion on the criteria establishing an 'economic consideration' see Chapter II, section 6.2.

before, the interpretation of the Bank's charter has been enlarged to include not only economic concerns but also nearly all policy issues that could have an economic effect<sup>683</sup>. Thus, over the last year the Bank has included in its operational policies specific rules regarding issues such as the environmental impact of its projects, gender related policies, policies regarding indigenous peoples, etc. Although some discussions have been held over the legality of some of the Bank's activities,<sup>684</sup> it has been generally accepted that the Bank should interpret its charter in a manner which is responsive to the actual economic demands of its members<sup>685</sup>. In fact the Bank has been urged to engage in policy regulation to promote policies that reflect other international agreements<sup>686</sup>.

### 3 Procurement principles

In Chapter III, it was mentioned that following the requirements in the Articles of Agreement, the World Bank procurement Guidelines are driven by four major concerns<sup>687</sup>. Firstly, the Guidelines need to ensure that the goods, works and services needed for the project are **procured with due attention to economy and efficiency**; secondly, the Guidelines need to secure compliance with the Bank's interest in **giving all eligible bidders** from developed and developing countries an **opportunity to compete** in providing goods and works financed by the Bank; thirdly, the Guidelines will **encourage the development of domestic contracting and manufacturing industries** in the borrowing country, stimulating development in those countries; and finally, the Guidelines will aim to ensure **transparency** in the procurement process<sup>688</sup>.

However, the Guidelines do not bring the precise definition for the principles set above. The only light brought by the provision is that an efficient public procurement is generally

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<sup>683</sup> For a careful interpretation of the Bank's charter in the context of human right see Ciorciari (2001). Also see Bradlow and Grossman (1995), and Handl (1998).

<sup>684</sup> See Shihata, (1991-2000); Wadrzyk, (1999). Also see Bradlow (1996) and Head (2004).

<sup>685</sup> Shihata (1991-2000) and Head (2004).

<sup>686</sup> See Head (2004), Handl, (1998), Darrow (2003) and Bradlow (1996).

<sup>687</sup> See Chapter III, section 3.

<sup>688</sup> Guidelines Procurement under IBRD Loans and IDA Credits para. 1.2. The Guidelines for the Selection and Employment of Consultants adds one more principle. This will be discussed on Chapter VII, section 5.3.

achieved through open competition<sup>689</sup>. Thus, any policy that would aim to exclude eligible contractors from the procurement process is expected to be forbidden in principle. The provision also suggests that although all eligible bidders will be allowed to participate, special attention will be given to the industry of the borrowing country. Thus, it is expected that some policies directed at industrial objectives might be allowed, although the precise limits of those cannot be clearly envisaged. For example, it is not clear whether policies directed at the development of the industries of a particular region of the country could be allowed. In addition, the lack of definition of some of the terms such as “development” leaves remaining questions. For example, can a policy directed at raising the environmental requirements of production methods, or one directed at raising labour conditions be regarded as encouraging the development of the domestic industry?<sup>690</sup> The answer is not clear.

The protection of the domestic industry of the borrowing country is the most striking difference from other major international procurement regulations. As seen in the previous Chapter, international agreements on public procurement rely heavily on free trade principles and, although preferences could eventually be set, the aim of those agreements is to limit discriminatory practices<sup>691</sup>. On the other hand, the World Bank establishes the development of the national industry of the borrowing country as one of its procurement concerns. While one can easily understand that the concern of the Bank with the industry of its member countries derives from its obligations under the charter, the choice of using procurement to foster the development of the industry of the borrowing country is not entirely justified. Unlike the GPA, which has provisions to take into account the development needs of all developing countries, the World Bank Guidelines provides that the industry of the borrowing country is of particular concern. As

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<sup>689</sup> Guidelines 1.3.

<sup>690</sup> For discussing on the relation between labour conditions, human rights and economic development see Banjeri and Ghanem (1997); Isham et. al (1997), Kneller (1994), McCrudden and Davies (2000). Also see Shihata (1988) for economic development, environment and human rights, stating there poor environmental conditions and human rights violations can affect the country's stability, prospective creditworthiness.

<sup>691</sup> See discussion over the GPA and the national treatment rules and the EC Directives and the objective of integration of the European market, Chapter VI, sections 3.2.2. and 3.3.1 respectively.

will be further discussed in the next Chapter<sup>692</sup>, in the light of the other procurement objectives, the World Bank might have to better justify the application of discriminatory policies in favour of the domestic industry of the borrowing country.

It is important to note that, as explained in Chapter III, the Bank sometimes finances just part of the project<sup>693</sup>. The Guidelines will only apply for the procurement of goods and services financed by the Bank. For goods and services provided for the same project but financed by other investors the borrowers might have to follow different procurement procedures. However, the Bank establishes that even in those cases, the borrower needs to ensure that the project will be carried out diligently; that the goods and works are of a satisfactory quality; that they will be delivered or completed on time, and that the paid price will not affect the economic and financial viability of the project<sup>694</sup>. For consultant services the Bank requires that the choice of the consultant ensures its professional qualifications, a timely completion of the assignments and consistency with the scope of the project<sup>695</sup>. All those requirements need to be secured to the satisfaction on the Bank, although no clear guidance is given on what would constitute a satisfactory procedure. Could national secondary policies, or policies imposed by other investors be implemented in those instances? The answer will need to be addressed on a case by case basis, depending on the effects of the policy. However, it is clear that the requirements imposed by the Bank could limit the application of some secondary policies even for goods, works and services not financed by the Bank.

Finally, it should also be mentioned that unlike other procurement regimes the World Bank does not allow derogations from the Guidelines based on grounds such as public morals, order or safety, human, animal or plant life or health; intellectual property, or the products or services of handicapped persons, philanthropic institutions or prison labour<sup>696</sup>. This is not to say

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<sup>692</sup> Chapter VIII, section 2.1.

<sup>693</sup> Chapter III, section 5.

<sup>694</sup> Guidelines rule 1.5. The same will happen where the Bank guarantees the repayment of the loan made by another lender. Guidelines 3.16.

<sup>695</sup> Consultants Guidelines 1.8.

<sup>696</sup> Those are allowed under the GPA. Also note the in the EC new procurement directives also bring provisions for the award of contracts in the context of sheltered workshops and handicapped persons.

that those and other secondary concerns could not influence the procurement process by adapting the design of the project, the draft of specifications, or the packaging to the contracts to meet some specify demands<sup>697</sup>. In fact the Guidelines acknowledge that sometimes international competition as set in its rules is not the most appropriate way to procure. Thus, it determines that for some products such as pharmaceutical products, and in some circumstances, such as when the project requires community participation, the borrowers will depart from the general requirement of international competitive bidding<sup>698</sup>. However, it is notable that this departure is not from the Guidelines themselves, and that the borrowers are not free to apply their national policies. In those instances the Guidelines bring some provisions which will allow variations on the procurement process that suits particular needs.

#### **4 Provisions Applicable to all Procurement Methods**

Since the basic principles directing the application of the Guidelines have been defined, we should now turn to some specific provisions which aim to address the concerns set out above. As explained before, there are several methods by which secondary policies can be implemented. Here, some general provisions which are applicable to all procurement methods, and which might reflect the possibility of using secondary policies under the Guidelines will be examined. Those policies will also be assessed as they have an impact on the procurement process.

##### **4.1 Applicability of the Guidelines**

At the start it is wise to determine when the borrower is bound to apply the Guidelines, and whether secondary concerns could lead to a departure from its application. According to the Guidelines' provisions, the World Bank procurement guidelines are applicable to all goods, works and services wholly or partly financed by the Bank<sup>699</sup>. From this statement there are two considerations that are relevant. The first is related to the eligibility of expenditures made by the

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<sup>697</sup> As will be seen further below, local supply capability, for example, can be taken into account in contract packaging, specifications and in choosing the procurement procedure – See Guidelines rule 3.17and Procurement Manual rule 13.5.2 . However, significant discretion is given to procurement staff and no detailed guidance is given on how and when discriminatory polices are allowed.

<sup>698</sup> See more detail explanation on other procurement methods below at section 5.2.

<sup>699</sup> Rule 1.5 of the Procurement Guidelines and rule 1.1 of the Consultants Guidelines.

borrower<sup>700</sup>. It should be noted that there are some expenditures that are not financed by the Bank, such as the purchase of military equipment<sup>701</sup>, the purchase of some high risk pesticides<sup>702</sup>, expenditures directed to the production, processing and marketing of tobacco<sup>703</sup>, etc<sup>704</sup>. Those restrictions are relevant when compared to other international regulations in public procurement, which excluded some of those items because of national security concerns. The Bank, as a multilateral institution concerned with the development of its members and the recovery from wartime losses, will not use its resources to invest in any military operation, even if it is to provide direct support for disarming combatants<sup>705</sup>. Thus, any secondary procurement policy applied in member countries regarding the purchase of those products will not be of the concern of the Guidelines.

The second concern relates to the procurement of co-financed goods, works and services. As mentioned in Chapter III, there are two forms of co-financing arrangements; joint financing and parallel financing<sup>706</sup>. In joint financing arrangements, procurement will have to follow the World Bank Guidelines and no addition requirement, such as conditions requiring bidders to provide supplier's credit or any other form of financing, can be imposed<sup>707</sup>. The major constraint for joint financing is precisely the reluctance of other lenders in accepting the eligibility criteria established in the Guidelines<sup>708</sup>. Thus, where there is no agreement, procurement has to be drafted so to allow for parallel financing and the Guidelines will not generally apply, although, as seen above, the Bank will have to be satisfied that some basic requirements are satisfied. In addition to the requirements mentioned by the Guidelines, the Bank also states that parallel

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<sup>700</sup> For eligibility of expenditures see OP 6.00, January 2004, Bank Financing.

<sup>701</sup> Under OP 2.30, *Development Cooperation and Conflict*, January 2001, the Bank does not finance humanitarian relief or military expenditures. Section 3.

<sup>702</sup> See OP 4.09, *Pest Management*, December 1998.

<sup>703</sup> OP 4.76, *Tobacco*, October 1999. Exceptions, which must be approved by the Vice President, Operations Policy and Strategy, may be allowed for countries that are heavily dependent on tobacco as a source of income.

<sup>704</sup> Also see the Operational Memorandum Demining—Operational Guidelines for Financing Land Mine Clearance, February 7, 1997.

<sup>705</sup> See O.P. 2.30 section 3 (a).

<sup>706</sup> See discussion on Chapter III section 5.

<sup>707</sup> Procurement Manual rule 21.2.

<sup>708</sup> See procurement Manual sections 21.2.1, 21.2.2 and 21.2.3. Also see eligibility requirements in the section 4.2.

financing procurement should not influence or prejudice the procurement of Bank financed contracts by giving an unfair advantage or other preference to the suppliers or contractors of parallel financed contracts<sup>709</sup>. Thus, it is possible that under parallel financing the borrower would have to carefully choose the contract financed by other investors in order to be able to apply the secondary policies required by them (such as only allowing bidders from a certain country or region).

There is however, one peculiar circumstance of co-financing where the Guidelines will not generally apply. This is the case where the Bank lends to an intermediary financing institution for on-lending to the private sector or to autonomous commercial enterprises of the public sector<sup>710</sup>. In those cases, procurement is usually carried out by the beneficiary according to commercial practices, provided these are acceptable to the Bank. Thus, provided that usual practices ensure good competition and reasonable contract value, it is possible that secondary policies usually pursued by the private and public sector can be allowed under financed projects. It should be mentioned that when the size and nature of the procurement package requires ICB procedures, the Bank will insist on the inclusion of such requirements in the loan agreement. Nonetheless, even in those instances, the Bank allows for modifications to accommodate requirements of the intermediary financing institutions, provided that the eligibility criterion is not compromised<sup>711</sup>.

Another instance where the Bank allows a different set of procurement procedures to apply is where the borrowers procure directly from specialised agencies of the United Nations<sup>712</sup>. Such agencies, acting as suppliers, will procure according to their own procedures. This is allowed for small off-the-shelf goods, primarily in the field of education and health, and for specialized products where the number of suppliers is limited, such as for vaccines or drugs. Such departures from the Guidelines will only occur in limited circumstances and will only be permitted where this is the “most appropriate method”.

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<sup>709</sup> Procurement Manual rule 21.3.

<sup>710</sup> See Guidelines rule 3.12 with the correspondent explanation in the Procurement Manual 21.2.1.

<sup>711</sup> Procurement Manual 21.2.1.

<sup>712</sup> Guidelines 3.9.

## **4.2      Grounds for exclusion – general provisions**

The Guidelines has a separate provision establishing grounds for the exclusion of bidders which is applicable to all procurement methods. These provisions are called eligibility criteria. At this stage the Bank is concerned with the ability of the contractor to participate in the procedure and thus establish rules based on the nationality of bidders, on the possibility of occurring conflict of interest situations, on the prevention of subsidies and on the prevention of fraud and corruption. It should be noted that the procurement entity will examine the eligibility of the supplier to participate in the procedure at the qualification stage. Thus, depending on the procurement procedure additional requirements might be imposed for bidders to qualify for the bidding process. At this stage, however, we should address the provisions which are directed at all procurement methods, since such are the only provisions where the Bank will impose its own secondary policies upon the borrower.

The rule 1.6 of the Guidelines states that “to foster competition the Bank permits firms and individuals from all countries to offers goods, works and services for Bank-financed projects”<sup>713</sup>. This rule provides the widest possible competition<sup>714</sup>. It is important to note that unlike international trade agreements, which provide for non-discriminatory measures to apply among member countries, this rule allows contractors from any country, and not only member countries, to provide goods, works and services in financed projects.

This change was introduced in the latest revision of the procurement guidelines concluded in May 2004. The former rule, which is still applicable for loans and credits for which the invitation to negotiate was issued before May 1, 2004, had restrictions based on membership<sup>715</sup>. The Guidelines used to establish that only bids from nationals of, and produced in or supplied from, Bank member countries were eligible to participate in the procurement procedures. Under the Consultants’ Guidelines the procedure was not only limited to firms that

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<sup>713</sup> Rule 1.11 under the Consultants Guidelines.

<sup>714</sup> Eligibility also varies if the resources come from trust funds, which are funds administered by the Bank for a specific purpose, and contributed by only a few of the Bank’s members.

<sup>715</sup> Andorra, Cuba, Democratic People’s Republic of Korea (North Korea), Liechtenstein, Monaco, Nauru, Tuvalu, are not Bank member and therefore are not eligible under old loan contracts.

were registered or incorporated in member countries, but it was also stipulated that individuals and personnel must be nationals of Bank member countries. These rules aimed to fulfil the Bank's concern to give firms in all member countries the opportunity to compete for contracts financed by the institution.

The limitation based on membership has been criticised since such policy did not reflect any economic consideration on the procurement itself, but was determined by political factors and reciprocity arguments. In fact, discriminatory policy based on nationality contravenes the economic theory of free trade and the primary objective of international trade rules, which is to open markets to the best suppliers<sup>716</sup>. It should also be noted that the free trade theory is the base for rules such as the UNCITRAL Model Law and the Bank, while helping borrowing countries to reform their procurement systems, will support projects based on the Model Law rules<sup>717</sup>, and will insist on the opening of the procurement market to foreign suppliers regardless of their nationality. Moreover, the old restrictions imposed additional burdens, especially where borrowers had undertaken other international commitments. If, for example, the borrower has a regional agreement or has signed plurilateral agreements such as the WTO Government Procurement Agreement, it might be bound to open its procurement market to other countries which are not members of the World Bank<sup>718</sup>. In this context it can be said that the changes introduced into the new Procurement Guidelines reflect an important change in the principles followed the Bank, although it must be acknowledged that, in practice, few effects will be felt because of the wide membership of the Bank.

There are, however, two exceptions to the eligibility rule. Section 1.8 provides that firms of a country or goods manufactured in a country may be excluded if *(i) as a matter of law or official regulation, the Borrower's country prohibits commercial relations with that country,*

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<sup>716</sup> See Chapter VI, section 2.1.1.

<sup>717</sup> For the World Bank efforts in reforming the procurement system of borrowing countries see Arrowsmith, Linarelli and Wallace (2000) and Hunja (1998).

<sup>718</sup> Liechtenstein for example is a member of the GPA and not a member of the World Bank. Possibly one of the reasons why developing countries are unlikely to sign the GPA is that some of them rely heavily on foreign aid. Sometimes this aid is tied to the donor countries, which means that the borrower can only choose from contractors from the donor countries. For further discussion on the accession of developing countries to the GPA see Arrowsmith (2002) (b).

*provided that the Bank is satisfied that such exclusion does not preclude effective competition for the supply of goods or works required, or (ii) by an act of compliance with a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations, the Borrower's country prohibits any import of goods from, or payments to, a particular country, person, or entity. Where the Borrower's country prohibits payments to a particular firm or for particular goods by such an act of compliance, that firm may be excluded.<sup>719</sup>* In such a case, firms will be excluded not only from the procurement market, but will be debarred from doing business in the borrowing country in the private market as well. Therefore, this provision does not bring any additional restriction to the procurement market but is intended to accommodate external legislation that might have an effect on the procurement process. Also note that, unless the restriction is based on a United Nations Security Council decision, the exclusion of providers from debarred countries is subject to the acceptance of the Bank. Thus, even national rules external to the procurement regulations could be overruled by the Guidelines provisions.

Eligibility is also subject to transparency and fairness concerns. Thus, firms which have been engaged by the borrower to provide consulting services for the preparation or implementation of a project, and any of its affiliates, will be disqualified from subsequent contracts providing goods, works, or services resulting from or directly related to the firm's consulting services for such preparation or implementation<sup>720</sup>. Also government owned enterprises in the borrower's country may participate only if they can establish that they (i) are legally and financially autonomous, (ii) operate under commercial law, and (iii) are not dependent agencies of the borrower or sub-borrower<sup>721</sup>. Those provisions do not necessarily reflect a concern with the primary objects of procurement since those firms could in theory provide good value contracts. However, their participation in the procurement process could bring concerns over the fairness and transparency. For example, government owned enterprises

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<sup>719</sup> The Consultants guidelines will bring the same restriction at 1.11.

<sup>720</sup> Guidelines rule 1.8 (b). Restrictions based on conflict of interests are also foreseen in the consultant's guidelines. See section below.

<sup>721</sup> Guidelines rule 1.8 (c). Under the Consultant Guidelines there is exception for this general prohibition. (See below).

could provide lower value products given the subsidies they receive from the government, while consultancy firms could draft contracts that they are particularly qualified to perform. The argument behind this exclusion is based on the fact that state subsidy is not seen as a legitimate comparative advantage among otherwise equal competitors, and that a fair procurement choice should account for that.

One interesting comment on the Guidelines' provisions is the fact that it restricts eligibility from government owned enterprises from the borrowing country, and not from any government owned enterprise. Thus it might be argued that foreign public firms could bid in financed projects without them having to comply with the financial, economic and management independence requirements. The limitation of the provision to the public firms from the borrowing country does not seem to be justified, and the transparency and fairness of the procurement regulations are probably better achieved if the provision is extended to any government owned enterprise.

Finally, eligibility is also restricted in view of firms caught in fraudulent and corrupt practices. Exclusion in those cases is a penalty and reflects the particular concern of the Bank with the effects of corruption in procurement in borrowing countries. Since the Bank places a significant emphasis on those concerns, fraud and corruption policies will be addressed in a separate sub-section.

### **4.3 Fraud and Corruption**

Although the pursuit of policies combating fraud and corruption is usually linked with the preservation of legal requirements directing the procurement relationship and ensuring the fairness of the procedure, the debarment of firms for their past behavior and corrupt practices must be seen as a secondary use of the procurement regulation to enforce anti-corruption policies. The fact that a firm has been involved in fraudulent or corrupt practices in the past does not necessarily mean that it will not be able to provide economically advantageous contracts in the

future. However, as seen in Chapter IV<sup>722</sup>, the Bank has established the debarment of firms involved in such unlawful practices as a means to implement its own anti-corruption policies for financed projects<sup>723</sup>. Those provisions probably reflect the main secondary policy imposed by the Bank upon borrowers.

The Bank has specific policies on fraud and corruption. In order to ensure that funds are only disbursed to finance goods, works and services approved in the Loan Agreement, the Bank requires borrowers and beneficiaries, staff members and from bidders, suppliers and contractors to observe the highest standards of ethic during the procurement procedure and the execution of contracts<sup>724</sup>. Its policy not only defines forbidden behaviours but also provides remedies and punishment for those who do not comply with the requirements. Thus, the Bank states that corrupt, fraudulent, collusive or coercive practices will not be accepted<sup>725</sup>, and that should they occur, the Bank may reject the proposed award; cancel a portion, or the entire loan, or debar involved firms from future contracts either permanently or for a period of time<sup>726</sup>.

The presence of policies aiming to secure probity in the procurement procedure is not particular to the World Bank system. As seen above, many national regulations also have policies directed at preventing corrupt practices<sup>727</sup>. The Model Law, for example, states as one of its objectives *promoting the integrity of and fairness and public confidence in, the procurement process*<sup>728</sup>. Moreover, it suggests that proposals from bidders caught in corrupt practices should be rejected<sup>729</sup>, and bidders who provide false information should be disqualified<sup>730</sup>. The Guide to Enactment also suggests that, in addition to the provisions, the enacting state should have in place an effective system of sanctions against corruption by government officials, including employees

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<sup>722</sup> Section 2.3.

<sup>723</sup> As mentioned in Chapter IV the Bank defines the practices that it considers to be unlawful regardless of the legislation of the borrowing country. See Salbu (1999) for differences in what should be regarded as corruption.

<sup>724</sup> Guidelines 1.14.

<sup>725</sup> Definition at Guidelines 1.14 (a).

<sup>726</sup> Guidelines 1.14 (b), (c), and (d).

<sup>727</sup> Chapter VI, section 2.4.

<sup>728</sup> Preamble paragraph (e).

<sup>729</sup> Article 15.

<sup>730</sup> Article 6 (1) (b) (v).

of procuring entities, and by suppliers and contractors, which would also apply to the procurement process<sup>731</sup>.

The Bank acknowledges and provides incentives to national policies in combating corruption. In fact, over the past few years the Bank has conducted a number of studies on the procurement practices of borrowing countries and has helped to reform procurement systems, with an emphasis on combating corruption<sup>732</sup>. However, if the borrower has implemented rules providing for the exclusion of suppliers from future government contracts if they are caught in misconduct, such rules must not be used under financed procurement unless the firm has also been debarred under the Bank's own procedure<sup>733</sup>. In fact, in financed projects, the only rule in the Guidelines allowing for the use of national anti-corruption policies states that with the specific agreement of the Bank, a borrower may introduce into bid forms for large contracts a clause requiring bidders to observe in competing and executing the contract the country's law against fraud and corruption<sup>734</sup>. The wording of the provision, however, brings two significant restrictions to the applications of national policies. The first one relates to the requirement of being satisfactory to the Bank. This implies that the Bank will not support any policy directed at combating fraud and corruption and that any rules regarding these issues have to pass Bank scrutiny. The second restriction relates to the size of contracts in which national policies can apply. The provision states that borrowers can ask for the inclusion of national policies only in large contracts. Thus, for small contracts the Bank will not accept the inclusion of such provisions.

Note, however, that as seen in Chapter III, the Guidelines are incorporated into the Loan Agreement which is an international agreement between the borrower and the Bank and, when incorporated into national regulation, displaces other national rules which are incompatible with

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<sup>731</sup> Guide to Enactment page 72.

<sup>732</sup> The World Bank. *Helping Countries Combat Corruption, Progress at the World Bank since 1997*, Washington D.C.: International Bank for Reconstruction and Development, June 2000.

<sup>733</sup> For the Bank's procedure in debarring firms see Sanction Committee Procedures, adopted on August, 2001. Note that on July 9, 2004, the Board approved an overall debarment reform policy.

<sup>734</sup> Guidelines 1.15.

its terms<sup>735</sup>. However, if the borrower has national rules such as criminal laws or competition laws which are not incompatible with the Guidelines, their requirement will have to be observed by bidders, the contracting agency and other people involved in procurement such as subcontractors. Thus, firms who have been caught in corrupt practices might suffer criminal sanctions under national law, although if they are not debarred by the Bank procedures, they probably cannot be excluded from future financed contracts.

The inclusion of policies directed at combating fraud and corruption in procurement regulations has several explanations. Some of them relate to the primary objective of procurement which is achieving best value for money. Corruption affects competition by awarding the contracts to the firms that might not have offered the best contract. It also sometimes increases the price paid by the government since contractors would include bribes and risk costs into the proposed contract. Moreover, the perception of a corrupt environment might deter some potentially good suppliers from entering the competition<sup>736</sup>.

However, most of the time governments do not implement anti-corruption measures based only on economic and financial concerns<sup>737</sup>. They do not weigh the cost of implementing the policy against the amount of money being directed to corruption<sup>738</sup>. The fight against corruption has many other objectives. First, there is an ethical concern. Governments usually want to be associated with best practices and with high standards of probity. This follows from the general requirement that public money should be used for the benefit of the community and not for the enrichment of some few individuals.

Besides ethical standards, the political image of the government might be affected if corruption is found to be endemic<sup>739</sup>. Scandals of bribery and illicit practices might cause the credibility of the government to decline. Moreover, an environment of lower accountability and

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<sup>735</sup> Chapter III, section 6.

<sup>736</sup> For perceptions on the impact of corruption in procurement see for example, Soreide (2002), Anecharico and Jacobs (1995), Bannon (1999), Celentani and Ganuza (2002), Rose-Ackerman (1999) and DeAses (2005); Westring and Jadoun (1996).

<sup>737</sup> For the relation between probity and other procurement objectives see Arrowsmith, Linarelli and Wallace, (2000), page. 37.

<sup>738</sup> See Anecharico and Jacobs (1995).

<sup>739</sup> See Westring and Jadoun (1996).

disbelief in governmental institutions might raise the risk of doing business with the country, and therefore lower the amount of investment flowing from national and foreign sources<sup>740</sup>. Thus, the prevention of corruption might be seen as a value that goes beyond the procurement process and extend governmental activities as a whole<sup>741</sup>.

In fact the Bank has identified corruption as *the single greatest obstacle to economic and social development*<sup>742</sup> and has instigated many anti-corruption measures and government initiatives to tackle the problem. It is interesting, however, to note that the concern with the effects of corruption is not particular to developing countries (although in those countries the impact of such practices is greater). As has been mentioned in the previous Chapter, the EC has incorporated in its new procurement directives provisions compelling member states to address corruption concerns in their procurement regulations<sup>743</sup>. The directives state that firms that were convicted of participation in a criminal organisation, corruption, fraud and money laundering should be excluded from participation in public procurement contracts governed by the directives<sup>744</sup>. Although implementation is left for each member country, the provision reflects a moral standard required in procurement procedures in the European Community<sup>745</sup>.

However, one concern that was identified in the European context and that extends to the Bank's regulations is the effectiveness of the rules in actually preventing corruption in practice<sup>746</sup>. In fact, there is evidence that even with all the measures imposed by the Bank, financed projects are still vulnerable to the general procurement environment<sup>747</sup>. In addition, even if corruption is detected, firms might change name, address and even shareholders to avoid debarment. Moreover, how the conviction of a firm affects individuals – managers, shareholders,

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<sup>740</sup> See Shihata (1996).

<sup>741</sup> See Rose-Ackerman (1999).

<sup>742</sup> See statement in the anticorruption website: <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPUBLICSECTORANDGOVERNANCE/XTANTICORRUPTION/0.menuPK:384461~pagePK:149018~piPK:149093~theSitePK:384455.00.html>  
Also see World Bank, Helping Countries Combat Corruption, Progress at the World Bank since 1997, 2000.

<sup>743</sup> Chapter VI, section 3.3.5.

<sup>744</sup> Article 45 (1) of the Directive 2004/18/ of 31 March 2004.

<sup>745</sup> See comments by Arrowsmith (2004) (b).

<sup>746</sup> Concerns over the effects of this kind of policy were also presented under the US legislation see Schooner and Yukins.

<sup>747</sup> See Indonesia CPAR, 2001.

administrators – is not clear<sup>748</sup>. In one specific debarment procedure the Bank has made it clear that debarment would extend to firms that were controlled by the firm being convicted, but that the sanction will not be extended to the firm that controls the debarred firm. Moreover, sister corporations would not be affected<sup>749</sup>.

When addressing concerns over the effectiveness of such policies it should be remembered that, as discussed in Chapter IV, corruption flourishes in an environment of great discretion and little accountability<sup>750</sup>. Thus, when addressing such concerns, measures improving transparency and providing for review mechanisms might be significant to the overall success of the policy<sup>751</sup>.

#### **4.4 Procurement Planning**

As seen in previous Chapters the Bank will help the procuring agency with all the procurement planning, including packaging and choice of procedure<sup>752</sup>. Thus, the first thing to consider is the possibility of implementing secondary policies at this preliminary stage. It is envisaged that secondary objectives might be used, for example, to influence the procurement decisions of the adequate packaging of the work, or the timing at which the goods and works will be required. Moreover, secondary objectives could influence the choice of the procurement procedure to be followed for each contract.

The Guidelines do not provide guidance on the limits in which the choice is made. The Guidelines only state in rule 1.16 that the borrower should prepare and present prior to the loan negotiations a Procurement Plan which would include the particular contract for the goods, works and services<sup>753</sup> required to carry out the project, the proposed method for procuring such

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<sup>748</sup> See further discussion on Chapter VIII, 2.2.1.

<sup>749</sup> See comments on the debarment of Acres International Limited at the Bank's web site at <http://web.worldbank.org/external/default/main?theSitePK=84266&querycontentMDK=64069700&contentMDK=64069844&menuPK=116730&pagePK=64148989&piPK=64148984>.

<sup>750</sup> See Chapter IV, section 2.3.

<sup>751</sup> See discussion on transparency and enforcement concerns in Chapter VI, sections 2.6 and 2.7.

<sup>752</sup> See Chapter III, section 2.

<sup>753</sup> Rule 1.24 on the Consultants Guidelines.

contracts, and the related Bank review procedure. The plan is drafted to the first 18 months and updated regularly<sup>754</sup>.

However, the Procurement Manual gives further guidance to the Bank's staff in helping the borrower in preparing such a plan<sup>755</sup>. The description of procurement planning in the manual explains that this is not a linear process but rather an interactive procedure that would explore several options. Choices are made on a case by case basis as each project might bring peculiar situations regarding the subject matter of the procurement contract, the time when the product is needed, the specific procurement infrastructure in the borrowing country, etc. However, three concerns become evident during the procurement planning process: contract packaging, procurement scheduling and the choice of procurement method.

#### *4.4.1 Contract Packaging*

The Procurement Manual states that contract packaging should be drafted with the main objective of achieving economy and efficiency in processing and delivering the procured goods, works or services<sup>756</sup>. Three main concerns will need to be addressed at this point: firstly, project needs should, as far as possible, be divided into those three categories, namely goods, works or service. This is done since particular procurement rules will apply for each of those categories. There are, however, exceptions, such as supply and installation contracts where the delivery and the installation of the products are combined into a single contract. Discretion is given to the procurement officer to determine when different categories are grouped, and no guidance is given besides the need to ensure economy and efficiency in the procurement process.

The second major concern regarding contract packaging relates to the ability of the local suppliers to provide the procured product and the likely interest of foreign bidders to participate in the procedure. The Manual states that where local firms are capable of providing the goods, works and services being procured, contract packaging should be set in order to permit their “effective” participation. However, the Manual also states that *if there are reasons of economy*

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<sup>754</sup> Updates are carried out annually or as needed throughout the duration of the project.

<sup>755</sup> Procurement Manual Section 13.

<sup>756</sup> Procurement Manual 13.5.2.

*and efficiency in choosing larger contracts packaging or if it is known or believed that foreign bidders will be interested in bidding, these should be the determining factors in contract packaging*<sup>757</sup> (emphasis added). Thus, it seems that the participation of local firms is subject to cost considerations and to the interest of foreign contractors. Nonetheless, contract packaging should address the possibility of letting local firms participate “effectively”. Although the term “effectively” is not clearly defined, the Manual suggest a mechanism to conciliate local and foreign interests. This is done by a “slicing and packaging” mechanism. In this system contracts are drafted in size and scope to allow local firms to compete for them. The procurement entity then calls for 5 or 10 of those packages at the same time. Small firms can then apply to one or more contracts while large firms (usually foreign firms) can apply for the whole lot. However, the application of such a system is also subject to costs concerns.

The third concern in contract packaging is related to co-financed projects. As noted above, the Guidelines’ provisions will be applicable to all goods, works and services financed by the Bank. Even for parallel financing the Guidelines state that the Bank will need to ensure that certain principles are followed. Thus one concern in contract packaging is that the portion financed by the Bank is subject to the Guidelines. The Procurement Manual also brings guidance on preserving competition for all the Bank’s eligible bidders. Thus the Manual states that there are two types of contracts which should be financed by the Bank *regardless of co-financers’ willingness and the availability of co-financing resources: 1) those where the contract award under tied financing arrangements would predetermine the outcome of related contract awards or give an unfair advantage to that bidder in subsequent competitive bidding under Bank rules; and 2) contracts that are of such importance to the overall success of the project that the Bank should maintain direct supervisory control over them.*<sup>758</sup> It should be noted that the Bank’s concerns on co-financed projects are not primarily linked with the main objective of procurement – achieving the best value for money contract – but relate to the secondary concern of giving all contractors which are eligible under the Guidelines a chance to compete for any contract financed

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<sup>757</sup> Procurement Manual 13.5.2.

<sup>758</sup> Procurement Manual 13.5.3.

by the Bank. Thus even if technically the most effective packaging of contracts suggests that the Bank and co-financers should jointly invite tenders, if the co-financer does not agree with the application of the Bank's procurement regulations, the contract will be broken in order to accommodate different requests.

#### *4.4.2 Choice of procedure*

The second issue to be carefully analysed when drafting the procurement plan is the procedure to be adopted for each part of the contracts. ICB procedures, for example, will usually take from 8 to 20 months to complete<sup>759</sup>. This might not be appropriate in some circumstances, such as emergency situations or when there is little international interest in the contract, or in cases where there are only a limited number of possible suppliers. The Procurement Manual states that the choice of the procurement method will depend on<sup>760</sup>: the nature of the goods and services to be procured; the value of the procurement; the likelihood of interest by foreign bidders, which is a function of the local availability and cost of goods and services; critical dates for delivery; and transparency of procedures proposed.

The Manual emphasises the Guidelines' clear preference for ICB<sup>761</sup> but acknowledges that in some circumstances this might not be the appropriate method. Secondary concerns might influence some of those criteria. For example, when determining the nature of the goods to be procured, the borrower might argue that local firms can provide equipment that is compatible with that already in used by the local government.

#### *4.4.3 Procurement Schedule*

Finally, the procurement plan will have to consider the timing when the goods and services are needed, and thus even if packaging had been drafted and the procurement method chosen, the procurement official would have to determine whether they were adequate for the schedule of the project. Thus, it might be possible, for example, to negotiate with the Bank the

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<sup>759</sup> ICB for Works with prequalification needs 16-20 months; ICB for Works without prequalification needs 8-12 months and ICB for goods needs 8-10 months.

<sup>760</sup> Procurement Manual 13.7.

<sup>761</sup> On the consultants Guidelines, preference is given to QCBS (rule 2.1).

choice of a procedure which would favour local contracts in cases where delivery schedule are short. The Manual clearly states that direct contracting and shopping can be used instead of competitive procedures when speedy responses are needed<sup>762</sup>. However, such methods will only be allowed as exceptions and for most procurement contracts the Bank will insist on the use of competitive bidding processes. When ICB will be used, for example, the Bank might allow payment for expenditures which had started to be procured before the loan was approved, provided all the Guidelines' requirements have been followed<sup>763</sup>.

## **5 Provisions for Specific Procurement Methods**

### **5.1 International Competitive Bidding (ICB)**

Having addressed some general provisions of the Bank's Guidelines, we should now turn to the examination of how and to what extent the Guidelines for the procurement of goods and works allow for the implementation of secondary concerns during the procurement procedure. Since, as mentioned earlier, the Bank insists on the use of ICB for most procurement under financed projects, the possibilities under this procedure will first be examined. The implementation of secondary policies under other forms of procedure and under the procurement of consultancy services will be considered in a later section.

#### *5.1.1 Technical specifications*

The procurement of all goods, works and services starts with the draft of the specifications of the product. Thus we should consider the possibility of implementing secondary policies at this stage. As seen previously, the implementation of secondary policies through this method is very common for environmental policies, although it is possible to address social and industrial concerns through the same means. Moreover, technical specifications can either be directed to the product or to the production method.

On procurement under the ICB procedure, it seems to be possible to use this method of implementing secondary policies, but restrictions will apply. The Guidelines state that "standards

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<sup>762</sup> Procurement Manual 13.6.3.

<sup>763</sup> See advance contracting. Procurement Manual 13.6.2.

and technical specifications quoted in bidding documents shall promote **the broadest possible competition**, while **assuring the critical performance** or other requirements for the goods and/or works under procurement. ... In all cases the bidding documents shall state that equipment, material or workmanship meeting other standards, which promise at least substantial equivalence, will also be accepted<sup>764</sup>" (emphasis added). Thus the Guidelines ensure compliance with the Bank's objective of giving all eligible bidders the chance to bid for contracts financed by the institution by imposing the widest possible competition, not only in terms of nationality of bidders, but also in terms of specification of the product. Brand names or similar classification must be avoided, and when unavoidable, specifications should state that the "equivalents" will be accepted. In those instances, a descriptive specification of the product should also be provided<sup>765</sup>. Thus, it seems that any specification which restricts competition, such as a requirement that a portion of the goods must be domestically produced, will not be allowed. Thus, industrial objectives cannot be implemented through technical specifications.

However, the draft of the provisions does not distinguish between specifications related to the product and specifications over the production method. There is also no clear guidance either on the provisions of the Guidelines or on the Procurement Manual if characteristics which do not affect the performance of the product of product can be required. Thus, for example, it is not clear if the procuring agency could buy 'green electricity' since the fact that it comes from renewable sources do not affect the performance of the final product. The lack of permission might be understood as a prohibition since those requirements will naturally limit competition. However, this will depend on the interpretation of the competition requirement. Does the procuring agency has to secure the widest competition for 'like products' or will it have to allow all products which promises the same performance? It seems that if the requirement is not aimed at discriminating among suppliers, the mere imposition of a requirement which is harder to some suppliers to achieve than to others should not *per se* be an obstacle. In fact, it has been reported that, for example, specification have been drafted to require labour intensive instead of a

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<sup>764</sup> Guidelines 2.19.

<sup>765</sup> Guidelines 2.20.

machinery based practices<sup>766</sup>. Thus, it might be argued that secondary concerns could lead to the draft of specification requiring a certain production method. However, it is not entirely clear if this would be allowed if such method is more costly. Moreover, there is a question of what ‘performance’ might mean. Does it include environmental performance, for example? If it does, can the procuring agency takes into account the environmental performance only at the consumption stage, or could a more wide examination be made- for example the environmental performance from cradle to grave? The answer is not clear.

Some guidance however might be found in the provisions 2.20 which allow specification based on accepted standards. In this provision, the Guidelines require that when products must comply with acceptable standards, international standards must be used when available, and in any reference to national standards the expression “or equivalent” must follow<sup>767</sup>. Thus, if environmental performance is required under those standards it is possible they could apply. However, governments must be careful in requiring some standard products so that they do not harm competition or impose measures that are *de facto* discriminatory<sup>768</sup>. For example, when requiring certified wood products, the government should take into account that only three percent of the world’s forest area is certified. Of this amount, developing countries account for eight percent while North America and Europe account for more than half<sup>769</sup>. Therefore, in cases where such a certificate is required, contractors providing goods from non-certified areas, but which can provide an equivalent product might question such a requirement.

The Bank does not give clear guidance on the limits of applications of technical standards. Are certified and non-certified goods comparable, or are certification schemes a hidden form of discrimination among suppliers<sup>770</sup>? Can certification be required only when it interferes with the intrinsic characteristics of the goods, or can it relate to production method?

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<sup>766</sup> See McCrudden (2004) reporting on the help the ILO have given in drafting such specifications.

<sup>767</sup> Guidelines 2.20.

<sup>768</sup> The Procurement Manual states that “care must be taken in drafting specifications to ensure that they are not restrictive”.

<sup>769</sup> For technical specifications of wood products see Wittmeyer, (2003).

<sup>770</sup> This is also a difficult issue under the EC procurement Directives. For discussion on discrimination and secondary policy under the EC see Arrowsmith (2005).

Those issues are not considered either in the Manual or in the Guidelines. Moreover, there is no qualitative study on the application of standards in practice. However, as a matter of principle, it should be stated that requirements which restrict competition among otherwise comparable bidders should be justified since the Bank requires under ICB procedures the widest possible competition.

Another distinction that needs to be made is over requirements leading to economic advantages and requirements which are established despite being more costly to the procuring agency. The Guidelines' provisions do provide for safeguards for the quality of the goods, works and services provided. Thus, despite the requiring wide competition, the specifications must also make a clear statement of the required standard of workmanship, standard of plant, and other supplies and performance of the goods and services to be procured. The Procurement Manual states that the specifications should require goods, plant and other supplies to be new, unused, and of the most recent or current models, and that they incorporate all recent improvements in design and materials unless otherwise specified<sup>771</sup>. Thus, the goods and works provided under financed contracts should not fall short of what has been specified. In addition the Guidelines also provide that bidding documents must specify any relevant technical data including of environmental nature<sup>772</sup>. However, what the parameters for specification are. Should specification requirements be linked with economic concerns –such as in cases where energy efficient goods are procured because in the long term they save money for the procuring agency<sup>773</sup>, or could secondary concerns outweigh economic objectives? Thus can, for example, national governments draft a project which requires a power plant run by alternative sources such as biomass or wind? Under this same line, could energy efficient equipment be procured under financed projects, even if it is more expensive than its peers? Neither the Guidelines nor the Manual establish restrictions on the kind of issues that could be inserted into the draft of specifications.

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<sup>771</sup> Procurement Manual 15.2.

<sup>772</sup> Guidelines 2.11.

<sup>773</sup> The Procurement Manual provides for evaluation based on efficiency of the product. However, it is not completely clear if at drafting specifications the borrower is allowed to procure only energy efficient products or if it will have to evaluate the life cycle cost of the equipment at the award stage. See section 19.3.4 of the Manual.

In order to secure transparency, the Guidelines also state that the bidding documents must set *clearly and precisely* the goods, works and services which are being procured<sup>774</sup>. Bidders should be able to respond *realistically and competitively* to the requirements of the purchaser without having to qualify or condition their bids<sup>775</sup>. This provision might trigger doubts over the acceptability of specifications requirements, especially in respect of innovative products. However, it is possible to foresee precise and clear specifications drafted in terms of required performance which would allow bidders to offer innovative proposals.

Transparency is also ensured by the Bank's supervisory role. It is vital to remember that with ICB procedures, the borrower will have to submit to the Bank a draft of the General, and Specific Procurement Notices and use the Standard Bidding Documents issued by the Bank with minimum changes, acceptable by the Bank, where necessary<sup>776</sup>. Therefore, if the Bank finds that specification criteria do not comply with the general procurement objectives of economy and efficiency, transparency and open competition, it will not allow the insertion of the requirements on the product specification.

Transparency might, however, be jeopardised by the uncertainty over the precise limits in drafting technical specifications. This could lead to unnecessary tension between the Bank and the borrower or between the borrower and the bidders. Moreover, since the Bank's work is carried out at a regional level, there might be discrepancies among the practice of different procurement offices. Thus, in order to improve transparency, clear rules regarding the possibility of adding secondary concerns into specifications should be provided.

### 5.1.2 *Grounds for exclusion under ICB procedures*

The second method of implementing secondary policies is through the qualification stage. At the qualification stage the contracting authority will generally analyse if there is ground for the exclusion of suppliers and several factors will be taken into account. Firstly, it will determine the eligibility of the contractor to participate in the competition. As seen above, the

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<sup>774</sup> Guidelines 2.16.

<sup>775</sup> Procurement Manual 15.2.

<sup>776</sup> Guidelines 2.12.

Bank has changed its rules to allow the widest possible competition among national and foreign suppliers.

The second requirement is related to the financial and technical capacity of the contractor. Those requirements will be primarily related to the primary objective, since they will influence the capacity of the contractor to deliver the contract. However, as seen in the previous Chapter, in many instances the procuring entity might also need to observe whether the bidder complies with other requirements, such as the absence of criminal or environmental convictions or compliance with certain labour policies. The imposition of such requirement might relate to secondary concerns.

The Guidelines do not allow the borrower to deny qualification to a firm for reasons unrelated to its capability and resources to successfully perform the contract<sup>777</sup> unless it is clearly stated in the Guidelines (debarred firms for example are not qualified). For large contracts, where a prequalification stage is needed, the Guidelines state that: “Prequalification shall be based entirely upon the capability and resources of prospective bidders to perform the particular contract satisfactorily, taking into account their (i) experience and past performance on similar contracts, (ii) capabilities with respect to personnel, equipment, and construction or manufacturing facilities, and (iii) financial position”<sup>778</sup>. This is a major limitation on the borrower’s ability to implement secondary policies through qualification criteria. For example, if the borrower wants to impose as a qualification condition that the supplier has a satisfactory general policy in recruiting disadvantaged individuals, this would probably not be permitted by the Guidelines since it does not relate to the capacity of the contractor to perform the contract. On the other hand, the exclusion of a supplier based on their capacity to perform the contract, such as measures limiting the pollution level while performing the contract, might be accepted, provided this requirement has been drafted in the contract.

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<sup>777</sup> Guidelines 1.6 and 1.7.

<sup>778</sup> Rule 2.9 Postqualification requirements are in principle similar to those for prequalification but bear mainly on the technical and financial resources available for fulfilling the contract. Procurement Manual 18.2.

The capability of the contractor to perform the contract includes its ability to comply with specifications. Thus, it has been argued in the section above, that it is not entirely clear if specifications can be drafted to include production method, especially regarding ‘green’ methods. However, if the answer is affirmative, suppliers might also be excluded if they can not comply with such requirement. Moreover, since the provision on qualification permits the evaluation of past performance, it might be possible to take into account the tender’s experience with similar environmental requirements or refer to a recognised environmental management system<sup>779</sup>.

Regarding policies that are directed to labour and industrial policies, the Guidelines are not clear, but the Procurement Manual gives further guidance on what would be accepted. There the Bank states that foreign firms should not be required to associate with domestic firms in joint ventures or employ specific personnel – e.g. maintain ethnic ratios in the labour force, as a condition for prequalification or bidding<sup>780</sup>. The possibility of implementing policies that relate to the ability of contractors to keep their workforce, such as an acceptable wage policy which does not generate a great turnover, might also be doubtful since the Procurement Manual states that typical parameters used at the qualification stage regarding personnel resources will be directed at key positions, and not at the workforce as a whole<sup>781</sup>. If the contracting authority wants to implement a policy based on social concerns it would be allowed to do so, but not under ICB procedures<sup>782</sup>.

The application of secondary conditions at the qualification stage might also be influenced by the exceptions on eligibility mentioned above. Thus, firms can be excluded based on their origin if *‘as a matter of law or official regulation, the Borrower’s country prohibits commercial relations with that country, provided that the Bank is satisfied that such exclusion does not preclude effective competition for the supply of goods or works required, or (ii) by an act of compliance with a decision of the United Nations Security Council taken under Chapter*

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<sup>779</sup> Such as that under ISO 14001 and 14004. It must be remembered that if such standards are required, any supplier that could prove to have significant ‘equivalent’ methods should also be accepted.

<sup>780</sup> Procurement Manual 16.2.

<sup>781</sup> Annex 2 Typical Parameters for prequalification evaluation clause 3.

<sup>782</sup> See below for community participation.

*VII of the Charter of the United Nations, the Borrower's country prohibits any import of goods from that country or any payments to persons or entities in that country*<sup>783</sup>. The Bank does not question the reasoning of the borrower to prohibit commercial relationships. Thus, firms from countries which are found to have poor human rights records, for example, could be debarred from government contracts, including financed contracts, if there is a general trade restriction with their country of origin. However, if there is only a restriction regarding national procurement regulations, this restriction will not apply under financed procurement<sup>784</sup>. Also remember that even if the Bank is not financing the procurement, but the goods, works or services procured are within the financed project, the borrower might have to show that the use of such a policy will not affect the price such as to adversely affect the economic and financial viability of the project<sup>785</sup>.

### 5.1.3 Award criteria

Secondary policies can also be implemented during the award stage of the procurement procedure. At this stage proposals will be evaluated according to the criteria stated in the bidding documents. The evaluation will follow six steps. Firstly, there is preliminary examination of the bids in order to determine whether it meets general procedural requirement such as signature by an authorised party, inclusion of all the required documents, adequacy of bids securities, correction of arithmetic errors, etc. At the second stage, it will determine whether the bid is responsive. Slight deviations from the bidding documents are allowed and only material deviation will lead to the prompt disqualification of bids<sup>786</sup>. At the third stage all bids should be converted into a common currency in order to be evaluated. The most common practice is to convert all bid prices into the borrower country's currency. At the fourth stage the procuring agency will apply the evaluation criteria set out in the bidding documents. These might be based

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<sup>783</sup> Rule 1.8 (a).

<sup>784</sup> See for example the *Myanmar/Massachusetts* case mentioned in the previous Chapter.

<sup>785</sup> Rule 1.5.

<sup>786</sup> The Procurement Manual brings the definition of material deviation. Material deviations are: those which affect the scope and quality or performance of a contract; limits the purchaser's/employer's rights or bidders obligations; and affects unfairly the competitive position of other bidders. Moreover it brings guidance on how to evaluate and quantify the omissions and deviations eventually found (section 19.4 of the Manual).

on price only, on price and other factors, on the life cycle cost, or on evaluations using a merit point system<sup>787</sup>.

The Guidelines state that “**bidding documents shall also specify the relevant factors in addition to price** to be considered in bid evaluations, and the manner in which they will be applied for the purpose of determining the lowest evaluated bid. For goods and equipment, other factors which may be taken into consideration include, **among others**, costs of inland transport and insurance to the specified site, payment schedule, delivery time, operating costs, efficiency and compatibility of the equipment, availability of service and spare parts, and related training, safety, and environmental benefits. The factors other than price to be used for determining the lowest evaluated bid shall, to the extent practicable, **be expressed in monetary terms, or given a relative weight** in the evaluation provisions in the bidding documents”<sup>788</sup>. (emphasis added)

This is not an exhaustive list and other factors might be taken into account. However, there is no guidance, either in the Guidelines or in the Procurement Manual, to the precise limits of the policies which will be allowed in ICB procedures. The Procurement Manual only provides explanation of the criteria related to transportation and insurance, price and delivery adjustments, costs of spare parts and on evaluation based on the life cycle cost<sup>789</sup>. For procurement for work contracts, non-price factors mentioned in the Manual include qualifications and experience of key staff, past experience of the bidder in similar projects, and the financial capability of the bidders<sup>790</sup>. Moreover, although the guidelines suggests that a relative weight can be attributed to the various criteria, the Procurement Manual restricts this option and states that since the attribution of points for some factors could be very subjective and open to manipulation, the merit point system should only be used with the Bank’s prior agreement, where the comparison of bids cannot adequately be based on price alone, and full life cycle costing is either impractical

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<sup>787</sup> Section 19.3 of the Procurement Manual.

<sup>788</sup> Guidelines rule 2.52.

<sup>789</sup> Procurement Manual section 19.3. Note that in the evaluation of the life cycle cost some factors which are beneficial to the environment might be taken into account. For example- energy efficient equipments might be better evaluated in a life cycle analysis than their pairs.

<sup>790</sup> Note that those factors are also taken into account when qualifying bidders. However, at the qualification stage minimum requirements are set while at the evaluation stage it is probably possible to attribute a weight to those factors.

or unjustified<sup>791</sup>. This statement significantly restricts the use of this system and since it does not provide the definition of what would be an unjustified situation, significant discretion is placed on the Bank's procurement staff when evaluating which criteria can be regarded as accepted, and the weight attributed to them. In addition, one cannot ignore the wording of the Guidelines and criteria related to the safety and the environmental benefits of the product will probably have to be allowed as lawful criteria when evaluating offers. However, the provision is not clear if the Bank will only allow environmental factors which lead to more efficient procurement practices<sup>792</sup> or if other environmental concerns could be taken into account. If the latter, it is not clear how much weight can be attributed to environmental benefits that can not be quantified in terms of economic benefits. Moreover, it is also not clear if social policies, such as the use of intensive labour instead of machinery, could be taken into account. In addition, there is no clear guidance as to whether the points system could be used to award extra points to suppliers adopting a general policy such as awarding extra points for those that have fair recruitment policies in their business generally. However since the examples stated in the list related to the subject matter of the contract, it is foreseen that general business requirements will not be accepted.

After evaluating the received bids and appointing the lower evaluated offer the procurement procedure will enter into its fifth step, which is not mandatory but will occur at the request of the borrower in some financed projects. Under ICB procedures there are express provisions allowing a margin of domestic preference to be applied in certain instances<sup>793</sup>. Such preferences can only be granted if the borrower requires its application, if the Bank accepts such a request, and if it is expressly included in the Loan Agreement. Thus borrowers cannot apply those provisions at the evaluation stage without having discussed this application before the loan is approved<sup>794</sup>. Moreover, in order to secure transparency the bidding document must specifically outline the procedure for its application.

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<sup>791</sup> Procurement Manual 19.3.5.

<sup>792</sup> See evaluation base don life cycle cost. For explanation of 'win-win' and 'win-lose' situations see Marron (2003).

<sup>793</sup> Guidelines 2.55 and 2.56.

<sup>794</sup> See Procurement Manual 19.8.

For contracts of goods, a margin of preference can be provided at the borrower' request in the evaluation of bids for the goods manufactured in the country of the borrower, regardless of the nationality of the manufacturer or supplier<sup>795</sup>. For the Bank the definition of "manufactured goods" includes *assembly, fabrication, processing etc., where a commercially-recognized final product is substantially different in the basic characterised of its components and raw material*<sup>796</sup>. For comparison, goods offered by foreign and domestic bidders must be identical or compatible in respect of quality, size, capacity and performance<sup>797</sup>. All qualified bids will be divided into three groups. In the first group will be the bids where more than thirty percent of the offering price will be for labour, raw materials and components from the borrowing country, even if the government has to import such goods. The second group will be of bids offering goods from within the borrowing country, but which do not qualify for group one. The third group will have bids offering goods from abroad and to be directly imported. The margin of preference will not be applied between groups one and two but will only be applicable if a bid from group three is the lowest evaluated bid. In that case, a margin of preference could apply between groups one and three, by adding to the price on group three an amount equal to fifteen percent of the CIF offering price.

For work contracts preference might be granted to domestic firms<sup>798</sup>, if the borrowing country has a per capita GNP of US\$ 760 or less<sup>799</sup>. Although the Guidelines do not provide a definition of a "domestic firm"<sup>800</sup>, the Procurement Manual states that eligibility for preference will be granted only to purely local firms or joint ventures of domestic firms with no more than ten percent sub-contracted to foreign firms. Moreover, the margin of preference must not exceed seven point five percent. For the purpose of evaluation, the margin will be added to bids from contractors other than domestic ones, and not lowered from the domestic bid<sup>801</sup>.

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<sup>795</sup> Appendix 2 rules 1-5.

<sup>796</sup> Procurement Manual 19.8.1.

<sup>797</sup> Procurement Manual 19.8.1.

<sup>798</sup> Appendix 2 rule 7.

<sup>799</sup> Procurement Manual rule 19.8.2. The figure is updated from time to time by the International Economics Department. The figure shown corresponds to the 1999 update.

<sup>800</sup> See discussion on the preference rules in Chapter VIII, section 2.3.2.

<sup>801</sup> Procurement Guidelines Appendix 2 rule 7.

The inclusion of a system of preferences established in the procurement Guidelines is based on the Bank's duty as a development institution to encourage the development of domestic contracting and manufacturing industries in the borrowing country<sup>802</sup>. Therefore, it is aimed at increasing the demand and contracts going to developing industries and stimulating the growth of the economy in the borrowing country. However, as will be discussed in the following Chapter<sup>803</sup>, the preference system as drafted might not guarantee the achievement of those objectives. Although, as discussed in the previous Chapter, the choice of a preference mechanism is preferable as compared with other methods of implementation, the Bank might have to take into account several other factors such as the possibility of manipulation, the level of development of the national industry, the use of mechanisms already on place, etc.

The adoption of a preference mechanism is also foreseen by the Model Law when helping countries to build or reform their procurement system. The mechanism suggested there is similar to the Bank's preference mechanism and both require approval by a separate entity and prior disclosure of the criteria. Thus, it is possible that many borrowing countries would have adopted a similar mechanism under the national procurement legislation. However, the Bank will not allow for national rules to be applied, even if the borrower has a consistent policy aimed at the development of a certain region or a particular industry. At the Bank's financed procurement eligibility for preferences must be based on the criteria established by the Bank's procurement regulations.

The final stage of the evaluation process is the filling in of the bid evaluation report which must be submitted to the Bank prior to the signature of the contract. The report will include all the key elements used by the borrower during the evaluation procedure<sup>804</sup>. Thus, if domestic preferences are used, they should be mentioned; if bidders were rejected, the reason for their rejection must be stated; any additions, adjustments and deviations must also be stated<sup>805</sup>.

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<sup>802</sup> Guidelines rule 1.2.

<sup>803</sup> See discussion on the preference rules in Chapter VIII, section 2.3.2.

<sup>804</sup> Guidelines 2.54.

<sup>805</sup> See details in the Procurement Manual 19.12.

The award and signature of the contract will only occur after the “no-objection” notice has been issued by the competent member on the Bank’s staff (TTL/PS/PAS)<sup>806</sup>.

#### *5.1.4 Contract conditions*

As discussed in the previous Chapter, the inclusion of contractual provisions that create obligations other than those necessary for the fulfilment of the contract is another way of generally implementing secondary policies<sup>807</sup>. An example would be the inclusion of a contract obligation to pay fair wages to those working on the project. It is important to recall that contract conditions will also be used as part of the implementation of policies which evaluate the capacity of bidders to fulfil the condition at the qualification and award stages. Therefore, bidders which were awarded a margin of preference for the delivery of domestic goods will be compelled by a contract condition to keep such an obligation. However, it is possible to have contractual conditions as the only way of implementing a secondary policy.

The application of contractual conditions or contract compliance might only guarantee a minimum legal standard, or might go beyond the legal requirements. For instance, it is possible that governments will require bidders to pay the minimum salary, or they might require bidders to pay fair wages to those working on the project, which is a concept that goes beyond the legal standard. This could apply to environmental standards and to other social issues, such as a prohibition from discriminating against a certain ethnic group. Moreover, they could apply to the project or could be a requirement that extends to the contractor’s business as a whole. Thus, following the example of labour standards, the government might state that such standards will be kept for the duration and for the people involved in the project, or it might require the contractor to have a general policy that keeps the standard throughout its activities.

The Guidelines do not foresees the application of any additional conditions of contract, and only require that the rights and obligations of borrowers and suppliers or contractors should be clearly defined in the contract documents<sup>808</sup>. They also state that any special condition

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<sup>806</sup> Procurement Manual 19.13.

<sup>807</sup> See methods of implementation Chapter VI, section, 2.5.5.

<sup>808</sup> Guidelines rule 2.3.8.

*particular to the specific goods or works to be procured* shall be included<sup>809</sup>. The standard bidding documents for the procurement of goods, which must be used in supply contracts financed by the Bank, also do not deal with this issue. Although there is no prohibition for the inclusion of secondary policies in the contract documents (under Special Conditions of Contract) the reading of the standard forms makes it clear that the Bank is concerned with the experience of the bidders<sup>810</sup> and the adequate standards of the goods to be supplied. However, other considerations are to be taken into account, such as the operating and maintenance costs of the product<sup>811</sup>. Thus, it is unclear if the application of secondary conditions under contract compliance will be permitted.

However, the standard bidding documents for work contracts do provide some clauses on safety, labour and environmental standards. The general conditions of contract state that the contractor is responsible for the safety of all site operations and methods of construction<sup>812</sup>, the payment, housing, feeding and transport of labour<sup>813</sup>, and the compliance with national legislation<sup>814</sup>. Moreover, it includes restrictions on working hours<sup>815</sup> and stipulates that the contractor should observe any environmental clause provided in the Loan Agreement between the Bank and the borrower<sup>816</sup>. Those clauses do not stipulate a pre-determined standard of conduct in all financed projects, but allow the national legislation of the borrowing country to determine the precise requirements to be followed by the contractor. If adequate policies are adopted, labour rights and environmental protection are guaranteed, but if the borrowing country does not have an effective policy on those matters, the Bank does not interfere with national policies. Moreover,

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<sup>809</sup> Ibid.

<sup>810</sup> See Standard Bidding Documents for the Procurement of Goods, ITB rule 13.3 on the qualification requirements. The Bank suggests that bidders should be required to have a minimum level of experience in manufacturing a similar product.

<sup>811</sup> See Standard Bidding Documents for the Procurement of Goods, ITB rule 26.5 on how to calculate the operating and maintenance costs.

<sup>812</sup> Part I: General Conditions, the “Conditions of Contract for Works of Civil Engineering Construction,” fourth edition 1987, reprinted in 1992 with further amendments, prepared by the *Fédération Internationale des Ingénieurs-Conseils* (FIDIC), Clause 8.2

<sup>813</sup> Ibid at Clauses 34.1 e 35.1.

<sup>814</sup> Ibid at Clause 26.1.

<sup>815</sup> Ibid at Clause 45.1. The clause prohibits night work and work on locally recognised days of rest. This restriction can be lifted if the kind of work to be done requires so. There is no restriction on the number of hours worked by the staff.

<sup>816</sup> Ibid at Clause 19.1.

there is no requirement obliging the contractor to follow the conditions usually imposed on contractors performing similar works in the borrowing country. Thus, for example, if there is national legislation that requires the payment of minimum wages, but there is a collective agreement for workers in the relevant field to be paid more than the minimum, there are doubts over the rights of the workers hired under financed projects. Being a development institution, the adequacy of such conduct is questionable and will be discussed in the following Chapter.

### 5.1.5 *Set-aside*

As for the methods of implementation of secondary policies, there is one final method to be commented upon: set-aside. With this method secondary policies will be implemented for only some of the procurement contracts. This might include for example, a number of contracts going to minority groups, or a certain amount of the budget being spent on domestic products

The Guidelines used to allow for set-aside in some instances. The former rules acknowledged that even when competition was the appropriate method of procurement, the borrower could wish to reserve procurement for one or more specific firms or enterprises. In those instances the Bank used to accept the reservation, provided that the reserved procurement was not eligible for contracting out of the Bank loan and that it would not significantly affect the satisfactory project implementation in terms of cost, quality and completion time<sup>817</sup>. The Procurement Manual also demanded that the reserved procurement would be carried out by a specific investment operation and the estimated cost of the reserved procurement excluded from the total projects costs for determining the loan amount<sup>818</sup>. Therefore, any reserved procurement would not be directly linked to the loan agreement but would be a specific operation.

The new Guidelines, however, do not include this provision. The exclusion of such provision is in line with the increased concern of the Bank to allow the widest possible competition in financed projects. The provision was also against the general principle of giving all bidders an equal opportunity to compete in a non-discriminatory manner. Moreover, to implement secondary concerns – either industrial, social or environmental - through set-asides is

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<sup>817</sup> Guidelines rule 1.12 (a) and (b). For consultancy services see Consultants Guidelines rule 1.17.

<sup>818</sup> Procurement manual rules 2.5.

seen as one of the least transparent and less efficient forms of implementation<sup>819</sup>. In addition, as the proceedings for such contract would come directly from a special loan, the Guidelines' provisions could be excluded altogether and special rules could apply.

## 5.2 Other forms of procedure

Apart from International Competitive Bidding, the Guidelines also foresee other forms of procedures to be used in limited circumstances. In this section, the way in which secondary concerns could come into play under those procedures will be examined. An analysis of each procedure will not be carried out as we will only be concerned with possibility of using the borrower's procurement system, which might include national secondary policies; or the implementation of the Bank's secondary concerns through those other methods. Moreover, since we have considered that ICB and many of those procedures are based on ICB principles, considerations will be drafted on the differences of each procedure, as compared with ICB.

### 5.2.1 *Limited International Bidding (LIB)*

The Guidelines define LIB as being essentially ICB by direct invitation<sup>820</sup>. There are four instances where the application of LIB is foreseen: firstly, it will be used where there is only a limited number of eligible suppliers; secondly, it will be used with specialised products such as pharmaceutical products, specialised equipment from offshore petroleum mining, etc.; thirdly, it will be used for contracts where small amounts of money are involved, such as in the procurement of a small number of vehicles; and finally, its will be used for exceptional reasons such as emergency actions related to natural disasters<sup>821</sup>.

Under this procedure bids will be solicited from a list of potential suppliers and open advisement will not be required. The precise criteria used in choosing the potential suppliers are not defined in the Guidelines. The provision only states that the list should be broad enough to ensure competitive prices, and that if there is only a limited number of suppliers, all of them should be invited to bid. The Procurement Manual also provides that the geographical spread of

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<sup>819</sup> See Chapter VI on the methods of implementation discussion, section 2.5.1.

<sup>820</sup> Guidelines 3.2.

<sup>821</sup> Procurement Manual see table on page 83.

invitation should be another concern<sup>822</sup>. Note, however, that the provisions do not provide a clear definition of its terms. Thus, it will be decided on a case by case basis; for example, how many suppliers will be enough to “assure competitive prices”? If there are ten potential suppliers, of which seven are from North America, two from Western Europe and one from the Middle East, how many would the borrower invite? Does the borrower need to invite the Middle East supplier in order to fulfil the geographical requirement? The answer to those questions is not clear, and probably decisions will be taken without the necessary transparency for the criteria used<sup>823</sup>.

Apart from the lack of advertisement of the contract, LIB procedures also differ from ICB procedures as they do not foresee prequalification of bidders. Given the limited number of suppliers and the speed needed in most instances where LIB is applied, prequalification will not take place and a supplier will only be qualified if its bid is the best evaluated bid. However, as mentioned above, post qualification should follow the same principles as prequalification. Thus, the same concerns over exclusion of suppliers will take place. As to the evaluation criteria, the borrower will have to follow the rules on ICB.

Finally, it should be mentioned that domestic preferences will not be allowed under LIB procedure<sup>824</sup>. Thus even if one of the invited bids is from a domestic firm, it will not be granted a margin of preference as compared to foreign bidders. The exclusion of the application of domestic preferences in cases where LIB is used because there are only a limited number of suppliers available is probably justified since the application of such rule would further limit the competition. However, it is not clear why domestic preferences cannot be applied in cases where LIB is used for small value contracts. In theory, the potential benefits for firms in the borrowing country can be even more significant than in ICB procedures where larger values are being procured, probably attracting larger firms.

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<sup>822</sup> See Procurement Manual section 16.4.

<sup>823</sup> See discussion on geographic requirement in Chapter VIII, section 2.3.4.

<sup>824</sup> Guidelines rule 3.2.

### 5.2.2 National Competitive Bidding (NCB)

When the contract is unlikely to attract foreign competition, national competitive bidding will be allowed<sup>825</sup>. NCB is a competitive procedure within the borrowing country. The Guidelines state that procedure normally used for public procurement in the borrowing country can be used if it is acceptable to the Bank. However, it seems that only in rare cases will the Bank accept the borrowers' procedure without any reviews or modifications<sup>826</sup>. The Guidelines state that such modifications should ensure economy, efficiency, transparency and broad consistency with ICB procedures. The Manual qualifies this statement by explaining that *an acceptable NCB system generally incorporates the basic principles of ICB including **inter alia**, timely notification through advertising in local newspapers, adequate competition, clarity of procedures, fair treatment for all bidders and award to the lowest evaluated bidder in accordance with the criteria set out in the bidding documents*<sup>827</sup>. Regarding the evaluation criteria, the Guidelines state that they should be objective, made known in advance, and should not be applied arbitrarily. In addition it is clarified to borrowers that if foreign firms want to compete they must be allowed to do so<sup>828</sup>.

As can be noted from the description above, although the Guidelines permit the use of national procurement procedures, there are severe limitations on them. The Bank will not allow departures from its general ICB rules and differences from ICB are likely to remain only in the use of national advertising, contract language and currency of payment<sup>829</sup>. However, it might be possible, for example, for NCB to provide for domestic preference, since this is foreseen under ICB as well. Unlike the LIB procedure, there is no restriction on the guidelines over the application of preference to domestic firms.

Doubts, however, remain on the possibility of using preferences for other policies such as the development of a particular region, or preferences directed at the development of particular

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<sup>825</sup> Guidelines rule 3.3.

<sup>826</sup> Such modifications will be reflected in the Loan Agreement.

<sup>827</sup> Procurement Manual section 16.3.

<sup>828</sup> Guidelines rule 3.4.

<sup>829</sup> See Procurement Manual 16.3.

minority groups, etc. If we recall the Guidelines' requirements, the national procurement procedure will be analysed for its efficiency, economy, transparency and broad consistency with ICB. Thus, if the policy pursued under national procurement cannot significantly interfere with the economy and efficiency; if it ensures competition among suppliers, and a reasonable price for the contract; if it is transparent so that any interested bidders know in advance the criteria which will be used; and if a preference system is applied (as opposed to more restrictive forms of implementing secondary criteria) can it be regarded as being "broadly consistent" with ICB? Probably the answer should be affirmative. However, there is no available data on the use of such policies in World Bank NCB procurement and, by the wording of the Guidelines and the Procurement Manual, the answer on the limits up to which the Bank will rely on national procedures are to be found in the CPARs<sup>830</sup>.

The World Bank limitations on NCB differ from some of the rules seen in previous Chapters. As has been seen, international agreements which are aimed at opening procurement to foreign competitors, such as the GPA, establish a defined threshold to contracts that are likely to attract foreign competition. Below these defined thresholds national procurement regulations will apply and limitations of them will only be found in other international agreements establishing general rules on trade<sup>831</sup>. The World Bank, however, reviews and modifies national procurement rules to make them adaptable to what the Bank considers to be the most effective way to procure. This behaviour might lead to questions over interference in the national sovereignty of the borrowing country. This issue will be further discussed in the following Chapter<sup>832</sup>.

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<sup>830</sup> See discussion on the use of NCB procedures and reliance on national procurement regulations in Chapter VIII, section, 3.

<sup>831</sup> In the EC where restrictions based on Treaty principles could interfere in general procurement obligations, such as the need for advertising contracts which are below the threshold (See Case C-324/98, Telaustria Verlags GmbH and Telefonadress GmbH v Telekom Austria and Herold Business Data AG [2000] ECR I-10745 For comments see Arrowsmith (2005)) note that there is also a general treaty which will reflect the aim of states in opening up their markets. However, in the World Bank system, member countries have not agreed in opening their markets generally.

<sup>832</sup> See Chapter VIII, section 3.

### 5.2.3 Direct Contracting (DC)

Direct Contracting is the procedure that most departs from ICB since no competition is held<sup>833</sup>. Under DC a bid is invited from a single source and its application is limited to very few instances. Five possible applications are foreseen: extension of an ongoing contract for similar goods or works; standardisation of equipment and spare parts requirements; single source availability; as a condition of a performance guarantee, and in exceptional circumstances such as natural disasters. Some of those applications are expected, such as when the equipment is proprietary or obtainable only from one source. However, secondary objectives could be hidden in other instances. Thus, when the Bank allows the extension of contracts it qualifies this statement by determining that the *Bank shall be satisfied that no advantage could be obtained by further competition and the price on the extended contract are reasonable*<sup>834</sup>. Regarding the use of DC for standardisation purposes, the Guidelines state that *for such purchases to be justified, the original equipment shall be suitable, the number of new items shall generally be less than the existing number, the price shall be reasonable, and the advantages of another make or source of equipment shall have been considered and rejected on grounds acceptable to the Bank*<sup>835</sup>. Once again the Bank retains the power to decide when the use of this procedure is justified and acceptable. Thus, any national policy setting contracts aside for particular suppliers or groups of suppliers, for example, will not be allowed. The permitted instances stated in the Guidelines seem to focus primarily on the economic requirements of the project.

### 5.2.4 Shopping

For off the shelf goods, and simple works, local or international shopping is the appropriate procurement method<sup>836</sup>. Bids will be required from at least three suppliers (national or foreign) but there is no indication of how the selection of them should be made<sup>837</sup>. Secondary concerns could be significant in this selection. Since the procuring agency is interested in small

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<sup>833</sup> Guidelines 3.6 and the corresponding explanation in the Procurement Manual section 16.6.

<sup>834</sup> Guidelines 3.6 (a).

<sup>835</sup> Guidelines 3.6 (b).

<sup>836</sup> Guidelines 3.5.

<sup>837</sup> See Procurement Manual section 16.5 where it is just require that quotations are submitted in writing.

off the shelf items, a large number of suppliers might be interested in bidding for such contracts. Although it is reasonable to expect that an open competition would be too time consuming, the selection of the invited bidders might direct the final outcome of the contract. The Bank, however, does not seem concerned with this choice and only requires that if international shopping is used, suppliers from at least two different countries should be invited<sup>838</sup>. The Guidelines also limit the evaluation criteria used in choosing from the received quotations by stating that they must follow the same principles of open bidding. The Procurement Manual exemplifies criteria which would be allowed: price, availability for delivery, availability and cost of maintenance services and spare parts. Depending on the specification of the product, some of those criteria might favour domestic firms as they will be more prone to deliver more quickly and to provide local maintenance, for example.

#### *5.2.5 Force Account*

Force account is used for construction by use of the borrower's personnel and equipment and its use is very limited<sup>839</sup>. Force accounts are generally used either in emergency situations or when private contractors are not available at a reasonable price. In order to guarantee a minimum level of productivity, the Bank and the borrower should agree on appropriate production standards which will mirror the private sector's performance in the same area<sup>840</sup>. Since the borrower will use its personnel and equipment, it seems that the application of secondary policies is not an evident issue in this procurement procedure.

#### *5.2.6 Community participation*

An important provision regarding the implementation of secondary concerns in projects financed by the World Bank is one on community participation. The World Bank states that "*experience suggests the projects tend to be more sustainable and yield higher returns when they involve those it intends to help*".<sup>841</sup> Thus, the Guideline's rule number 3.17 provides as follows:

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<sup>838</sup> Procurement Manual section 16.5.

<sup>839</sup> Guidelines 3.8.

<sup>840</sup> Procurement Manual section 16.7.

<sup>841</sup> Procurement Manual section 23.1.

*“Where, in the interest of project sustainability, or to achieve certain specific social objectives of the project, it is desirable in selected project components to (i) call for the participation of local communities and/or nongovernmental organizations (NGOs), or (ii) increase the utilization of local know-how and materials, or (iii) employ labour-intensive and other appropriate technologies, the procurement procedures, specifications, and contract packaging shall be suitably adapted to reflect these considerations, provided these are efficient. The procedures proposed shall be outlined in the Staff Appraisal Report, the President’s Report, and the Loan Agreement”* (emphasis added).

The Manual states that the term “community” includes the following groups<sup>842</sup>:

Disadvantaged individuals or group of beneficiaries; community groups with no legal status; associations or groups with legal status, with or without separate legal personality as a group; small scale artisans and other local or small commercial organisations and associations disadvantaged because of the lack of adequate financial assets or institutional capacity; small and local level organisations, particularly NGOs which support and facilitate the flow of Bank funds to individuals.

Therefore it is possible to take social policies into consideration when drafting the procurement plan to be used in a certain loan agreement. Note, however, that the social policy to be applied is not the ordinary policy that might generally be in place in the borrowing country. The Guidelines’ provision is directed at the community involved in the project and aims at enhancing community ownership and sustainability of the project<sup>843</sup>. Thus, for example, if the borrowing country has a general policy of giving preference to firms located in a certain region in procurement contracts, this policy might not be accepted by the Bank if the project is to be implemented in another region with no direct impact for the firms generally protected.

In order to ensure that the economy and efficiency of the project is guaranteed, the participation of the community in financed projects will have to be discussed and agreed with the lending institution and could only be applied if expressly stated in the Loan Agreement. The

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<sup>842</sup> ibid.

<sup>843</sup> See Procurement Manual section 23.3

Bank will access the community technical and financial capacity and their accounting and procurement skills<sup>844</sup>. If weaknesses are found, their participation will be conditional on investments in training and capacity building programmes. As an alternative, NGOs might be called to act as agents for the communities and procure on their behalf.

The Guidelines do not determine how the policy will be designed and to what extent community participation can be taken into consideration. The Manual, however, states that community should be involved as suppliers ONLY when *goods required are of a type commonly provided by community groups including furniture, roofing materials, wooden sleepers for railways, groups of small scale artisans may provide wooden desks in an education project etc.; works are to be performed by unskilled labor and construction of small infrastructure, informal groups within the community may also be hired to manage and supervise construction of such works; procurement involves execution of specific irrigation work on communal or privately owned land by irrigator associations formed by farmers; and in emergency recovery and reconstruction projects, project committees may be formed by communities to enter into procurement contracts with contractors and suppliers of goods and services required.*<sup>845</sup> Regarding the size of contracts the Manual limits community participation only to small value contracts (usually below US\$25,000). Moreover, it requires that goods should be available locally and works provided by contractors in the geographic area.

For the procurement of contracts in which community participation is foreseen, three procurement methods cold be used, namely: National Competitive Bidding, local shopping and Direct Contracting<sup>846</sup>. The Bank also allows for flexibility on contract packaging<sup>847</sup>(in the Philippines Second Education Elementary project NCB was used as the primary method of procurement of furniture. However, to encourage local small scale artisans, contracts of up to US\$3.8 million were packaged into amounts of less than US\$5,000 and could be procured

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<sup>844</sup> Procurement Manual 23.2

<sup>845</sup> Procurement Manual 23.3.

<sup>846</sup> Procurement Manual 23.4.

<sup>847</sup> Procurement Manual 23.6.

through shopping); simplification of the bidding documents<sup>848</sup> (contracts are usually written in a simple language), modifications on the forms of advertisement (if the beneficiary community is illiterate, for example, advertisement could take the form of radio commercials or commercials in cinema theatres before the main feature)<sup>849</sup> and a lower level of prior review obligations (while in general the Bank requires prior review of between 50-80 per cent this rule is modified for projects involving community participation)<sup>850</sup>.

The participation of the local community in projects financed by the Bank is not necessarily a concern of the borrower. In fact, local policies could only have a role in that they fit the Bank's defined framework and procurement requirements. In most cases, the participation of local communities will be related to the Bank's aim of leading local development. However, the limitations imposed on their participation suggests that concerns over minority groups or underdeveloped industries will only be allowed for very small contracts, which foreign firms are not likely to be interested.

The Bank's concerns for community based projects are found in the following benefits: increasing the economy and speed of the procurement; increasing the capacity and skills of the community; generating employment and economic opportunities within the community and reducing the burden on centralised procurement on the borrower implementing agency<sup>851</sup>. In fact, a study from the Bank's Operations Evaluation Department has found that the rating of community based development and community driven development projects is much better than the rating of other projects, and that, at least quantitative goals are better achieved<sup>852</sup>. If there is a deeper involvement of the community in designing, preparing and implementing the project, the likelihood of success is increased, since those are the people who will ultimately benefit from the outcome of the project. However, this is not always the case and there is evidence that sometimes communities can be hard to stimulate in taking part of the project. In Ghana, for example, where

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<sup>848</sup> Procurement Manual 23.7.

<sup>849</sup> Procurement Manual 23.5.

<sup>850</sup> Procurement Manual 23.9.

<sup>851</sup> Procurement Manual 23.1.

<sup>852</sup> World Bank Operations Evaluation Department, The Effectiveness of World Bank Support for Community -Based and -Driven Development (2005).

the community was called to provide cladding for school pavilions, only 48 out of 276 pavilions were clad<sup>853</sup>. Moreover the same study showed that the Bank has not systematically and realistically accessed the costs and benefits of such projects to itself, to borrowers, or to the community<sup>854</sup>. In this context, it seems that policies directed at community participation are not entirely justified on economic grounds but also on the political acceptance of the project by the local community<sup>855</sup>.

### 5.3 Procurement of consultancy services

As mentioned in Chapter III, the *Guidelines Selection and Employment of Consultants by World Bank Borrowers* brings some distinct features from the rules stated in the Guidelines for the procurement of goods and works<sup>856</sup>. Although the selection of consultants will be mainly based on the same general procurement principles set above<sup>857</sup>, the Guidelines for the selection of consultants bring an additional principle which will guide the procurement process, namely, “**the need for high-quality services**”<sup>858</sup>. Thus at this section the distinctive features of this process will be examined, with the aim of determining how particular secondary concerns might be implemented. An in-depth examination of the rules of the Consultant Guidelines will not be carried out since some of its principles and regulations resemble those in the Procurement Guidelines. The objective here is to point out some distinctive key features which are relevant for this study.

#### 5.3.1 Cost vs. quality

The first distinction to note is the heavy emphasis placed on quality. The Consultant Guidelines rate the need for high-quality services as the first procurement concern<sup>859</sup>. Although

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<sup>853</sup> The World Bank report No. 29581, Project Performance Assessment Report GHANA PRIMARY SCHOOL DEVELOPMENT PROJECT CR. 2508-GH, (July, 2004).

<sup>854</sup> World Bank Operations Evaluation Department, (2005), at (xiii).

<sup>855</sup> For further discussion on community participation see Chapter VII, section 2.3.3.

<sup>856</sup> See comments on Chapter III section 3.

<sup>857</sup> The Consultants Guidelines brings the same principles as the procurement Guidelines but adding quality to the hall of main procurement principles.

<sup>858</sup> Rule 1.4.

<sup>859</sup> The principle comes in paragraph (a) of rule 1.4 which establish the procurement principles under the Guidelines.

procurement principles are not ranked in the Guidelines, the inclusion of the quality principle above other principles suggests that quality is indeed the primary concern of the selection of consultants under financed projects. It should be noted that the Guidelines on the procurement of goods and works also include quality as one of the issue to be taken into account in determining the best offer<sup>860</sup>. However, in the Consultant Guidelines, quality is stated as a major procurement objective.

The great emphasis placed on quality can also be seen in the procurement methods foreseen under the Guidelines. For the selection of consultant firms the Bank states that it generally prefers that competition is held only among a short-list of qualified firms and that proposals should be evaluated based on their quality and, where appropriate, on the cost of the services provided<sup>861</sup>. It is worth noting that the balance stated for quality and cost is 20 points for cost and 80 points for quality criteria<sup>862</sup>. Moreover, the Bank foresees that competition could be held based only on quality if, for example, the project requires innovative techniques<sup>863</sup>.

It should be pointed out that in general quality is linked with the primary objectives of procurement - achieving the best contract for the best value. However, the weight attached to quality under procurement for consultant services reflects a secondary concern with the outcome of the choice. What the Bank is saying is that, given the nature of consultancy services, it will not trade quality for cost in financing such services, and that it is prepared to pay more for a high-quality product.

An important concern when cost is not used as the main criterion is the potential departure from objectivity in choosing the best offer. Quality criteria are potentially much more flexible and allow much more discretion than cost based procurement. This might lead to a lack of transparency in the decisions taken during the procedure. Thus, one question is, could secondary policies be concealed under the discretion allowed for quality based procedures? The

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<sup>860</sup> See section 5.1.3.

<sup>861</sup> Guidelines rule 1.5.

<sup>862</sup> Guidelines rule 2.23.

<sup>863</sup> Other methods include: Selection under a Fixed Budget (SFB); Least Cost Selection (LCS); Selection Based on Consultants' Qualifications (SBCQ); Single Source Selection (SSS); Commercial Practices (CP).

Guidelines tried to impose some limits and to define what should be regarded as acceptable. The Consulting Services Manual also provides examples of best practice. However, as will be seen in the following subsections, there seems to be scope for considerable discretion in choosing firms either at the short listing stage, or at the evaluation stage. Moreover, since the Guidelines allow for negotiation after evaluation, bidders and borrowers might have even more opportunity to use unforeseen criteria. This lack of transparency might place an extra burden on the review mechanism to be adopted.

### 5.3.2 *Use of national capacity*

The Bank's concern with the development of the consulting industry in the borrowing country is generally reflected in three provisions of the Guidelines: firstly, at the short listing stage there is a geographic requirement which states that no more than two firms from any one country, and at least one firm from a developing country, should be short listed<sup>864</sup>. It is worth noting that this does not require the short listed firm to be a domestic firm, but it should be a firm from a developing country. In order to determine the nationality of the firm the Guidelines state that nationality should be determined according to the place where the firm is registered or incorporated, and in the case of joint ventures, the nationality will be determined by the leading firm<sup>865</sup>. However, there is no requirement for the firm to have an office in the country in which it is registered. Thus, firms could be registered in a developing country and carry out their activities in another country and still qualify for short listing.

Also at the short listing stage, the Guidelines state that the short list could comprise entirely of national consultants if the assignment is below the ceiling established in the Procurement Plan<sup>866</sup>. Although such ceiling is to be negotiated on a case by case basis, the Consultants Manual provides that it is usually above US\$200,000<sup>867</sup>. The Guidelines also note that for short listing of purely national firms there should be a sufficient numbers of qualified firms, and that the interest from foreign firm should be limited. However, the Guidelines are clear

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<sup>864</sup> Guidelines rule 2.6.

<sup>865</sup> Ibid.

<sup>866</sup> Guidelines rule 2.7.

<sup>867</sup> Consultants Manual section 3.3.

on determining that if a foreign firm wants to compete it must be allowed to do so<sup>868</sup>. This provision resembles the provision on NCB for goods and works, but in the consultants guidelines not all interested national firms will be able to present a proposal; only the short listed ones.

Finally, the participation of national firms or national individuals could be taken into account at the evaluation stage. The mechanism defined under the Consultants Guidelines is different from the domestic preference mechanism set out in the Procurement Guidelines. Here the preference is not awarded on the basis of adding to the price a set percentage but a points mechanism will determine the weight to be attached to the participation of national individuals at key staff positions<sup>869</sup>. The maximum value will be 10 points out of 100. In the evaluation, these points will be allocated to each proposal in a proportion equal to the percentage share of national key staff in the total key staff time effort proposed<sup>870</sup>. Points are awarded for the participation of nationals as key staff both in national and in foreign consulting firms. Moreover, a consulting firm which hires national staff for junior or clerical positions will not be awarded any points. In addition, the criterion is associated with time and effort, thus if nationals are appointed for key positions but the working hours attributed to them are not significant, the firm will only be awarded a small number of points.

The criteria established under the Consultants Guidelines seem to be more effective than the domestic preference mechanism set out in the Procurement Guidelines. Here the effective participation of nationals in the consulting process is the main objective of the mechanism. Moreover, the points mechanism allows a margin of competition among consulting firms in order to determine the best way to apply local knowledge. In addition, since national individuals will be placed in key positions, this might lead to improving management and consulting skills in the borrowing country since those people will probably be able to multiply such skills<sup>871</sup>.

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<sup>868</sup> Guidelines rule 2.7.

<sup>869</sup> Guidelines rule 2.15.

<sup>870</sup> Consultants Manual 17.6.

<sup>871</sup> For further discussion on the preference mechanism see Chapter VIII.

### *5.3.3 Qualification conditions*

The eligibility requirement to participate in the procurement for consulting services resembles those under the Procurement Guidelines. Thus competition is generally open to bidders from all countries, with the two exceptions regarding the prohibition of trade under national law and UN sanctions, as discussed above<sup>872</sup>. Moreover, firms can also be disqualified based on conflict of interest<sup>873</sup> and fraud and corrupt practices<sup>874</sup>. Conflict of interest might arise either between consulting activities and procurement of goods, works and other services<sup>875</sup> or among consulting assignments<sup>876</sup>. Conflict of interest can also arise from the relationship between consultants and the borrower's staff<sup>877</sup>. Those could be related to family or business ties of the consulting firms with a member of the borrower's staff<sup>878</sup>. If a member of staff is directly or indirectly involved in the project a conflict of interest will arise. The position on conflict of interest regarding consulting services is much wider than that in the Procurement Guidelines. In fact, it seems that the very nature of the competition among consulting service requires a greater protection from external interference. If a particular firm has the opportunity to have qualified information about the assignment, the fairness and transparency of the competition will be in jeopardy.

Concerns over the fairness of the competition also lead to limitations based on comparative advantage. Thus the borrower must disclose all information that would give a comparative advantage to consultant firms and their affiliates which had provided consultancy for a related assignment<sup>879</sup>.

Another difference from the Procurement Guidelines relates to the participation of government owned university and research centres in the borrowing countries<sup>880</sup>. As mentioned

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<sup>872</sup> Guidelines rule 1.11 (a).

<sup>873</sup> Guidelines rules 1.9.

<sup>874</sup> Guidelines rules 1.11 (e) and 1.22.

<sup>875</sup> Guidelines rule 1.9 (a).

<sup>876</sup> Guidelines rule 1.9 (b).

<sup>877</sup> Guidelines rule 1.9 (c).

<sup>878</sup> For discussion of conflict of interest and family ties in procurement see Priess (2002).

<sup>879</sup> Guidelines 1.10.

<sup>880</sup> Guidelines 1.11 (c).

before, such firms would not be generally qualified since they may not be independent and sometimes may not operate under commercial terms<sup>881</sup>. They might receive subsidies and grants from governments and other sources which would interfere in the price attributed to their work. However, in some cases the knowledge of those experts is unique in the country and the implementation of the project might depend on the use of these sources<sup>882</sup>. Thus, with the agreement of the Bank, the borrower might be allowed to contract the consulting services of these entities<sup>883</sup>.

#### 5.3.4 *Short listing*

The short listing stage is a crucial part of the procurement procedure in choosing consultant services since only short listed firms will be allowed to submit proposals. The Guidelines state that the short list will comprise only three to six firms unless expressly agreed otherwise<sup>884</sup>. The choice of the firms which will be included depends mainly on the qualification of the firms which expressed an interest in competing<sup>885</sup>.

The need for consultancy services will be determined in the procurement plan and published in the General Procurement Notice. For contracts above US\$200,000 a specific advertisement is needed<sup>886</sup>. The borrower will require at this stage only the necessary documents to form a judgement of the firms' qualification for the assignment<sup>887</sup>. Interested firms will then send expressions of interest which contain, among others, documents like the descriptions of similar assignments conducted, experience in similar conditions, and availability of appropriate staff. That information will then be used to determine the short list of qualified consultants.

The Consultants Manual gives further guidance on what should be taken into account. It provides that the borrower should carry out a diligent review of the following aspects:

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<sup>881</sup> See Procurement Guidelines rule 1.8 (c).

<sup>882</sup> Consultants Manual 3.2.3.

<sup>883</sup> Government official and civil servants could also under some circumstances be hired for consulting services Guidelines 1.11 (d).

<sup>884</sup> Guidelines 2.6 and respective explanation at the Consultant Manual section 13.3.1.

<sup>885</sup> See Consultants Manual section 13.3.1. When a shortlist meeting the diversity criteria set out in the Consultant Guidelines cannot be drawn from the expressions of interest, the Borrower may add known firms or ask the Bank in writing to furnish a long list extracted from DACON.

<sup>886</sup> Guidelines rule 2.5.

<sup>887</sup> Ibid.

*qualifications in the field of the assignment; technical and managerial capabilities of the firm; core business and years in business; qualifications of key staff; client references; administrative and financial strength, and record of integrity.* As mentioned in Chapter III, although experience is to be taken into account, the evaluation of the success of past experience is not foreseen<sup>888</sup>. The Bank relies on the qualifications of staff and past experience on the specific assignment to ensure the qualification of the firms. However, these criteria do not focus on performance and do not provide the necessary incentives for consultants to perform their best.

The Manual also states that the documents required from consultants at this stage should not be too burdensome<sup>889</sup>. This is not a prequalification of consultants but the documents should consist only of what is needed to form a judgement. The Manual also emphasises the need for brevity in the consultants' response<sup>890</sup>. However, too superficial information could lead to greater discretion in decision making. Moreover, for procuring agencies with little experience in making such choices, the lack of more precise investigation could lead to poor choices.

In addition to the firms' qualifications, we should remember that the geographical location of the firms will also be taken into account since the Guidelines require a geographic spread of the short listed firms. The inclusion of such requirement is not an economic concern but a political policy of giving all eligible bidders a chance to bid in financed projects<sup>891</sup>.

Fair competition concerns also lead to the exclusion of firms with a different nature from the short list prepared by the borrower. Thus, NGOs, universities, government institutes or UN agencies, for example, should not be generally short listed in QCBS procedures. When the nature and scope of the service requires such a mix, QBS or SFB should be used<sup>892</sup>.

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<sup>888</sup> See Tucker (1997).

<sup>889</sup> Consultant Manual 13.2.

<sup>890</sup> Ibid.

<sup>891</sup> See further discussion on Chapter VIII, section 2.3.4.

<sup>892</sup> Guidelines rule 2.8.

### *5.3.5 Transfer of technology*

Another important concern of the Consultants Guidelines is with the transfer of technology<sup>893</sup>. In many consulting services the borrower might be interested in acquiring the knowledge of the service being provided. Moreover, sometimes training of the borrower staff will be required by the contract. In those cases the transfer of technology will be the main subject matter of the contract<sup>894</sup>.

When transfer of technology is required this should be clearly stated in the contract documents and the borrower must be prepared to pay for it as a separate requirement<sup>895</sup>. There are two main ways in which the transfer of technology could be taken into account. Firstly, as noted above, it could be the main subject matter (such as in training programmes). In this first form, the borrower is procuring the best contract for training its personnel. Secondly, it could be considered when drafting the required service (by determining for example that the consultant firms should allow members of the borrower staff to closely follow the activities foreseen in the assignment) as a complementary activity to the assignment. In both cases, the quality of the proposed transfer of technology could be considered at the evaluation stage by awarding points for the best proposal<sup>896</sup>. In the latter case a maximum of 10 out of 100 points will be attributed to the quality of transfer of technology offered by the short listed firms<sup>897</sup>. However, this limit could be extended when transfer of technology is an important part of the assignment such as in the case of training. In those cases the analysis of the proposal will take three issues into account namely; relevance of programme, training approach and methodology and qualification of experts and trainers<sup>898</sup>.

Transfer of technology criteria is particularly important for developing countries since the number of skilled workers is low in many such countries. In fact, learning the skills provided

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<sup>893</sup> Guidelines rule 1.19.

<sup>894</sup> The Consultants Manual section 6 explains various contracts where transfer of technology is required (on the job training for the borrower's staff; stand alone training; and twinning of organizations).

<sup>895</sup> See section 6.1 of the Manual.

<sup>896</sup> See Guidelines 2.15.

<sup>897</sup> See Manual section 17.5.

<sup>898</sup> For rules on how the evaluation of the quality of the transfer of technology should be done see Consultants Manual 12.5.

by consultant services might significantly influence the sustainability of the project and the buyer's capacity to reproduce the knowledge in similar assignments. In this context, the Model Law, for example, when used as basis for the development of the reform of procurement systems allows for the use of transfer of technology as a criterion in evaluating procurement offers, both for the procurement of goods and works, and for the procurement of services<sup>899</sup>. The Bank, however, does not mention transfer of technology as a criterion under the Procurement Guidelines. The lack of such rule does not necessarily imply that such criterion is not allowed there. As seen in section 5.1.3 the list of award criteria under the Procurement Guidelines is not exhaustive and thus transfer of technology might be allowed. The justification for the difference in the provisions of the Procurement Guidelines and the Consultant Guidelines is not entirely justified and might reflect the special character of consulting services.

### 5.3.6 *Evaluation*

Since consulting services are a subjective product there is a substantial risk of discrepancies in evaluating the proposals. In order to mitigate this risk the Consultants Manual recommends that the borrower should adopt a rating system with fairly objective criteria to be followed in all evaluations<sup>900</sup>. The Guidelines state that there are five main criteria for evaluating the offers of consulting firms: relevant experience for the assignment; methodology adopted; qualification of key staff; transfer of technology, and participation by nationals<sup>901</sup>. Those criteria should usually be divided into sub-criteria<sup>902</sup>. Since we already examined the last two, we should now turn to the first three evaluation criteria.

Relevant experience (up to 10 points): guidance on what "relevant experience" means can be found in the Manual<sup>903</sup>. This would include past experience with similar projects, experience in the same area and conditions, size, operation and management of the organisation, and availability of a Quality Management System. Some of these requirements relate specifically

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<sup>899</sup> Article 34 (4) (c) (iii) and Article 39 (1) (d). For transparency purpose the Model Law requires that any requirements on transfer of technology should be stated in the request of proposals Article 27 (v).

<sup>900</sup> See section 17 of the Manual.

<sup>901</sup> Guidelines rule 2.15.

<sup>902</sup> Guidelines rule 2.16.

<sup>903</sup> Manual section 17.2.

to the capacity of the firms to undertake the assignment. However, the requirement of having a Quality Management system might cause certain problems. Does this system have to be an international evaluation system? Can national standards be set as a criterion? If, for example, the assignment involves environmental risks can environmental management systems be taken into account? There is no clear guidance for those questions and discretion given by the Guidelines provisions will lead to decisions on a case by case basis.

Methodology (from 20 to 50 points): at this stage proposals will be evaluated for their understanding of the objectives of the assignment; completeness and responsiveness; creativity and innovation; clarity; efficiency and resource utilisation; flexibility and adaptability; technology; timeliness of output; logistics; quality management<sup>904</sup>. Note that although the Manual tries to provide some certainty on the criteria used for evaluating proposals, the wording of the requirement is wide enough to embrace several secondary policies. Thus, for example, in evaluating the creativity and innovation of an offer, can new forms of environmental preservation be considered particularly relevant? It does not appear to have any legal restriction for the inclusion of such criteria.

Qualification of key staff (30 to 60 points): the qualification of key staff members will be based on general qualifications such as number of years of experience and the age of the personnel (for sensitive and complex assignments older staff are preferable, while for projects of innovative nature and for using new technological mechanism, younger professionals are to be preferred); adequacy of the assignment and experience in the region and language<sup>905</sup>. The requirement of knowledge of the local language could, for example, lead to a better evaluation of national firms. However, the Bank requires that for foreign participants knowledge of the local language will be an advantage, while national firms should be awarded points for knowledge of the language of the contract (one of the World Bank official languages)<sup>906</sup>.

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<sup>904</sup> Manual section 17.3.

<sup>905</sup> Manual section 17.4.

<sup>906</sup> Manual section 17.4.2.

Evaluation of cost: after the quality of the proposal is evaluated, all the firms meeting a minimum qualifying mark will be called to present their financial proposals where cost is a factor in choosing the consultant (QCBS)<sup>907</sup>. As mentioned before, cost will represent 20 points out of 100, while quality will represent the other 80 points.

### 5.3.7 *Negotiation*

After the evaluation of the proposals the higher ranked offer will be called to negotiate the contract<sup>908</sup>. The Bank states that this stage of the procedure is aimed at achieving a “mutually satisfactory contract between the borrower and the consultants”<sup>909</sup>. Several items will be open to negotiation, including scope of work; technical approach and methodology; work plan and activity schedule; organisation and staffing, and time schedules for key staff; deliverables; counterpart staff; counterpart facilities and equipment; contract special conditions; staff unit rates; reimbursable expenses; and proposed contract price<sup>910</sup>. Since the alterations of those items could significantly alter the qualification of the proposals, the Bank imposes limits on the extent of what can be negotiated<sup>911</sup>.

The Guidelines state that discussion should not “substantially” alter the terms of the TOR, the quality of the final product, or the offered price<sup>912</sup>. The Manual repeats the limitation clause without giving further guidance on what would be a “substantial” modification<sup>913</sup>. It is foreseen in the Manual that conduct that significantly affects the evaluation of the qualified firm will not be accepted. As an example, the Manual states that sometimes, consultants intentionally propose methodology and key staff with qualifications above the requirements of the assignment in order to be selected and called to negotiate (“high balling”)<sup>914</sup>. Although this strategy of increasing quality also implies an increase in the offered price, the chances of being selected remain high because either the price is not a factor of selection (QBS) or it is allocated a limited

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<sup>907</sup> For cost evaluation see Guidelines rule 2.20 until 2.23 and Manual section 16.6.

<sup>908</sup> See Guidelines rules 2.24 until 2.27.

<sup>909</sup> Manual section 18.

<sup>910</sup> Manual section 18.2.

<sup>911</sup> Manual section 18.4.

<sup>912</sup> Guidelines rule 2.24.

<sup>913</sup> Manual section 18.4.

<sup>914</sup> Ibid.

weight (QCBS). During negotiations the consultants could propose to trim the scope of work of their proposal if the offered price exceeds the budget. This practice should not be accepted, and may require calling for new proposals. However, the precise limit of what can be trimmed and what cannot be altered is not defined, giving further scope for discretion, and reducing the transparency of decisions<sup>915</sup>. Could, for example, contract conditions related to the employment of local labour or sub-contracting local firms be negotiated at this stage? Could the rate of transfer of technology be lowered or increased under such negotiations? The answer is unclear.

## 6 Conclusion

Before a more critical review of the rules is carried out, it is useful to provide a summary of the rules discussed in this Chapter. Firstly, it was noted that procurement under financed projects is guided by four main principles: economy and efficiency; access to all eligible bidders; transparency, and the development of the industry in the borrowing country. For consultant services the quality of the product is also an important procurement concern. In order to achieve its objectives the Bank sets a series of rules which must be followed in all financed projects. A few of those policies are imposed by the lender but others are left to the borrower discretion.

In general, the Bank is quite strict on its procurement rules and generally imposes requirements which are aimed at ensuring that the primary objective of procurement is achieved. However, there is one particular instance where secondary concerns are imposed upon the borrower, namely, when the Bank defines the eligibility criteria. The Bank demands that firms from all countries must be allowed to bid unless there is a limitation imposed by the provision. Thus, by the application of fraud and corruption measures the borrower is not given the option of allowing debarred firms to participate even if they are potentially good suppliers. The Bank uses its procurement rules as a mean to impose its anti-corruption policy and no discretion is given on the application of such policy. In addition, government owned enterprises are not generally

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<sup>915</sup> Other systems such as the GPA, UNCITRAL and the EC Directives provide for more limits on the scope of post tender negotiation. For UNCITRAL see Guide to Enactment page 88. Also see Arrowsmith (2004) (a). For procedures under the EC Directives see Arrowsmith (2005). Also see Steinicke (2001), Kruger (1998) and (2004) The procedures under the GPA see Arrowsmith (2002) (b) For further discussion on the limits of post tender negotiation see Arrowsmith , Linarelli and Wallace (2000).

allowed to participate in the procedure because of their economic strings and not because they could not provide a good offer. Also firms caught by the provision on conflict of interest, can not rebut the presumption imposed on them.

During the procurement procedure there are considerable uncertainties over the possibility of implementing secondary policies. The Bank's broad definition of the criteria which are allowed in each phase of the procurement process leaves unclear the precise limits in which such criteria could be applied. This is the case, for example, of the draft of technical specifications; in the use of social and environmental criteria at the award procedure; the inclusion of contract conditions, etc. However, there are areas where the Bank defines specific policies which are allowed to be included in the procurement procedure at the discretion of the borrower. This is the case, for example, in the domestic preference mechanism set for each of the procurement products namely goods, works or services. Each mechanism will have its own criteria (amount of national content, nationality of the contractor, or use of national staff) but all will be based on nationality. Another secondary policy which is expressly allowed under the Consultants Guidelines is the evaluation of the quality of the transfer of technology offer included in the bid.

After the overview of the Guidelines' provisions to determine the scope for implementing secondary policies, there are three main issues that the analysis should address. Should revisions be made regarding the use of national policies? Can the provisions on the policies already pursued by the Bank be improved? Should the Bank use procurement in financed projects to implement other secondary policies such as human rights, labour rights and environmental protection? Thus, a critical review of those issues will be carried out in Chapter VIII.

## **CHAPTER VIII – SECONDARY POLICIES UNDER THE WORLD BANK**

### **PROCUREMENT - A CRITICAL ANALYSIS**

#### **1 Introduction**

As was seen in the previous Chapter, the World Bank Procurement Guidelines and the Consultants Guidelines bring some provisions addressing secondary procurement concerns. The Guidelines' provisions are drafted based on the procurement principles stated by the Bank, which, more generally, follow the purpose established by the organisation in its charter. Thus, the Guidelines' provisions are aimed at achieving a good level of economy and efficiency, ensuring access to all eligible bidders, stimulating the development of the borrowing country and ensuring transparency on the procurement decisions. In addition, the Consultants Guidelines will need to ensure the quality of the services provided. In order to achieve those objectives, the Guidelines have rules which are not only concerned with the choice of the best contract for the best possible price, but also with other objectives such as probity, fair competition, the development of the national industry, etc. However, in some instances the Guidelines' provisions are not very precise and there are doubts over the implementation of some policies. In this context, the discretion given to the borrower and the Bank's staff at the negotiation stage might result in a lack of transparency and inconsistency in the application of the Guidelines. In addition, the Bank limits to a significant extent the pursuit of national secondary policies already in place. Given the size and scope of the World Bank financed projects, there is also some pressure from national stakeholders and the international community for widening the use of procurement as an instrument to achieve secondary policies under financed projects.

In this context, the aim of this Chapter is to provide a critique of the current provisions, based on the literature referred to in Chapters VI and VII, and to offer some proposals for reform. The proposed reform will consider three different facets of the use of secondary policies in financed projects.

Firstly, the possibility of improvements to the current provisions will be considered. To address this first point, not all the provisions will be re-examined, but only those where it was

determined that concerns existed over their limits and efficacy, regarding the principles they aim to achieve. For organisation purpose, the first part will address the provision in the same order as in Chapter VII. Thus, principles will be addressed first, followed by general provisions of the Guidelines, and finally, some of the specific provisions will be considered.

Secondly, given the increased number of procurement reforms in borrowing countries, scope for further use of established national policies of the borrowing country will be examined. In this analysis it will first be considered whether the interference of the Bank in the national procurement regulations under NCB procedures could infringe the principle of national sovereignty. Moreover, it will be determined whether the Bank should allow for greater use of national policies. Since justifications and efficacy might vary between policies directed at industrial, social and environmental objectives, each set of policies will be considered separately. It will be discussed which policies should be allowed and to what extent they should be reflected into the Bank's procurement Guidelines.

Finally, the possibility of using the Bank's procurement power to promote other policies, especially labour and environmental standards, will be addressed. Here it will be examined whether there are any policies that should be imposed by the Bank and, if so, through which mechanism. In this context, there seems to be an obligation of the Bank's charter that will limit the possibilities of implementing such policies, although grounds could be eventually found by giving the charter a dynamic interpretation. Finally, the possibility of requiring compliance with international agreements to which the borrower is a signatory will also be examined.

## **2 Improving the Guidelines' provisions on secondary policies**

### **2.1 Procurement Principles**

#### *2.1.1 The use of procurement to foster the development of domestic industry*

As explained in Chapter VI, there are several criteria upon which national governments have based their decisions on protecting domestic industries<sup>916</sup>. Justifications are commonly

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<sup>916</sup> See Chapter VI, section 2.1.

based on grounds such as increasing domestic employment opportunities and profits to the national industry; easing balance of payment constraints; ‘infant industries’ arguments; as safeguards against the free trade effects suffered by some specific industries; improving the standard of living and income of citizens of declining regions, etc<sup>917</sup>. The Bank, however, justifies the inclusion of the “development of the national industry of the borrowing country”, as one of its main procurement concerns, based on its Articles of Agreement requirement for *fostering the development of the productive resources of members, and assisting in raising productivity, the standard of living and conditions of labour in their territories.*

However, the Article of Agreement requirement does not necessarily lead to the implementation of industrial development concerns into the procurement regulations. In fact, as seen in Chapter VI, there are doubts over the efficacy of using procurement to achieve industrial development<sup>918</sup>. Evidence has shown that several factors might lead to poor choices in managing protectionist policies<sup>919</sup>. Firstly, it is difficult to draft policies that can actually result in the desired benefits. Some of the factors leading to failures are: the choice of the industry to be protected might be based on political rather than economic reasons<sup>920</sup>; the policy could run for longer than necessary since there might be political pressure to keep it in place<sup>921</sup>; protectionist policies might not provide the necessary incentive for the development of efficient industries since they are preserved from open competition; protectionist measures might bear the additional cost of losing more profitable opportunities since other suppliers might not find the procurement environment particularly attractive, etc. Secondly, even when benefits can be achieved, they must be compared with the benefits brought by other forms of incentive, such as direct investment, training, development of awareness of how to compete for government contracts, etc<sup>922</sup>. In

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<sup>917</sup> Those justification were seen in Chapter VI, section 2.1.1, 2.1.2, 2.1.3 and 2.1.4.

<sup>918</sup> For further discussion see Chapter VI, Section 2.1. For economic arguments on the effects of protectionist policies see Trionfetti (1997) and Mattoo (1996).

<sup>919</sup> For discussion on these and other factors influencing the decisions of implementing such policies in the procurement context see Arrowsmith, Linarelli and Wallace (2000).

<sup>920</sup> On the tension between domestic interests and free trade Shuman (1994) and McGinnis and Movsesian (2000).

<sup>921</sup> See Deltas and Evenett (1997) suggesting that protectionist policies provide large economic rents for domestic firms.

<sup>922</sup> Arrowsmith (1995).

addition, the choice of implementing such policies through procurement must take into account the additional price which will be paid and the losses in quality that might also follow. The cost of enforcement measures is also an important factor since measures such as cancellation of the contracts might lead to delays and the need to commence another procedure.

In this context, the Bank's use of procurement as an instrument by which to foster the development of the industries in the borrowing country is not entirely justified. It is noticeable that at this stage we are not questioning the method or the scope of the provisions implementing such a concern<sup>923</sup>. What we are discussing is the inclusion of industrial development objectives as a matter of principle in procurement procedures. Such inclusion implies that the interpretation of the Guidelines' provisions is subject to development evaluation<sup>924</sup>. However, there is nothing to suggest that the Bank carries out an extensive evaluation of the level of development of industries in its member countries. If it is right to say that the Bank will lend mainly to developing countries and that, in theory, such countries have undeveloped industries, there are many countries eligible to receive the Bank's funds and which have highly developed industries which are capable of competing on national and international levels<sup>925</sup>. In those instances protectionist measures might lead to public money going to private hands without the development benefits.

In addition, the principle envisaged by the Bank is to foster the development of the industry of the borrowing country, and not the development of industries in developing member countries in general. Thus, the principle foresees protectionist measures and does not stimulate competition, even among the industries of developing countries. This kind of protectionist measure directed to developing countries is also envisaged under the GPA, for example. However, the rationale for the provision is that agreement is probably not linked to the economic development of the domestic country but to the concern for broadening developing country

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<sup>923</sup> The discussion on the preference mechanism which is designed to implement this principle will be held below at section 2.3.2. Moreover, discussion on projects requiring community participation will be held in section 2.3.3.

<sup>924</sup> For rules interpreting treaties see Chapter II, section 7.1.

<sup>925</sup> Countries such as Brazil, Mexico and Russia qualify for Bank's loan and have some developed industries.

membership of the GPA<sup>926</sup>. It is expected that by allowing procurement to be used as an instrument of internal development, the political pressure against the implementation of the agreement should diminish. Under the World Bank, it seems that a similar rationale would apply. Thus, protectionist provisions are based on political rather than economic concerns, since the improvement of the global economic welfare and the development of the industries of all other member countries are put aside in favour of the industry of one particular member. Probably the protection of the industries of borrowing countries is linked with the stakeholders' concerns over the acceptance of the Bank's financed projects.

However, it should be noted that the relationship between the Bank and the borrower under the loan agreement develops in a different way. The Bank enjoys much greater power to drive procurement related policies<sup>927</sup>. While to accept international agreements liberalising procurement trade, the country must envisage good trade effects (such as the potential to export products and services), the rationale for accepting the World Bank's procurement rules relates to the fact that borrowers need the money that is being lent<sup>928</sup>. In this context it seems that the Bank could play a more prominent role in ensuring that countries resist the political pressure against open trade and thus provide a more efficient use of the resources. In addition, since there is a move towards reforming the procurement system of many developing countries in order to provide for open competition, leaving protectionist policies for limited instances, the Bank's procurement principles might have to be revised in the long term.

For the moment, the Bank still has to balance the borrowers' desire to use protectionist polices<sup>929</sup> and the Bank's objective of providing an effective procurement mechanism. In addition, the Bank's projects could eventually suffer resistance from national groups which are opposed to free trade polices, and might need to minimise the impact of these pressures for the success of the project. In this scenario the permission of some protectionist polices, provided that they are implemented in a way controlled by the Bank (so that other principles are not

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<sup>926</sup> See Arrowsmith (2002) (b) Chapter 13 at 13.7.1.

<sup>927</sup> For discussion of the Bank's role and powers under procurement process see Chapter III.

<sup>928</sup> See Carrier (1997) (b).

<sup>929</sup> For examples of several countries use for protectionist polices see Carrier (1997) (a).

undermined), might bring the necessary stability in financed projects. Thus, as will be seen in Sections 2.3.2, and 2.3.3 the Guidelines' rules, which are used to give effect to this principle, only allow protectionist measures in limited ways, such as in the use of domestic preference mechanisms and in projects requiring community participation. However, even those provisions could be further improved and national attempts to apply them effectively encouraged.

## 2.2 General provisions

### 2.2.1 *Fraud and Corruption*

In previous Chapters we have discussed not only the content of the rules on fraud and corruption, but also the reasons for the adoption of anti-corruption measures<sup>930</sup>. In addition, the role of the provisions on fraud and corruption in ensuring compliance with the Guidelines' provisions was determined<sup>931</sup>. However, in that analysis some concerns over provisions set out in the Guidelines have been identified<sup>932</sup>. Firstly, it was determined that there are doubts over the efficiency of such provisions in achieving their objective. Secondly, a lack of clarity in the procedures and the extent of the remedies to be applied when such practices are detected was identified. Thirdly, it was established that there are limitations on the application of national regulations which tackle corruption in procurement procedures. Finally, it was ascertained that the prevention of corruption might be linked not only to specific provisions addressing this concern, but also to provisions which are aimed at ensuring transparency, with enforcement measures and remedies available, and with the discretion awarded to officials in making their procurement choices.

It must be noted that there is extensive literature which tries to determine the causes, and possible cures for corruption<sup>933</sup>. However, there is no easy recipe and the suggestions made by

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<sup>930</sup> See Chapter VII, section 4.3.

<sup>931</sup> See Chapter IV section 2.3.

<sup>932</sup> See discussion on Chapter VII, section 4.3.

<sup>933</sup> See for example Rose-Ackermen (1999); Soreid (2001); Celentani and Ganuza (2002); Abramo (2003); Salbu (1999); in the World Bank context see Bannon (1999) Shihata (1997); Haarhuis and Leeuw (2004).

some authors are sometimes challenged by a later study<sup>934</sup>. Although some interesting suggestions to improve the efficiency of anti-corruption measures have been made – such as the use of a ‘white list’<sup>935</sup> or the implementation of a ‘performance rating system’<sup>936</sup> – it is beyond the scope of this study to provide a comprehensive analysis of the possible means to address fraud and corruption practices. Instead, this work will focus on providing a critical evaluation of the use of the mechanisms adopted by the Guidelines for excluding from contracts firms caught in fraudulent and corrupt practices as a means to implement the Bank’s anti-corruption policy.

The provisions of the Guidelines are directed at excluding bidders in two situations. Firstly, it excludes bidders who are caught in fraudulent and corrupt practices during the specific procurement procedure. Thus the Bank states that it will reject a proposal for an award if it is determined that the bidder recommended for the award has engaged in unlawful practices<sup>937</sup>. Secondly, it excluded bidders who have been caught in unlawful practices previously and have been debarred according to the Bank’s procedures. Thus, it uses procurement as a sanction for past procurement violations<sup>938</sup>. In assessing the system’s efficacy several factors would need to be taken into account<sup>939</sup>; namely, the definition of the forbidden conducts, the range of persons subject to exclusion, the procuring agency to which it will apply, the existence of a time limit to

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<sup>934</sup> For example, Rose-Ackermen (1999) stated the view that competition will generally lower corruption. This argument, however, was later challenged by Soreid (2001), and more recently studies by Celentani and Gauza (2002) have proved that under some circumstances this statement might be entirely wrong.

<sup>935</sup> See Soreid (2001) who, advocates in favour of the OECD suggestion on the draft of a “white list” in which companies certifying that they comply with all anti-bribery laws and that they have internal managing and accounting practices adequate to ensure compliance with these laws can be included on the list.

<sup>936</sup> See Soreid (2001) suggesting that this system could be used in ICB procedures. She states that this would provide more flexibility in competitive procedure to consider the past performance of suppliers. Such system would provide greater incentives to companies in performing well in respect of contract agreements and they would be rewarded for helping the government to avoid mistakes. In order to improve their “performance rating” they would also have incentives to make investments and innovations specifically for the government work. The use of performance rating system was also suggested by Tucker (2001) he noted corruption practices and poor choices in procurement flourish in an environment where the rules are too strict and procurement officer are only allowed to take into account the documents presented at each procurement process.

<sup>937</sup> Procurement Guidelines 1.14 (b).

<sup>938</sup> Procurement Guidelines 1.14 (d).

<sup>939</sup> For an assessment of the provision requiring the exclusion of suppliers under the new EC Directives see Williams (forthcoming). For an assessment of rules in the US see Schooner (2004) and Yukins (2004).

consider the unlawful conduct, the standard of proof to be required, and the means to discover misconduct<sup>940</sup>.

As mentioned in Chapter VII<sup>941</sup>, the provisions on fraud and corruption provide a definition of such conducts. The rules state that “corrupt practice” *means the offering, giving, receiving, or soliciting, directly or indirectly, of any thing of value to influence the action of a public official in the procurement process or in contract execution*; “fraudulent practice” *means a misrepresentation or omission of facts in order to influence a procurement process or the execution of a contract*; “collusive practices” *means a scheme or arrangement between two or more bidders, with or without the knowledge of the Borrower, designed to establish bid prices at artificial, non-competitive levels*; “coercive practices” *means harming or threatening to harm, directly or indirectly, persons, or their property to influence their participation in a procurement process, or affect the execution of a contract*. Note that the definition states the actions or omission which would be relevant, but does not require the results to be achieved. Thus, giving a “present” to a public official is seen as unlawful conduct if it is intended to influence the action of such official. Even if, in practice, the official does not take the “present” into account, in taking procurement decisions, the firms can still be punished with exclusion. This kind of provision is designed to reflect a standard of ethical behavior and thus, the achievement of the result is seen as secondary.

The choice of specifying the conducts which will not be accepted derives from the need to prove a fair and transparent environment for exclusion<sup>942</sup>, where suppliers and public officials know which kinds of conduct will not be tolerated. This provides certainty to the policy and tends to discourage the described conducts. However, when this rule-based approach is chosen, care should be taken in drafting the provision so that other forms of corruption are not left out. Under

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<sup>940</sup> There are other factors which are related to the specific process of debarment such as burden of proof; speed of the procedure; interim measures; access to the relevant documents, etc. For consideration of those factors in the context of the World Bank debarment procedures see Thornburgh report (2002). Also see Chanda (2004) who also consider measures regarding punishment of Bank’s staff involved in corrupt practices.

<sup>941</sup> Section 4.3.

<sup>942</sup> See Thornburgh report (2002) which state that in previous time the exclusion of firms was done in an informal way. Moreover, this informal mechanism of exclusion is still in place in some international organisations.

the Bank's provision, for example, if one bidder, which offers a higher price, offers money to its competitors to leave the competition, this might not be seen as an action which could trigger debarment procedures<sup>943</sup>.

In order to characterise corruption practices the term 'public official' will also have to be defined. The term 'public official' includes World Bank staff and employees of other organisations taking or receiving procurement decisions<sup>944</sup>. However, could a bribe directed at technical personnel defining the draft and scope of projects, be caught by the provision? Certainly technical decisions at the draft stage of the project could influence the procurement packaging and method of procedure to be adopted. However, the organisation providing such technical advice would not 'take or receive procurement decisions'. Thus, it is not clear whether this would be regarded as an unlawful conduct, subjecting the firm to debarment.

Regarding the range of persons subject to exclusion, the Guidelines' provisions state that firms and individuals could be declared ineligible if they were found to have engaged in any of the unlawful practices. However, the Guidelines do not provide a precise definition of the firms which could be excluded. In the Sanctions Committee Procedures, Section 13 (d), the Bank only states that *When the Committee recommends to the President that a sanction be imposed on a particular Respondent, the Committee may also recommend to the President that an appropriate sanction be imposed on any individual or organization that, directly or indirectly, controls or is controlled by the Respondent*. However the criteria for the application of the sanction to those individuals and organisations are not set out. It is not clear whether being the controlling firm or being a firm controlled by a debarred firm would be enough to be excluded from future contracts, or whether there should be a link between the corrupt activity and the related firm (such as awareness of such activities or lack of control of such activities). Thus, for example, if it were determined that despite an anti-corruption policy being applied in the firms, some individuals of a subsidiary firm had engaged in corrupt practices, could the holding firm be punished? Would it

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<sup>943</sup> Unless other bidders knew the offered price and agree to leave the competition so that the procuring agency would pay an artificial or non-competitive price.

<sup>944</sup> Procurement Guidelines footnote 17.

be punished, but with a less restrictive measure, such as a letter of reprimand? In practice, it seems that the same sanctions will be applied to any firm or individual that at any time during which the sanctions remain in effect, directly or indirectly, controls or is controlled by the respondent<sup>945</sup>. This approach seems desirable in order to prevent evasion of the sanction. However, care should be taken not to sanction firms which, despite their link with a debarred firm, had not been directly or indirectly involved in the corruption so that threat of investigation does not discourage firms from entering the competition<sup>946</sup>.

As to which procuring entity this provision will cover, it has been determined that this is a general provision which will apply in all projects financed by the Bank<sup>947</sup>. Moreover, the conducts are prohibited during the ‘procurement process’ and during the execution of financed contracts. However, we should remember that the Bank usually finances only part of the project. Thus, for example, corrupt practices might occur in financed projects, but in a contract which is not being financed by the Bank. If this comes to the Bank’s attention, could a debarment procedure be brought? Apparently not<sup>948</sup>, since the Bank is only concerned with the proper allocation of the funds it disburses, although there is no impediment to bringing the issue to the attention of other lenders.

Another characteristic of the provision is that it does not stipulate a time limit to consider the unlawful conduct<sup>949</sup>. This is seen by firms as unfair to them since they might have to keep

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<sup>945</sup> See Thornburgh report (2002) section V (O). However, in one specific debarment procedure the Bank has made it clear that debarment would extend to firms that were controlled by the firm being convicted, but that the sanction will not be extended to the firm that controls the debarred firm. See comments on the debarment of Acres International Limited at the Bank’s web site at <http://web.worldbank.org/external/default/main?theSitePK=84266&querycontentMDK=64069700&contentMDK=64069844&menuPK=116730&pagePK=64148989&piPK=64148984>.

<sup>946</sup> See recommendation of care in entering in competition under financed projects issued by Oberdorfer, Kim and Martinez attorneys for debarred firms at Patton Boggs LLP in Washington, D.C. at [http://www.pattersonboggs.com/files/News/89db43d8-b1bc-48fb-919e-b91e61e665f8/Presentation/NewsAttachment/47c98bf1-620a-44fd-94ee-04213b703ebf/2002\\_09\\_24\\_WorldBankArticle.pdf](http://www.pattersonboggs.com/files/News/89db43d8-b1bc-48fb-919e-b91e61e665f8/Presentation/NewsAttachment/47c98bf1-620a-44fd-94ee-04213b703ebf/2002_09_24_WorldBankArticle.pdf).

<sup>947</sup> See Chapter VII, section 4.3.

<sup>948</sup> The sanctions committee only has attribution to pursue cases under IBRD and IDA loans. Not even cases arising from the misuse of MIGA and IFC funds can be investigated by this committee. See suggestions for change in the Thornburgh report (2002) section V (O).

<sup>949</sup> The first draft of the mandatory exclusion provision in the new EC Directives stated a limit of five years. This limitation however, has been dropped in the final version. See Williams (forthcoming).

records and files of projects that have long been accomplished<sup>950</sup>, and are under a continuous threat of being debarred. However, the lack of such a time limit in the Bank's procedures is justified in that it needs to protect itself and its members from future harm<sup>951</sup>. However, in practice it seems that a three year period is used at triage due to the large numbers of cases being referred for investigation. Nonetheless, due to the difficulties in finding all the relevant documents, and since the Bank will have to expect cooperation from the borrowers and bidders, a strict time limit might not be appropriate for those procedures, although if possible, a longer limit might be applied to remove the threat of suppliers being investigated at any time.

A significant factor influencing the efficiency of anti-corruption policies is the standard of proof required for debarment. In general, there are few documents that could demonstrate such practices. To this extent, the unlawful practice has to be proved to the satisfaction of the Bank<sup>952</sup>. The official standard of proof which needs to be met to impose sanctions requires evidence that is "*reasonably sufficient to support a finding that the Respondent engaged in a fraudulent or corrupt practice...*" However, there is no guidance as to precisely what this means. Arguably "reasonably sufficient support" might be less than clear proof, but the efficacy of the Bank's standards have been doubted since national courts have found firms guilty beyond reasonable doubt in cases where the Bank could not find sufficient support for debarment<sup>953</sup>.

Finally, the ability of this mechanism in providing the necessary stimulus to the reporting of unlawful practices should be taken into account. Firstly, for those firms which are not involved in corruption but are aware of such practices, there is no great incentive to report such activities since there is no available enforcement mechanism that will provide correction for the procurement procedure<sup>954</sup>. Thus, reports of corruption will not necessarily stop the procurement procedure, nor will they cancel the contract. Moreover, firms might not be willing "to bite the

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<sup>950</sup> See Oberdorfer, Kim and Martinez note 946.

<sup>951</sup> See Thornburgh report (2002) section V (D).

<sup>952</sup> If the Bank comes to the conclusion that there is evidence, it is the supplier that has to prove that the Bank is wrong see comments made by attorneys note 946.

<sup>953</sup> See Acres case as reported by Chanda (2004).

<sup>954</sup> At Chapter IV section 2.2 it was discussed the role of bidder under the informal enforcement mechanism in place.

hand that feeds”, and thus might be unwilling to report unlawful practices in order to maintain a good relationship in future business<sup>955</sup>. Even if one were to argue that such firms could use the Hotline set up by the Bank<sup>956</sup>, concerns over the lack of confidentiality of this procedure might deter reports of violation<sup>957</sup>.

Secondly, firms which are actually involved in such practices might be in a better position to uncover large chains of corruption. Thus, the Guidelines could provide some incentive for such reports. At the moment, the Guidelines’ provision suggests that punishment other than debarment might be possible. It states that [the Bank] *will sanction a firm or individual including declaring ineligible* (emphasis added). Thus, the sanction will include other measures as well. The Sanction Committee Procedures clearly state that apart from debarment, a letter of reprimand could be issued, along with “other measures as the Committee deems appropriate”. However, there is no clear guidance on which measures those might be<sup>958</sup>. Moreover, the procedures do not state in which cases a less restrictive measure might be applied. Thus, if for example, a firm were to be approached by a procurement official requiring a bribe to keep the firm in the procedure, it might have to pay for a chance of winning the contract. However, after the award of the contract and after the procurement official has been removed from the operation, the same firm might want to report the corrupt activity. However, if it does so, under the current system the chances are that it will be debarred from future contracts. However, if a less strict measure is in place for firms willing to report on corrupt practices, this might stimulate further reports.

Another measure that might be further explored is the possibility of including the national legislation on anti-corruption practices in the bidding documents, and even as contract conditions, when this is foreseen under the local law. This possibility will be further developed in section 3.4.

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<sup>955</sup> It was discussed in Chapter V bidders might have an important role in the enforcement mechanism. However, see Pachnou (2005) (a) for factors influencing bidders in the decision of bringing a complaint.

<sup>956</sup> See Chapter IV, section 2.3.

<sup>957</sup> See lack of confidentiality reported by Chanda (2004).

<sup>958</sup> The Thornburgh report (2002) section V (L) has made some suggestions.

### **2.2.2 Procurement Planning**

The choices made at the procurement planning stage might significantly interfere in the possibility of applying secondary policies into the procurement for financed contracts. It was seen in the previous Chapter that contract packaging, for example, could take into account the ability of local firms and allocate contracts accordingly<sup>959</sup>. However, since the World Bank Guidelines and Procurement Manual do not have such clear rules on contract packaging, discrepancies might occur in the application of the requirements around the world. A high level of discretion is placed on the negotiations of procurement planning held between the borrower or the implementing agency and the Bank's regional procurement staff when preparing the procurement packs. However, the uncertainties over the adequate packaging of contracts might generate tensions among the different interests, and choices would have to be made under the pressure of many stakeholders. Thus, local firms and NGOs might press for breaking contracts into manageable sizes, while large firms and middle men might try to bulk pack as much as possible so that they would have a better chance of being granted a contract. Since the Guidelines do not allow conditioning large contracts to the requirements of local contracting or associations, choices will have to be made on which interests the contract would rather serve. Although it is true that the Bank foresees intermediate options, such as the “slicing and packaging” mechanism, guidance is not given on when those options should be used.

To ease the pressure, consultancy firms are called upon many times to help in drafting a project plan, including the procurement plan. It is expected that such firms would provide an independent view based on the economic and efficiency criteria of the best way to package the contract. However, it would not be too much to expect some guidance from the Bank on the parameters that should be taken into account when making such evaluation. If, in assessing local capacity, for example, it is detected that there is a competitive local market, although underdeveloped, in the sense of having many small contractors instead of large firms, must this be taken into account? In transition economies, where private suppliers might lack experience,

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<sup>959</sup> See discussion on the rules on contract packaging in Chapter VII section 4.4.

should their development level lead to more contracts going to international firms, or should their development be stimulated by making contracts more likely to attract them? In sum, could economic and efficiency evaluations take into account as one of the criteria the impact of contracts on the long term development of a country? If they could, this would be considered a secondary policy, since it is not concerned with the economy and efficiency of the contract being awarded? However, it could be argued that such criteria would relate to the economy and efficiency of the system. Thus, the issue of interpretation is whether those concerns relate to the economy and efficiency of the particular contract, or to procurement more generally.

At this moment, the Bank clearly states its preference for bulk packaging and advocates that ICB should be seen as the main procurement mechanism<sup>960</sup>. In fact, there is evidence that in practice the Bank believes that bulk packages will result in better prices and it will group a wide variety of items under the same contract. An interesting case has been reported in Sudan where an ICB procedure was found to be the appropriate method for a contract which would include tractors, lifts, pumps, car spares, karaoke machines, prefab houses, computers, warehouses and many other items<sup>961</sup>. Although some guidance is given on the limits of thresholds for procurement procedures in the CPARs when generally assessing the capacity of each borrowing country, further work seems to be needed at project level<sup>962</sup>. More flexibility for the adoption of other methods should be clearly foreseen. Moreover, the Bank should establish general parameters for all financed projects, leaving only the practical application of such parameters to the procurement staff and implementing agencies.

## 2.3 Specific provisions

### 2.3.1 General considerations

As seen in the previous Chapter, there are many areas of uncertainty regarding the application of secondary policies under the Guidelines<sup>963</sup>. What is clear is that the Bank's

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<sup>960</sup> This is stated in the Procurement Manual section 16.1 and on the Procurement Guidelines 1.3

<sup>961</sup> See Tucker 2001.

<sup>962</sup> See, for example, the need to address community capacity in community based projects (section 2.3.3).

<sup>963</sup> For main concerns see summary at the section 6.

significant involvement with the procurement procedure, by providing advice, reviewing procurement documents and advertising and clearing procurement decisions, will give the lending institution greater power to decide which criteria would be acceptable under the specific contract being discussed. Thus, given the uncertainties of the rules, the scope for the implementation of social, environmental and development related polices in financed projects will have to be negotiated between the borrowers and the Bank's staff during the various steps of the procurement process. However, an overview of the provisions of the Guidelines and the Procurement Manual suggests that, with few exceptions, those concerns will generally be restricted during the negotiation process.

However, as seen in Chapter VI, national government has traditionally used procurement to address those issues, and thus international agreements have to some extent considered the possibility of their use and the limits to their implementation. In this context, the discretion and negotiation that arise under the World Bank system is seen as a peculiar characteristic<sup>964</sup>. One of the effects of such a characteristic is the fact that while under international agreements uncertainties could be solved by legal challenges and court interpretations, in financed projects there is no centralised entity providing interpretation and guidance on the application of the Guidelines. Thus, discrepancies might exist on the application of provisions around the world.

As seen in Chapter VI, it is useful to provide a clear legal basis for the implementation of secondary policies, regardless of the limits or discretion provided for the procuring agency<sup>965</sup>. A clear and transparent procurement regulation brings certainty to the procedure and mitigates risks. Thus, even if the Bank makes the ultimate decision on the application of a substantive policy, the rules should clearly say so. In addition, clarity provides potential suppliers with a better view of what could be expected in the evaluation of their proposals. Thus, they can formulate their best possible bid. If suppliers are informed at an early stage of any requirement

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<sup>964</sup> In the GPA negotiations also arise but at a previous stage in determining whether the agreement would apply or not to a particular contract or entity – see discussion at section 6.2.1. At the Bank's system the Guidelines will always apply but the draft of the procurement requirements might be altered by negotiation between the parties.

<sup>965</sup> See discussion on the need for transparency in Chapter VI, section 5.

relating to their performance, either during the contract, or in general business practices, they could take steps to adapt to the required policy. Transparency will also bring accountability and reduce the chances of misconduct.

Given the advantages of having clear regulations, it is suggested that the World Bank Guidelines could be improved if further guidance were to be provided in some key areas. Firstly, the extent and limits of the use of standards in the technical specification of the products should be further explained. Since indirect discrimination could arise from the implementation of such standards it is suggested that the application of such requirements should be carefully analysed and only allowed when particularly necessary for the case. Also, regarding the provisions of technical specifications, it would be useful to provide some guidance on the possibility of requiring a specific production method. Could concerns over employment lead to the drafting of specifications requiring labour intensive practices in works contracts? If requirements which do not relate to the subject matter of the contract are not allowed, could production methods be taken into account in so far as that they alter the subject matter, such as in the requirement for organic products<sup>966</sup>?

Regarding the provision of award criteria, the Guidelines are clear that the list provided is not exhaustive<sup>967</sup>. However, the limits of the criteria which could be used are not clear. While, for example, the Guidelines provide that safety and environmental benefits would be allowed during evaluation, the Procurement Manual gives no further guidance on those issues<sup>968</sup>. Moreover, the points system allowed in the Guidelines is restricted by the Procurement Manual. Thus, borrowers and Bank procurement staff supervising the preparation of procurement documents might have doubts over the application of a policy awarding points for a contract that inflicts less damage on the environment.

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<sup>966</sup> In fact, the ILO has helped draft specifications for projects financed by the World Bank where labour intensive practices have been adopted instead of equipment based projects. See McCrudden (2004)

<sup>967</sup> See Chapter VII, section 5.1.3 for discussion on the award criteria

<sup>968</sup> Except to the extent that Life Cycle Cost could be used. Further environmental discussion will be held in section 3.3 below.

The greatest concern, however, is with the discretion provided in the Consultants Guidelines. While on one hand the services rendered by consultants are generally specialised and therefore, it is natural that borrowers would have further discretion in awarding the contract to the firm that can provide the best quality product, on the other hand, more discretion means greater room for misconduct. Thus, the rules should be clearer on which criteria would be allowed, especially at the short listing and evaluation stages, so that borrowers know in advance the precise grounds upon which suppliers can be qualified and their proposals evaluated.

Finally, despite the improvements that could be made in explaining the Guidelines' provisions, it is foreseen that doubts could arise on a case by case basis. Thus, it might be useful to establish a centralised body which could provide non binding interpretation to the provisions<sup>969</sup>. Several advantages could be envisaged in setting up such a body. Firstly, a centralised body could provide harmonisation on the application of the provisions around the globe. In addition, since those decisions are not binding, there would still be room for negotiation between borrowers and the Bank, but good practices could be reproduced more quickly. Secondly, the body could have procurement staff specialised in the World Bank's procurement rules. This would provide more certainty since the interpretation given by such a body could guide the decisions of the implementing agency, which is not usually a specialist in the Guidelines. This would help borrowers in dealing with the external set of rules that they have to apply. Thirdly, in order to provide efficiency to this agency, bidders would probably not be able to address concerns to them, but borrowers and implementing agencies should be able to. By evaluating the concerns brought by the different borrowers, the body could from time to time update the Manual in order to address major problems identified in practice. Finally, the uniform interpretation could bring further transparency to the procurement process and provide accountability in choosing the right contract.

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<sup>969</sup> This suggestion could also be taken in the context of the harmonisation efforts among MDBs. Thus a centralized organ could provide interpretation for key issues, which would reduce the burden on borrowers in dealing with external rules. For further discussion on harmonisation see Chapter III, section 5.

### 2.3.2 *Preferences*

One of the clearest provisions in the Guidelines regarding the possibility of applying secondary concerns in financed projects is the one setting a preference mechanism for goods with national contents, preference for national firms in awarding work contracts, and preference for firms using national individuals at key staff positions in consultancy services. The Bank is clear in basing those provisions on its procurement objective of providing development for the domestic industry and manufacturing of the borrowing country. However, as discussed in section 2.1 above, there are some concerns over the efficacy of using protectionist policies to achieve economic development. In this section we will look further at the main mechanism allowed by Bank to protect national industry; namely, the preference system as established in the Guidelines.

First, we should analyse the provisions on preference for domestic goods. The Guidelines establish that goods manufactured in the borrowing country and for which at least 30 per cent of its price accounts for labour, raw material and components coming from within the borrowing country, qualify for the preference system. In order to avoid firms being established with the specific purpose of qualifying for preference, the Guidelines require that the production facility must have been engaged in manufacturing or assembling at least since the submission of bids. The policy set by the Guidelines, however, does not take into account national policies of development. The adoption of a strict approach is probably aimed at preserving other procurement objectives such as economy and efficiency<sup>970</sup>. However, the borrowing country might have developed a consistent policy implemented by procurement and other methods to encourage the development of the industry of a certain region, or industries run by a minority group. In those instances, despite being a less restrictive policy, the borrower cannot use its domestic policies to give preference to bids coming from those groups<sup>971</sup>. Another factor would be the fact that preferences can be granted to domestic firms, regardless of their level of development. Therefore, firms which would in fact able to compete with foreign suppliers might

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<sup>970</sup> As commented in Chapter VI, the adoption of a preference mechanism is less damaging than other method such as set aside.

<sup>971</sup> For further comments on the possibility of including national policies see the following section.

use the preference to increase the price paid by the government. It is notable that preference for national goods will be awarded to the qualifying group on the basis of 15 per cent of the CIP bid price. It is not clear in the Guidelines if borrowers could, for example, reduce the margin of preference granted or increase the amount of national content for the qualifying group. In theory, since such preference mechanism would be set at the request of the borrower, it would be wise to provide some flexibility to the provision if the borrower wants to increase competition and allow, for example, a margin of preference of 10 per cent for goods with at least 50 per cent national content.

The preference mechanism set for the awarding of works contracts states that a margin of preference of 7.5 per cent can be awarded to domestic contractors. In this provision, however, the borrower is the one responsible for defining the precise meaning of a ‘domestic contractor’, although as seen in Chapter VII, the Procurement Manual requires “purely local firms” or joint ventures with no more than 10 per cent of sub-contracting to foreign firms<sup>972</sup>. In contrast with the provision in the evaluation of goods, the preference is given on the basis of nationality of the supplier, and not on the value of national content. Thus, there is nothing requiring, for example, that firms are composed of national individuals, or that they should employ local labour for the contract. Depending on the definition given by borrowers, any firms which are registered or incorporated in the borrowing country might qualify for the margin of preference. Regarding the level of development of the local industry, the Guidelines also do not require a precise analysis of the protected industry. However, a general safeguard is set, and preference for work contracts will only be allowed for countries which qualify by having a low per capita GNP. In this context, it is suggested that the provision could be further improved if guidance is given to borrowers in setting the definition of ‘domestic firms’ by requiring a greater level of involvement with the borrowing country. Firms could be required, for example, to have a minimum number of national individuals in key positions, or at least have a minimum number of national employees.

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<sup>972</sup> On the preference system see Chapter VII, section 5.1.3.

The third preference mechanism is the one in the Consultants Guidelines which allows addition points to be awarded both to national and foreign firms based on participation by nationals among key staff. As mentioned before, this mechanism is not based only on the number of nationals in key positions, but also on the amount of time they have been dedicated to the project<sup>973</sup>. This approach provides some safeguards against the misuse of the preference mechanism where individuals could be used as ‘puppets’ and have no significant involvement with the knowledge being applied in service. However, since the provision is based on the nationality of key staff, there is not necessarily a link with the borrowing country. Foreign consultancy services could hire national individuals for the specific assignment and still qualify for preference. It is not even required that those individuals should have practical links with the borrowing country. Thus, you could have individuals who have lived abroad for many years and have a greater relationship with another country, and render services to the borrowing country under protectionist policies, without bringing the correspondent level of development to the borrowing country. In this context, it is suggested that if the main objective is the development of the domestic consultant services of the borrowing country, the provision should reflect that by requiring a greater involvement by the firm or individuals with the borrowing country. Another possible solution would be to allow for more points for the transfer of technology, rather than points for the participation of nationals.

Finally, since, as seen above, the efficacy of using protectionist policies through procurement is questionable, it is noticeable that there is no evidence of an evaluation system set to determine whether the preferences given are in fact helping in the development of domestic industries, and thus achieving the Bank’s objective. In fact, there is evidence suggesting that preferential policies in procurement could lead to higher prices, without the correspondent development of domestic industry<sup>974</sup>. Moreover, it was discussed in Chapter VI that in general governments are often more susceptible to political pressures than to economic considerations,

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<sup>973</sup> See Chapter VII, section 5.3.2.

<sup>974</sup> As discussed in Chapter VI, the US, following the Adarand case, have started evaluating its discriminatory policies and found this effect. See the conclusions of the United States review of its policies in Federal Register vol.61 No.101.

which makes the chances of supporting non-competitive industries a high concern<sup>975</sup>. In this case the government would have increased the value of its procurement, consuming scarce resources from its tight budget, without receiving the benefits of such investment. Moreover, there are other instruments that governments and the Bank could use to support national industries, such as grants of loans and subsidies or support for reforming taxation policies. Thus, it is suggested that the Bank should evaluate its policies to determine whether they are in fact bringing development benefits or whether they are used to ease political pressures in the borrowing countries, in which case they should be restricted.

One way of getting around the problem and still keeping the role as a development institution would be for the Bank to carefully analyse the procurement system of borrowing countries, and if there is a consistent policy of development of certain groups or areas, the Bank could allow for the domestic system and policy to operate in financed projects, provided that this is done in a transparent way and that economic objectives are not put in jeopardy<sup>976</sup>. A move towards this approach could be found in use of preferences under local procurement in borrowing countries. When discussing the issue at the OECD/DAC – World Bank Roundtable, multilateral development banks - including the World Bank - have agreed on a common platform when working in the same country<sup>977</sup>. By this agreement preference could be given to some classes of bidders in national bidding, provided that this was required by law<sup>978</sup>. Moreover, the procedures for the application of such preference must be ‘defined’ and ‘acceptable’. Although the definition of such requirement was not given, it was stated that non-quantified bid evaluation criteria would not be acceptable. The move towards harmonising the requirement of donors and the borrowing country’s policy might have the advantage of promoting a coherent policy in the country and

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<sup>975</sup> In particular see discussion on section 2.1.2.

<sup>976</sup> See further discussion below on the use of national policies.

<sup>977</sup> OECD/DAC – World Bank Roundtable. Paris, 22-23 January 2003. Annex A (c).

<sup>978</sup> Annex A – *Open Bid – National Competitive Bidding* – paragraph (d) rule (10).

therefore lessening the burden of having to deal with a different set of rules when procuring for externally financed projects<sup>979</sup>.

### 2.3.3 *Community Participation*

In Chapter VII, it was ascertained that in projects requiring community participation, the procurement of goods, works and services should reflect the objectives of the project by drafting procedures, specifications and contract packaging accordingly<sup>980</sup>. However, there is little evidence on how decisions are made under those projects in practice. Since contracts awarded under projects which require community participation are usually of small value, they do not generally require prior approval of the Bank, and thus are not included in the contract award database on the World Bank website. Moreover, when projects are designed under community driven projects, the power to manage the resources is given to the community. Thus, little data is available on the precise allocation of resources.

However, the importance of those projects under the World Bank portfolio should not be underestimated. While it represented 2 per cent in 1989, their share has risen to 25 per cent in 2003<sup>981</sup>. A recent study undertaken by the World Bank Operations Evaluation Department called *The Effectiveness of World Bank Support for Community -Based and -Driven Development* revealed some particular strengths and weaknesses of adopting community based and community driven development projects. While acknowledging that the quantitative goal of such projects has been significantly achieved<sup>982</sup>, the study shows that the Bank has not systematically identified

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<sup>979</sup> Following this work the World Bank has produced a study exploring the possibility of expanding the use of country systems in Banks supported operation.(*Expanding the Use of Country Systems in Banks-Supported Operation: Issues and Proposals*, Operation Policy and Country Services, March 2005) This includes an analysis of the borrower's procurement system from broad consistency with the Bank procedures and use of national rules if they find to be appropriate. In particular see report on progress made in Mexico where rules are been reformed to comply with the Guidelines (paragraph 14), and the study on the procurement regulations of new members of the EU Central and Eastern countries (*Framework for World Bank support for the European Union (EU) New Member Countries of Central and Eastern Europe* (SecM2004-0283), May 28, 2004.

<sup>980</sup> For Guidelines provisions on community participation see Chapter VII, section 5.2.6.

<sup>981</sup> World Bank Operations Evaluation Department, (2005).

<sup>982</sup> Page ix.

and tracked its portfolio of CBD/CDD projects, and therefore has lacked a comprehensive understanding of the evolution and scope of its work in this field<sup>983</sup>.

In evaluating some CBD/CDD projects the study found that one of the main weaknesses is related to fiduciary and safeguards compliance<sup>984</sup>. In this regard, lack of procurement compliance is an important feature. Particularly challenging situations occur when control over resources and procurement responsibility is transferred to the community, especially remote ones<sup>985</sup>. In one particular project in Vietnam procurement procedures were almost completely rejected and the contract was awarded to a monopoly state owned enterprise<sup>986</sup>. The study acknowledges that monitoring large investment projects is much easier than monitoring the allocation of resources where small subprojects are being implemented by hundreds of remote communities in scattered locations. However, it suggests that the Bank needs “*to strengthen operational guidance for the application of safeguard policies and fiduciary oversight of CBD/CDD projects and for cost-benefit analysis and monitoring and evaluation (M&E) systems*”<sup>987</sup>. In addition it suggests an audit report on such projects, to be carried out until 2006. The study also notes that the majority of the CPARs reviewed did not report on community capacity<sup>988</sup>. A greater integration of projects requiring community participation into the CPARs and other documents included in the CAS is thus suggested<sup>989</sup>.

The findings on the study seems to be in line with the observations made in the previous Chapter regarding the lack of guidance on the precise application on the procurement regulations in projects involving the community participation<sup>990</sup>. When greater discretion is given to those who are not prepared, the chances of poor choices and deviation from the regulation are increased. It should be noted, however, that the study shows that the rate of success in CDD projects, where communities are empowered with management decisions, is significantly

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<sup>983</sup> See page 157.

<sup>984</sup> Page xiv.

<sup>985</sup> Page 43.

<sup>986</sup> Box 5.2.

<sup>987</sup> Page x

<sup>988</sup> Page 44

<sup>989</sup> Page 166

<sup>990</sup> See Chapter VII section 5.2.6

increased when they have supported *indigenously matured participatory efforts or when they have provided sustained, long-term support to communities*<sup>991</sup>. Thus, it seems that when a consistent local development programme is in place, communities are better off managing the resources allocated to them. However, when no indigenous programmes exist, communities will need guidance and orientation on how resources should be allocated. In this context, it is suggested that the Guidelines' provisions should be altered to provide further guidance on the implementation of procurement regulations in projects with community participation. Flexibility of the rules should be granted for cases where there is a consistent programme of development in place, but more detailed guidance is needed in other instances. In addition, the need for a systematic evaluation in order to determine the precise necessities of the communities should be emphasised. In particular, in the light of the apparent low efficiency of procurement to achieve development outcomes, studies need to take into account the appropriateness of using procurement mechanisms as a tool to address local concerns.

### 2.3.4 Geographic requirements

The Guidelines state as a procurement principle the need to ensure that all eligible bidders have the chance to participate in procurement under financed projects. Note that in this instance no restriction is made regarding the nationality of the suppliers, but the Guidelines state clearly that *bidders from developed and developing countries* shall be given the same information and equal opportunity to provide goods, works or services in financed projects<sup>992</sup>. As mentioned in the previous Chapter, this rule is aimed at providing the widest possible competition and is thus in line with the procurement principles foreseen in most international instruments<sup>993</sup>.

However, there are some provisions aimed at implementing this principle that might be questionable. The geographic spread requirement stated in the Procurement Manual for short listing in LIB procedures and in the procurement for consultancy firms<sup>994</sup> is particularly striking. Under this requirement borrowers are required to short list suppliers from different countries in

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<sup>991</sup> Page ix

<sup>992</sup> Rule 1.2 (b).

<sup>993</sup> See discussion on general eligibility criteria in Chapter VII, section 4.2.

<sup>994</sup> The requirement is also at the Consultants Guidelines 2.6.

order to achieve a geographic spread, even if the selected firms do not correspond to the best qualified suppliers. Discriminatory policies based on nationality should not be justified under the principle of giving eligible bidders a chance to compete. In fact, a fair competition among qualified bidders should be based on the merits of their proposals and the level of expertise of their staff, and not on the nationality of the firms. Nationality requirements might even affect the quality of the final product since firms that are exposed to a higher level of national competition, and thus have higher incentives to provide better products, are likely to be disqualified in favour of a competitor which is placed in a lower competitive market. Thus, it is suggested that the Bank should revise the geographic requirement as a criterion for short listing.

### **3 The use of national procurement regulation**

In a critical review of the Guidelines, the possibility of increasing the application of national procurement regulations in financed projects should also be discussed. As we have seen, national policies are already taken into consideration to some extent but they could have a much more important role. This is particularly relevant for cases where National Competitive Bidding has been chosen as the appropriate method for conducting the procurement mechanism<sup>995</sup>.

As seen in Chapter VII, at the moment the procurement Guidelines foresee the use of national competitive bidding in cases where procurement is unlikely to attract foreign competition. In those cases, the Bank will “review and modify” the procedures as necessary to achieve economy, efficiency, transparency and “broad consistency” with ICB procedures. Although the extent to which the Bank would allow for the application of national regulation is not clear, the Procurement Manual states in general that NCB will differ from ICB in the advertising, language and currency of the contract. In this context, it was determined that the Bank’s interference into national regulation could bring some concerns over national sovereignty<sup>996</sup>.

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<sup>995</sup> However, this might also be relevant for ICBs, given the Bank’s latest efforts in expanding the use of national systems. See *Expanding the Use of Country Systems in Banks-Supported Operation: Issues and Proposals*, Operation Policy and Country Services, March 2005.

<sup>996</sup> See discussion on Chapter VII section 5.2.2.

Protection of national sovereignty is one of the arguments used for governments to retain control over their procurement process<sup>997</sup>. As seen in Chapter VI, governments generally take into account several factors when designing their procurement policy. National employment levels, money flows related to balance-of-payments concerns, industrial development policy, national security, and environmental concerns are some examples of possible policies implemented through procurement regulation<sup>998</sup>. In order to retain the power to pursue such policies freely, many countries, especially developing countries, have refrained from entering into international procurement agreements<sup>999</sup>. Those agreements, as seen in previous Chapters, generally limit the possibility of using procurement as an instrument of public policy<sup>1000</sup>. Thus, the decision to limit national sovereignty in this sense generally comes from the possibility of exporting products and services to countries offering reciprocity<sup>1001</sup>.

Under the loan agreement, however, borrowers decide to limit their power over procurement decisions in return for the money lent by the Bank. As commented on in Chapter II, the decision of the borrower to take the loan agreement is a sovereign decision, as is its decision to enter into any international agreement<sup>1002</sup>. Thus, the decision to limit their power is a sovereign decision. It should be noted in this regard that the Bank does not condition the loan to implementation of a general procurement policy, but limits the application of the Guidelines to the procurement under financed projects. In this context, it seems that the interference of the Bank into national procurement regulations for the procurement of contracts under financed projects must be regarded as a lawful one, since it is directed at ensuring that the resources are being used for the purpose for which they were lent.

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<sup>997</sup> For the sovereign argument in retaining public procurement power see Carrier (1997) (b).

<sup>998</sup> See generally Chapter VI, section 2.

<sup>999</sup> See Hoekman and Mavroidis (1995) and Arrowsmith (2002) (b) on the GPA problems with membership.

<sup>1000</sup> See Chapter VI, section on the GPA.

<sup>1001</sup> See Carrier (1997) (b) explaining that since developing countries generally have industries which can not produce goods and services of equivalent price or quality, they fear that by opening up their markets net cash flows could be moving out of the country and thus see no point in limiting their power to determine public policy through procurement.

<sup>1002</sup> On sovereign decision to enter the agreement see Chapter II, section 7.

However, it should be argued whether or not the Bank should allow more scope for the use of national policies. Since there are relevant considerations depending on the kind of policy pursued, comments will be provided in four major areas, namely, industrial policies, social policies, environmental policies and other policies (which will include anti-corruption policies).

### **3.1 Industrial policies**

As described in Chapter VI, national procurement regulations could be used to pursue industrial policies that are aimed at protecting the national industry as a whole, a particular sector or industry, or a particular declining region. Moreover, they could be used to ease balance of payment problems or as bargaining tool in trade negotiation, among other things<sup>1003</sup>. However, there are many concerns regarding the application of such policies. The choice of the industries to be protected<sup>1004</sup>, the time for the application of the policy, the practical effect that such policies would have in the protected industry<sup>1005</sup>, and the efficiency of such policies as compared with alternative options<sup>1006</sup> are some of the concerns expressed in the literature<sup>1007</sup>. In addition, there is evidence that protectionist policies are not only detrimental to the global economy, but to the economy of the country imposing them<sup>1008</sup>.

We have seen, however, that probably for political reasons, the Bank allows for the adoption of protectionist measures at the request of the borrower. The Bank, however, does not accept national policies, but requires the adoption of the domestic preference mechanism set out in the Guidelines. We have seen above that a more flexible approach has been discussed under harmonisation efforts among multilateral development institutions, and that national policies might have a more prominent role in procurement under national competition. However, since there are several factors that discourage the use of procurement to achieve industrial objectives, it

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<sup>1003</sup> See Arrowsmith, Linarelli and Wallace (2000).

<sup>1004</sup> See Shuman (1994) and McGinnis and Movsesian (2000).

<sup>1005</sup> See the trade effect explained by Trionfetti (1997) and Mattoo (1996).

<sup>1006</sup> Jackson (1997).

<sup>1007</sup> For more detailed comments on such policies see Chapter VI.

<sup>1008</sup> For comparative advantage theory, see Jackson (1997), Sykes (1998), Trebilcock and Howse, (1999) and Lowenfeld (2002). Also see Schuman (1994) and McGinnis and Movsesian (2000) for different view on the impact of trade liberalisation at a local level. For explanation of the economic theory on the context of public procurement see Arrowsmith (2002) (b) and Arrowsmith, Linarelli and Wallace (2000).

is suggested that local polices should only be allowed if they are less restrictive than the policy adopted by the Bank. It is envisaged that, at a national level, protection could be granted, for example, only to the industry of a certain region or to a particular sector of the economy, such as small business. In addition, protectionist measures could adopt a less restrictive method. In Brazil, for example, it was seen that protection was granted to the national industries only as an untied condition<sup>1009</sup>. In this context, it is suggested that the provisions should be made more flexible to take into account less restrictive measures adopted by borrowing countries which are engaged in opening up their procurement. Thus, the guidelines should state that if national law is less restrictive, national provisions should be used.

### **3.2 Social policies**

Social polices are generally implemented in the procurement regulation in order to promote ethnic and gender equality policies, to promote labour rights, etc. Such policies could include provisions related to the contract or impose general behaviours to the contractors. Moreover, they could be directed at national level or try to influence the behaviour of foreign countries<sup>1010</sup>. Such policies are based on the perception that governments should be concerned with applying the highest standards of conduct for its contracts<sup>1011</sup> and that low prices should not be paid at the expense of poor labour practices<sup>1012</sup>. Moreover, governments use their power to influence the behaviour of the private sector and either require acceptable conducts, or at least encourage by example<sup>1013</sup>.

However, several difficulties could be encountered in the effective implementation of social polices<sup>1014</sup>. For instances, preferential treatment given to a particular disadvantaged group might delay its integration into the competitive market, or else might trigger even more tension

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<sup>1009</sup> See Chapter VI, section 2.1.1.

<sup>1010</sup> See discussion on the *Burma/Massashussets* case in Chapter VI, section 2.3. Commenting this case see McCrudden (1999) and Cleveland (2001).

<sup>1011</sup> See Priess and Pitschas (2000) (b).

<sup>1012</sup> For discussion on the legitimacy of the use of procurement to implement those policies see Arrowsmith (1995).

<sup>1013</sup> See Priess and Pitschas (2000) (b).

<sup>1014</sup> See debate on Chapter VI, section 2.3.

among ethnic groups. Following this debate, we have seen in Chapter VI<sup>1015</sup> that in the US, for example, a significant limitation on “affirmative policies” has been imposed by the Supreme Court<sup>1016</sup>. If the economic benefits of an open competition will be undermined in favour of a discriminatory policy, such policy should have a direct effect on the social outcome that it is aiming to achieve. In this context, a systematic evaluation of the policy will be essential for determining the efficiency of the policy. However, we have noted that many jurisdictions do not provide for a robust evaluation scheme<sup>1017</sup>.

In this context, it seems that while considering the possibility of applying national policies in financed projects, three issues need to be taken into account. Firstly, there is a need to clarify the existing rules. Secondly, it needs to be determined how these rules will set the scope for using national policies. The examination of whether specific provisions should be included in the Guidelines allowing for certain policy mechanisms or certain substantive policies should be carried out. Thirdly, it should be determined whether the Guidelines could provide a system whereby policies not specifically permitted under the precise rules should be allowed, subject to a justification mechanism<sup>1018</sup>.

### *3.2.1 Clarification of the rules*

As far as the first point is concerned, at the moment, the Bank, in the few provisions which take social concerns into account, is not clear on how those policies might be implemented in financed projects. On projects requiring community participation, for example, it is not clear how disadvantaged individuals or groups of beneficiaries could be used as suppliers, or how procurement planning should take their needs into account<sup>1019</sup>. In addition, where contract conditions make reference to national legislation regarding labour standards, it is not clear

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<sup>1015</sup> The US has ‘affirmative action’ requirements which are implemented through contract compliance. Under the affirmative action policy contracts are required to take a series of steps to adopt policies related to the employment of people from the target group. See Morris (1998).

<sup>1016</sup> See *Adarand Constructors v. Pena*, 115 S.Ct. 2097 (1995). In this case the Court stated that any such policy has to be evaluated and justified. For comments see Eades, (1996). For more recent debate over the Court ruling see Fetterman (2004), Weeden (2002).

<sup>1017</sup> See this argument made in Chapter VI section 2.3 citing Arrowsmith, Meyer and Tribus (2000). Also see Siemens (2003) in the context of environmental policies.

<sup>1018</sup> See section 3.2.3 below.

<sup>1019</sup> On community participation see Chapter VII ,section 5.2.6.

whether other requirements imposed on national contractors could also be extended to foreign contractors (such as collective agreements)<sup>1020</sup>. Although the Guidelines state that qualification criteria must be related to the capacity of the contractor to perform the contract, it is not entirely clear if suppliers could be required to pay minimum wages for workers under the contract<sup>1021</sup>. The list of award criteria is also unclear about the possibility of including social concerns<sup>1022</sup>. In this context, the first suggestion would be to clarify the provision in the Guidelines. To ignore the possibility of national governments requesting their use brings doubt to the procedure and could put transparency objectives into jeopardy, since decisions will be taken on a case by case basis, without proper orientation about best practices.

### *3.2.2 Scope of the provisions*

A second question is how far the implementation of national policies should be allowed under the specific rules. It is suggested that under the World Bank procurement process a restrictive approach is to be preferred for several reasons. Firstly, while in theory it might be interesting to provide support for well-developed initiatives and programmes, it is difficult to identify such policies in practice. In adopting such policies governments are sometimes not driven by economic and development objectives, but by political reasons. Thus, if the Bank decides to support specific national policies, there is a risk that any substantive benefits that can be offset by the costs involved in such policies. Secondly, as seen in Chapter VI, national governments seldom justify and evaluate their programmes based on the development effect they might be having on the targeted objective<sup>1023</sup>. When such an exercise is actually undertaken, the results might show few achievements<sup>1024</sup>. Finally, the Bank should be concerned with the impact that such measures would have on other procurement objectives. Thus, while transparency concerns could be minimised by formulating and publicising the policy in advance, the trade restrictive effects that social policies might bring could be detrimental to the principles of

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<sup>1020</sup> See clause inserted at works contracts discussed at Chapter VII, section 5.1.4.

<sup>1021</sup> On qualification criteria discussed at Chapter VII, section 5.1.2.

<sup>1022</sup> Discussion on award criteria has held in Chapter VII, section 5.1.3.

<sup>1023</sup> See discussion on Chapter VI, section 2.3.

<sup>1024</sup> See the conclusions of the United States review of its policies in Federal Register vol.61 No.101 and discussion on evaluation and enforcement in Chapter VI section 2.6.

economy and efficiency, and on the ability of the Bank to provide opportunities for suppliers from all countries<sup>1025</sup>. Thus, it is submitted, the Bank should not amend its rules to allow further policies automatically but should require justification before such policies are allowed under financed projects.

However, an exception to the restrictive approach should be made when the policies pursued reflect international accepted standards, to which the borrower has freely adhered, and thus are external from domestic policies discussion. As was explained in Chapter VI<sup>1026</sup>, although the position is not entirely clear, it has been suggested that in the interpretation of international procurement agreements, for example, entities should be allowed to include contractual conditions related to labour standards when such inclusion reflects other international obligations<sup>1027</sup> since in those instances, the trade effects of the adoption of social policies are limited and might reflect genuine concerns with social standards applied in government contracts<sup>1028</sup>. In such cases, the implementation of the policy through the procurement mechanism might be seen as legitimate, and sometimes also required by the international instrument. Thus, the Bank could insert a specific provision stating that when policies are implemented following the government obligation under an international agreement, such polices would be acceptable for procurement under financed contracts<sup>1029</sup>. Care should be taken with the form of implementation of those obligations. Thus, if the international convention provides for a specific means of implementation, this should be accepted. However, if it does not provide the precise means of implementing the policy, the Bank should require a less restrictive means, such as implementation through contract conditions, instead of exclusions. References may also be

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<sup>1025</sup> See Arrowsmith (2002) (b), arguments in the context of the interpretation of the GPA agreement.

<sup>1026</sup> See discussion on the GPA section 3.2.10.

<sup>1027</sup> This should be the case for example, for countries that are signatory of the ILO Convention No 94 on Public Contract. As noted in Chapter VI, section 3.2.10 the convention provide for the insertion of labour clauses into contracts between by private parties and central public authorities and requires that wages, hours of working and other conditions of work under those contracts are not less favourable than those established for work of the same character in the trade industry concerned in the district where the work is carried on. For the inclusion of ILO provisions on World Bank projects see comments made by AID WATCH, in [www.aidwatch.org.au/news/13/index.htm on 22/02/02](http://www.aidwatch.org.au/news/13/index.htm on 22/02/02).

<sup>1028</sup> See McCrudden and Davies, (2000). Also see Arrowsmith (2002) (b) and Nielsen (1995).

<sup>1029</sup> The Bank could also use its power to promote the implementation of such international obligations, thus requiring from those who have signed the convention that a provision is included in financed contracts. This possibility will be discussed in section 4.

useful for policies aiming to include excluded groups, such as the one used in South Africa, for example<sup>1030</sup>.

### 3.2.3 *Justification mechanism*

If the Bank decides to take national policies directed at social objectives into account, care must be taken over the practical effects of such policies. Thus, it might be desirable to require the policy to be justified before it is applied to financed projects. Under the justification analysis some factors would be relevant. Firstly, policies should be evaluated against the Bank's objectives. Thus, for example, policies directed at segregating a particular group (either for religious or ethnic reasons) should not be accepted since those policies will not improve the development of member countries, nor increase the living and labour standards for individuals within the country. In addition, policies which have a discriminatory effect should be carefully considered. Thus, for example, if they state that contractors must have an equality recruitment policy this could generally be allowed, despite the fact that some contractors might have more difficulty complying than others, since any contractor should in theory be able to comply. However, if the policy states that a particular ethnic minority representative of the borrowing country is to be protected, then such policies should only be considered in procurement which is unlikely to attract foreign competition, since in this case only national suppliers will be in the position of pursuing the requirement. In sum, in order to fulfil the Bank's principle of giving all eligible bidders a chance in the procedures, it is necessary to treat contractors which are alike in the same manner, but discrimination cannot be accepted between suppliers which are in a different position. The second concern to be taken into account is the method of implementation. Thus, it will be relevant if the policy is applied through qualification conditions or through award criteria. If the policy is less restrictive, the effect of such policy in other procurement objectives will be minimised, and thus acceptance for such policies could be more easily pursued. Still related to the method of implementation is the need to evaluate the objectivity of the criteria set by the national policy. If the policy is designed in a clear and objective way, transparency might

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<sup>1030</sup> For discussion on the South Africa system see Chapter VI, section 2.5.4.

be ensured, and the possibility of misuse of the discretion given to contracting agencies minimised. A third factor would be the existence of an evaluation system which determines the effects of such policies in the objective they aim to achieve. If an evaluation system is in place the borrower could advocate that the money is indeed being used for the development of the country on a long term basis. A fourth factor could be the existence of national legislation requiring the implementation of this policy. When policies are set in the legislation there is generally greater transparency than when they can be implemented by an administrative act. In addition, the discussion produced by enacting a national law might lead to a proper deliberation for the policy, and ensure that they have the necessary support<sup>1031</sup>. Finally, the possibility of setting up other mechanisms to achieve the same objective should be considered. Thus, if subsidies, tax relief, or direct investments are more efficient methods by which to improve the conditions of a determined group of individuals, the protection of such groups through procurement contracts might not be justified.

The final analysis of the acceptable policies should be included in the CPARs, together with an explanation of the policy. Thus, any interested person could clearly see which policies the borrower would eventually be allowed to use when procuring for financed projects.

### **3.3 Environmental policies**

When analysing the position of national governments regarding the application of environmental concerns, a distinction should be made regarding policies which will have an economic impact and policies which are purely related to secondary objectives. The first situation arises when governments procure goods which will preserve the environment, but at the same time offer the best economic deal. Thus, for example, governments might procure energy efficient light bulbs and this will benefit the environment, but will also mean that the government spends less money on electricity<sup>1032</sup>. As suggested in Chapter VII, this kind of provision should generally be permitted by the Guidelines since they do not infringe the procurement rules and are

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<sup>1031</sup> This probably would apply to countries adopting a democratic political structure but would be less important in dictatorial regimes.

<sup>1032</sup> See Marron (2003) explaining a “win-win” situation.

in line with the Bank's procurement principles<sup>1033</sup>. It was in fact determined that, to some extent, those policies are allowed. Thus, for example, the Guidelines permit that procuring entities take into account at the award stage the life cycle cost of equipment, if the follow-on cost of operation and maintenance are substantial. However, it is suggested that in order to provide clear guidance, the Guidelines should spell out this possibility throughout the procurement process, and even encourage these practices. Thus, in determining which product should be procured, procuring agencies should be called to evaluate the acquisition on a long term basis. For example, if the project requires air-conditioning for a school, the decision of whether to buy central systems or individual units must take into account the long term cost of operation of each of these systems. In this context, the draft of procurement specifications should take into account not only the initial price to be paid, but also the long term costs of each product. In sum, the Guidelines should emphasise the advantages of efficient procurement decisions throughout the procurement process and allow policies directed at this aim to be applied.

However, a more difficult situation arises where environmental concerns are applied, increasing costs and decreasing performance of the product<sup>1034</sup>. Arguments used for the justification of such policies generally resemble those used for social policies. Thus, governments might want to encourage best practices<sup>1035</sup> and might not be prepared to pay lower prices at the expense of environmental degradation<sup>1036</sup>. Moreover, there could be national and international pressure for the adoption of environmentally friendly practices<sup>1037</sup>. However, as discussed in

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<sup>1033</sup> See discussion on technical specification in Chapter VII, .5.1.1.

<sup>1034</sup> Also see Marron (2003) explaining a "win-lose" situation.

<sup>1035</sup> For the effect of government behavior in private sector also see Marron (2003).

<sup>1036</sup> See Kunzlik (2003) (b).

<sup>1037</sup> *Environmentally Preferable Procurement Meeting*, Co-sponsored by World Bank, Asian Development Bank, United Nations Environmental Programme, United Nations Development Programme, Consumer's Choice and Global Ecolabeling Network available at <http://www.consumerscouncil.org/green/procurement.html>. Melser and Robertson (2005); Chapman (1998); Eyester (2002); Sands (1998). For discussion of the necessity of designing environmental policies that will suit a particular country see Phillip Sands, (1998). In particular see his comments on the fact that integrating environment and development may serve as the basis for "allowing, or requiring, "green conditionality" in bilateral and multilateral development assistance, as well as the application of differentiated legal standards for states on the basis of *inter alia*, their historic responsibility in contributing to an environmental problem and their capacity to respond to environmental requirements". Also see Abdel Motaal (2001) for discussion of the tension of Multilateral Environmental Agreement (MEAs) and trade agreements.

Chapter VI, such practices might have an effect not only on the price paid by the government, but also on restricting trade and discouraging potentially good suppliers<sup>1038</sup>. Environmental policies are also sometimes used as indirect discriminatory measures against foreign suppliers. In this context, strict environmental standards could lead to higher costs, and not necessarily to greater environmental protection. In addition, the effectiveness of greening government purchasing might not lead to environmental gains if several other factors do not contribute to the policy<sup>1039</sup>. Nonetheless it must be acknowledged that environmental protection is part of the national and international agenda of many countries, and that the use of procurement to pursue such policies or to enforce other national policies in this regard might become increasingly important<sup>1040</sup>.

In this context the analysis of the possibility of implementing national environmental concerns in financed projects resembles those considered under the sub-heading above. Thus, consideration should be given to the clarification of the rules, to determination of which policies should be allowed, if at all, and through which method, and finally, the possibility of having a mechanism for allowing policies not expressly foreseen under the Guidelines should be considered.

### *3.3.1 Clarification of the provision*

At the moment, the World Bank procurement Guidelines are timid in providing guidance on how environmental policies could be implemented in financial procurement. Under the provision on technical specifications, for example, the Guidelines determine that specifications should allow for the **broadest possible competition** while assuring the necessary **performance**

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<sup>1038</sup> See Jackson (1997) for trade restrictions based on environmental factors.

<sup>1039</sup> See Marron (2003) considering the impact of shifting to green procurement while the private sector does not adopt the same policy. Also see Siemens (2003), Richards (2003) and Johnstone (2003) on other factors influencing the effectiveness of environmental policies.

<sup>1040</sup> For examples on domestic social and environmental policies see Arrowsmith, Meyer and Tribus (2000) and Siemens (2003). For examples on the possibility of using procurement to address environment under international trade agreements see Kunzlik (2003) (a) For examples on the concern with the environmental issues in public procurement by international organization see comments, opinions and works presented at the *Environmental Preferable Procurement Meeting* (2001 event co-sponsored by World Bank, Asian Development Bank, UN Environmental Programme, UN Development Programme, Consumer's choice Council and Global Eco labelling Network).

and other requirements of the product<sup>1041</sup>. However, as seen in Chapter VII, the provisions do not mention whether technical specifications could include requirements over the production method<sup>1042</sup>. The lack of this permission might be understood as a restriction, since the provision determines the need of the widest possible competition. However, unlike the GPA and the EC Directive which defines the meaning of technical specification, the Guidelines do not have such a definition<sup>1043</sup>. Thus, it is difficult to determine whether the rule will only apply to ‘like’ products (competition will be limited to products which are produced in a way which does not harm the environment), or whether it will prohibit any specifications regarding the production method (and thus the requirement for a wide competition will allow for products which are produced in all sorts of ways). In addition, it might also be argued that the ‘performance’ requirement could include ‘environmental performance’, which could be widely interpreted to cover both the production stage and the consumption stage<sup>1044</sup>. Nonetheless, the Guidelines do not provide any definition of the terms and only state that the bidding documents must specify in advance any relevant technical data ‘including of an environmental nature’<sup>1045</sup>. However, it is not clear whether ‘technical data’ is a concept restricted to the performance of the product at the consumption stage, or whether it could be related to the production method of such product.

However, it was also seen in Chapter VII that the Guidelines do allow for international standards, and, where these are unavailable or inappropriate, national standards to be used in defining the specifications of the product<sup>1046</sup>. Thus, if such standards require a certain production method, they will probably be allowed. However, it was also commented that care must be taken with the implementation of such standards since they might conceal indirect trade

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<sup>1041</sup> Guidelines 2.19.

<sup>1042</sup> See Chapter VII, section 5.1.1.

<sup>1043</sup> For comments on the definition of the EC and WTO see Arrowsmith (2005), Arrowsmith (2002) (b) and Kunzlik (2003) (a). Note that under the EC the Commission has stated that only requirements which have an impact that the consumption stage (such as the level of pollution emission of certain equipment) can be taken into account. However, the examples given by the Commission suggest that requirements over the production level could also be accepted such as ‘green’ electricity. The inconsistency is reported by both authors.

<sup>1044</sup> See this argument made by Kunzlik (2003) (a) when interpreting the GPA provision.

<sup>1045</sup> Guidelines 2.11.

<sup>1046</sup> Guidelines 2.19.

discrimination<sup>1047</sup>. However, the fact that some suppliers will be in a better position to fulfil the requirement than others should not in itself be an obstacle to the adoption of such standards<sup>1048</sup>.

In order to secure other procurement objectives the Guidelines state that in all cases products offering at least substantial equivalence should be accepted<sup>1049</sup>.

Regarding the position of environmental criteria at the award stage, the Guidelines state that environmental benefits could be part of the award criteria, but surprisingly, the Procurement Manual does not provide further guidance on which kind of benefit would be allowed<sup>1050</sup>. The Guidelines provide that contracts will be awarded to the bid offering the lowest evaluated cost. However, it is not clear if this means that environmental criteria will only be allowed when leading to a low economic analysis. Thus, could environmental benefits not quantifiable in terms of economic benefit be taken into account? A reading of the Guidelines rule 252 supports an affirmative answer since it permits a system of relative weight to be used in the evaluation of proposals. However, even if this interpretation is correct, there is also the need to define the limits of the weight to be attached to each criterion. Moreover, it is not clear if in order to comply with transparency requirements, it is necessary to publish the precise weight, or if it is enough to state that environmental benefits will be taken into account.

Another question that might be asked is whether the evaluation of the environmental benefit is restricted to the time during which the product is being used by the procuring agency, or if a more extensive ‘cradle to grave’ analysis could be made. At the moment, the Bank does not offer much guidance in this process. Although it is true that the Procurement Manual states that it is possible to evaluate bids on the basis of life cycle cost, this should only be done for works and equipment in which the follow-on cost of operation and maintenance are substantial. In addition, the Manual’s examples in such analysis suggest that only costs related to the operation of the product - such as the cost of spare parts and labour for maintenance; the estimated residual scrap value; and the cost of the fuel to be used during the life of the product -

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<sup>1047</sup> See Chapter VII. Section 5.1.1.

<sup>1048</sup> See Kunzlik (2003) (a).

<sup>1049</sup> Guidelines 2.19.

<sup>1050</sup> For more detailed exam of the provisions see Chapter VII, section 5.1.3.

can be taken into account. The analysis does not take into account the cost of discarding the product at the end of its life; the environmental impact of its operation, for example, noise disturbance, or levels of emission; or the implications of its production methods. Those would be related to the cost analysis of a particular product if the procuring agency has, for example, to pay taxes over the emission of certain pollutants.

One of the arguments for the provision in the Manual is that the costs involved in a comprehensive life cycle analysis are great<sup>1051</sup>. Thus, this evaluation will only be justifiable in the procurement of products that have a significant follow-on cost<sup>1052</sup>. In addition, it must be remembered that the World Bank will be implementing projects mainly in developing countries and that there might be a lack of local experts in making such analysis. However, since one of the great constraints on the use of ‘green’ products seems to be associated with a lack of information about the products available and their impact on the environment, and on the possibility of cost saving for procuring agencies<sup>1053</sup>, it might be useful for the Bank to provide further guidance in order to drive the attention of procurement agencies to the long term impact of their procurement decisions.

In addition, at the qualification stage, it is not entirely clear whether suppliers could be excluded for inability to comply with environmental requirements during the contract, although it has been suggested that they could<sup>1054</sup>. Exclusions based on behaviour unrelated to the contract, however, are probably forbidden, but it is not clear whether overall behaviour could be included as a contract condition<sup>1055</sup>.

As with social policies, uncertainties over the limits of applications could bring tension and discrepancies during the implementation of projects. Thus, further guidance on the precise limits of environmental requirements and on the possibilities of implementation in each part of the procurement process would also be useful.

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<sup>1051</sup> See Siemens (2003) and Richard (2003).

<sup>1052</sup> Many jurisdictions have used eco-labels to minimize those costs. See Marron (2003). On the possibility of using eco-labels under international procurement agreements see Kunzlik (2003) (a).

<sup>1053</sup> See Marron (2003 and Siemens (2003)).

<sup>1054</sup> See discussion the qualification provision in Chapter VII, section 5.1.2.

<sup>1055</sup> See Chapter VII, section, 5.1.4.

### 3.3.2 Scope of policies

Regarding environmental policies in which an addition price will have to be paid for the environmental requirement, the difficulty lies in determining which environmental concerns deserve particular protection. Under national policies, governments can set priorities and even enter into international agreements for the protection of a particular environmental asset. The choices made by each particular country are based on its financial possibilities, on the impact of certain environmental problem, over its territory, or on its political choices. However, in some specific instances the Bank interferes in this choice and demands the use of some specific policies under financed projects. This is the case, of example, in the use of pesticides in financed projects<sup>1056</sup>. In OP 4.09 the Bank states that *In assisting borrowers to manage pests that affect either agriculture or public health, the Bank supports a strategy that promotes the use of biological or environmental control methods and reduces reliance on synthetic chemical pesticides* (emphasis added). This statement is nuanced by the provisions in paragraph 5 which provide that *Where environmental methods alone are not effective, the Bank may finance the use of pesticides for control of disease vectors*. Moreover, as stated in Chapter VII, section 4.1 the Bank will rely on the classification of pesticides formulated by the WHO and will ban certain types of pesticides from the hall of goods financed by the Bank<sup>1057</sup>.

However, the basis for the adoption of such policies is unclear. Do they relate to the economic analysis of the projects and environmental policies which are adopted because they are seen as better economic alternatives, or are they based on international environmental principles and standards? If it is the former, can countries insist on using less environmentally friendly practices if economically they are better options? If the latter, which are the environmental assets that the Bank considers to be relevant, and why them? The answer is unclear.

Nonetheless, it must be stated that the Bank conducts an extensive environmental impact analysis of the projects it helps to finance. The rule on paragraph 3 of OP 4.01 seems, in this

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<sup>1056</sup> For other environmental concerns of the World Bank see OP 4.01 on Environmental Assessment as reviewed in August 2004.

<sup>1057</sup> See OP 4.09 paragraph 7.

context, particularly relevant. It states that EA considers natural and social aspects in an integrated way. It also takes into account the variations in project and country conditions; the findings of country environmental studies; national environmental action plans; the country's overall policy framework, national legislation, and institutional capabilities related to the environment and social aspects; and obligations of the country, pertaining to project activities, under relevant international environmental treaties and agreements. However, one question that must be asked is the relevance of this rule for procurement decisions. At the moment, it seems that environmental concerns are usually mitigated at the project design and preparation stage, and the procurement decisions are restricted in taking those concerns into account. However, it is suggested that procurement sometimes offer a more transparent and economically efficient means to compare options. Thus, for example, 'brown products' could sometimes not be excluded in the draft of the project, but their economic impact could be assessed at the procurement evaluation stage when compared with their 'green' equivalents. Thus, it is suggested that the Guidelines could be relaxed in order to allow for environmental concerns to be taken into account when it is identified that procurement is the appropriate means to address the concern identified in the Environmental Assessment<sup>1058</sup>.

In addition, the Bank could also allow for environmental measures which reflect international agreements. In this context, paragraph 3 also states that *The Bank does not finance project activities that would contravene such country obligations, as identified during the EA*<sup>1059</sup>. Thus at the environmental assessment the Bank has a prominent role in enforcing some international agreements. Thus, if a country has signed an agreement banning a particular hazardous chemical, for example, the Bank will not finance the procurement of such products. However, a more difficult question is the extent to which procurement could be affected by this provision. Thus, if, for example, the government has agreed to reducing emissions of certain toxic substances and that public contract would reflect this obligation by providing a margin of

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<sup>1058</sup> Also see discussion below, where it will be argued that not only should there be greater flexibility for states but that the Bank should encourage the use of this flexibility by providing guidance, training and other tools.

<sup>1059</sup> OP.4.01.

preference to suppliers that offer lower emission equipment, could this rule be enforced under financed procurement? The answer is unclear, but it is suggested that they should be. This kind of provision would not directly interfere with the political choice of member countries in adopting environmental policies but would clearly show that the Bank would support the implementation of such polices<sup>1060</sup>. Moreover, as the commitment of establishing limitations on government contracts will be done under the international scenario it is possible that the market closing effects of such polices will be limited<sup>1061</sup> since it is less likely that exclusion would conceal indirect protectionist measures.

### *3.3.3 Justification Mechanism*

Unlike the policies discussed above, which should generally be allowed, other national environmental policies could be subjected to a justification mechanism. The justification mechanism should include considerations for compatibility with the Bank's objectives, which would include the possibility of restricting the implementation for cases unlikely to attract foreign trade; methods of implementation, and objectivity of the criteria to be set; the presence of an evaluation system<sup>1062</sup>, the existence of national legislation requiring the implementation of the policy; and the presence of other alternatives for achieving the same objective<sup>1063</sup>.

## **3.4 Other policies**

As seen in previous Chapters, national governments might also include in procurement regulations measures to implement several other policies, such as those directed at the prevention of fraud and corruption, imposition of social security and taxation law, etc<sup>1064</sup>. International

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<sup>1060</sup> See some examples of multilateral environmental agreements in Abdel Motaal (2001).

<sup>1061</sup> For the possibility of requiring the implementation of international agreements for financed contracts see the following section.

<sup>1062</sup> For difficulty in finding data for evaluating national environmental policies see Siemens (2003). For criteria in evaluating environmental policies see Marron (2003) determining that factors such as the portion of the market that they target; the burden that they place in producers and consumers; the incentives they create for innovation; their financial costs for the government; and the degree they can be influenced by political and personal decisions, are some of the main considerations to be taken into account.

<sup>1063</sup> For a comparison among other policies in place and their effect on the decision of adopting environmental concerns into public procurement see Marron (2003). In particular see his comments on the possibility of overregulation.

<sup>1064</sup> Chapter VI, section 2.4.

procurement agreements also foresee the application of some of these policies<sup>1065</sup> and sometimes even require their implementation through procurement regulation<sup>1066</sup>. It was also commented that it is difficult to measure the effects of such policies, and that their implementation might have a greater moral effect than a practical effect in preventing tax evasion, fraud, corruption etc<sup>1067</sup>. However, the fact that they might not have a measurable effect does not necessarily mean that they are not legitimate policies. In fact, the moral effect that such provision might bring could lead to a better view of the procurement environment, and bidders might be more willing to participate if they find that measures are in place to prevent abuse and competition is preserved from bad payers and criminals.

We have seen above that the Bank imposes its own polices of fraud and corruption upon borrowers, but it probably does not allow for national polices to apply under financed projects<sup>1068</sup>. One argument is that the Bank might not trust the borrower's system to judge firms in a fair, transparent and efficient manner<sup>1069</sup>. This would be a valid argument, especially for countries where there is a risk of having corrupt courts. Moreover, there might be a fear of having political decisions, especially against foreign competitors.

However, unless there is clear evidence that those rules are unduly restrictive, or that the system in place does not offer impartial decisions, there seems to be no reason for prohibiting their implementation in financed procurement. The Bank acknowledges the significant problems that corruption could bring to member countries and has even identified corruption as *the single*

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<sup>1065</sup> Under the GPA for example, firms could be excluded for bankruptcy or false declarations, provided that such action is consistent with the national treatment and non-discrimination provisions. (Article VIII (h)). The EC, for example, provide for a list of possible grounds for exclusion. Bidders can be excluded on grounds of bankruptcy; if they are convicted of an offence concerning their professional conduct; if they have committed grave professional misconduct; if they have not fulfilled obligations relating to the payment of social security contributions; if they have not fulfilled obligations relating to the payment of taxes, or if they are found guilty of serious misrepresentation. See Chapter VI, sections, 3.3.6 and section, 3.2.6.

<sup>1066</sup> The EC in the new Directives require from member countries the implementation of procurement measures excluding from the procurement process bidders convicted of participation in a criminal organization, corruption, fraud or money laundering. (Article 45 (1)).

<sup>1067</sup> See Arrowsmith (2004) (b).

<sup>1068</sup> On World Bank polices see discussion in Chapter VII, section 4.3.

<sup>1069</sup> For the discussion of some of the risks in national enforcement mechanisms see Chapter V, section 4.2.

*greatest obstacle to economic and social development*<sup>1070</sup>. Moreover, the borrower is generally in a better position to know where the risk of corruption lies in its own country. Thus, if there are measures directed at minimising those risks, such as the application of criminal law, they should in general be allowed and limitations should only apply if such measures affect other procurement objectives. In this context, it is suggested that further scope for the use of anti-corruption policies should be allowed if they are generally required under national law. In order to prevent abuse, a clause could be inserted into the Guidelines stating that at the request of the borrower, and with the acceptance of the Bank, national polices could be taken into account. This would give the Bank sufficient discretion to deny implementation when there is high risk of political interference and unfair trial in a particular member country. In addition, there seems to be no reason to deny the application of national procurement regulation regarding the exclusion of bidders for non compliance with national criminal, taxation or security law, in cases when procurement is unlikely to attract foreign competitors. Even for international competitive procedures, compliance with national legislation could be required from national competitors so that borrowers are not put in the awkward position of having to accept a contract with a convicted firm under financed projects.

Regarding the inclusion of anti-corruption measures into contract conditions, the suggestion would be to shift from the rule in place<sup>1071</sup>, which generally forbids such inclusion and would only allow borrowers to request for the Bank's permission in large contracts. Instead, borrowers should be stimulated to mitigate corruption in all government contracts, including financed contracts. The adoption of anti-corruption measures as contract conditions should be generally accepted since this method of implementation is less restrictive than the exclusion of bidders<sup>1072</sup>. Thus, bids are allowed from all qualified suppliers, but they have an obligation under

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<sup>1070</sup> See statement in the anticorruption website: <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPUBLICSECTORANDGOVERNANCE/EXTANTICORRUPTION/0,,menuPK:384461~pagePK:149018~piPK:149093~theSitePK:384455.00.html>  
Also see World Bank, Helping Countries Combat Corruption, Progress at the World Bank since 1997, 2000.

<sup>1071</sup> See discussion of the current provision in Chapter VII, section 4.3.

<sup>1072</sup> On the advantages of implementing policies through contract conditions, see Chapter VI, section 2.5.5.

the contract not to be involved in corrupt or fraudulent activities. For a breach of this obligation fines or a termination of contract could be imposed as remedies. However, in order to prevent abuse, the application of such remedies should be cleared by the Bank.

#### **4 Using the Bank's power to promote secondary policies**

At the start of this section, it is useful to provide some explanation of the scope of the discussion that will be held at this point.

Firstly, a distinction needs to be made between the possibility of applying secondary policies to procurement and the possibility of applying such policies in loan decisions. Some commentators have considered the latter and have explained the different views over whether it would be lawful for the World Bank to withhold financing for countries which have poor human rights records, or whether the Bank should finance projects directed at creating employment opportunities for refugees, or promoting gender equality in certain countries<sup>1073</sup>. Considerations over the appropriateness of loan decisions are out of the scope of this work. However, some of the arguments discussed by those authors might be relevant for the analysis of whether the Bank can lawfully promote such policies through secondary procurement measures, and will, thus, be considered.

Secondly, a distinction needs to be made over the possibility of incorporating into the Guidelines additional provisions related to industrial development and non-industrial policies. As seen above, procurement might not be an efficient means to promote industrial development. Moreover, protectionist measures might even be detrimental to the economic development of a country. In this context, it was suggested that the Bank should revise the protectionist policies already in place and limit, as far as possible, the implementation of such measures through financed procurement. Regarding non-industrial policies, it was seen that procurement might not be an efficient way to address the issue. However, as explained in Chapter VI, non-industrial policies bring non-economic concerns that might be relevant to the Bank and to borrowers. The decision of the adoption of policies related to the protection of human rights or of the

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<sup>1073</sup> See for example, Moris (1997); Ciorciari (2001); Shihata (1988), Darrow (2003).

environment is generally based not on economic grounds, but on the view that public money should not be associated with poor practices. In this respect, those concerns override the primary concern of getting best value for the contract, and might either reflect a legal obligation of the government or be based on moral grounds. In this respect, the Bank also could be seen as an important agent for the promotion of those standards and might even be bound by international law in this respect. Thus, this section will only consider the possibility of imposing non-industrial policies on the procurement Guidelines.

A preliminary discussion will be held on the legal limitations of implementing secondary policies in the Bank's financed procurement. Thus it should be determined whether social and environmental concerns can be included in the procurement system, given the limitations of the Bank's charter. Following this discussion the work will concentrate on two main possibilities, namely, the implementation of secondary policies chosen by the Bank to apply in all financed projects, and the possibility of using the Bank's power to enforce international agreements. For organisation purposes, separate sections will discuss each particular set of policies. The first part of each section will consider whether a particular substantive policy should be pursued under financed projects and, if so, through which method of implementation. The second part will discuss whether the Bank could have a more prominent role in enforcing international agreements and could require from borrowers, which are signatory of international agreements, the implementation of the international obligations in financed contracts.

#### **4.1 Legal limitations on the use of the Bank's power**

As mentioned previously, the Bank does not generally impose secondary policies through the procurement Guidelines. However, given the amount of money spent by the Bank on procurement opportunities, and the fact that in general borrowers are low income countries which do not always have desirable social and environmental policies, it has been suggested that the Bank could use its power to promote secondary policies through public procurement<sup>1074</sup>. It is alleged, for example, that the competitive bidding procedure could push bidders to lower labour

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<sup>1074</sup> See note 1027 for example.

rights and to use less environmentally friendly practices in order to lower the bid price<sup>1075</sup>. Therefore, people working for financed projects could have worse labour conditions than those offered in general by the market for that kind of work. The environment will also suffer the consequences of such competition as bidders are less likely to worry about environmental damage. Thus, it must be considered whether the Guidelines should incorporate some provisions on social, labour and environmental policies.

However, before the analysis of any substantive policies, it should be determined whether the Bank can lawfully pursue any secondary policy. It is notable that the implementation of such requirements will probably have a multi-territorial effect. Say, for example, that the Bank determines that the supplier should have a gender equality policy in recruiting personnel. In this case domestic and foreign suppliers might have to adapt their practices to comply with the World Bank's requirement. The effect of such policies might even go beyond the borrowing country and the supplier's country, since a change in recruitment policies could affect subsidiaries and branches in a different country<sup>1076</sup>. Moreover, since policies adopted by the World Bank are seen as models which are followed by other public and private international organisations<sup>1077</sup>, they could have a global impact.

The main advantage of adopting general policies for all financed contracts, as opposed to following the national policies of the borrowing country, would be standardising the requirements. All bidders will know in advance the minimum standard required and could evaluate their policies to establish their compliance beforehand. If, on one hand, the imposition of certain conditions might seem intrusive, on the other hand, the Bank will be sure that financed projects are not being used to maintain suppliers that violate labour, or human rights. Moreover, by applying a differentiated legal standard in its procurement projects the Bank could help to develop best practices. In addition, while there are issues that might be regarded as domestic policy and should not be harmonised among member countries, there are others that could be

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<sup>1075</sup> For comments on procurement and labour right see Nielsen (1995).

<sup>1076</sup> See McCrudden (1999) saying that even domestic polices could have a wide extra territorial effect.

<sup>1077</sup> See in particular Mac Darrow, (2003) pages 145-146.

regarded as global concern (such as child labour, employment discrimination, some systematic methods of pollution, etc). In those cases the Bank could debar firms for not complying with international standards<sup>1078</sup>.

In the World Bank context, however, there are significant limitations on the use of those policies under loan agreements. As seen in Chapter II, the World Bank is not an institution which was drafted to promote human rights or environmental standards<sup>1079</sup> but a financing institution which is prohibited by its Article of Agreements from interfering in the political affairs of member countries<sup>1080</sup>. In this context, the imposition of certain behaviours could constitute violation of national sovereignty and a breach of the World Bank's charter rule. If, for example, the Bank imposes a requirement of having a gender equality policy for contractors that are not subject to such requirement by their national law and, even worse, if this is seen as a controversial political issue, some member countries might bring a case against the Bank. The increased tension among member countries could even culminate in a drop in membership.

Even if the legal constraints could be overcome, there are still limitations on what those policies can achieve if the importance of the issues addressed is undermined in the view of the borrowers and the suppliers. Thus, a recruitment policy could be implemented in order to compete for World Bank projects, and dropped as soon as the supplier is no longer interested in such contracts. Furthermore, those policies could be poorly implemented and a great cost could be incurred under enforcement measures. This could bring a lack of competitiveness to the Bank's loans since borrowers might not be prepared to comply with too many conditions, and might look for other sources of lending<sup>1081</sup>. Therefore, if there is no general acceptance for such policies, their chance of success are low.

However, one should not forget the World Bank's primary objectives. Despite being a lending institution, the Bank was created to foster wealth and development for its member

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<sup>1078</sup> See below for examples in the core ILO standards.

<sup>1079</sup> See Chapter II, section 4 for further explanation.

<sup>1080</sup> See Chapter II, section 6.2.

<sup>1081</sup> On this particular issue see Oestreich (2004) discussion on the tensions between being a financing institution and at the same time a development agency.

countries. If we recall the Bank's Article of Agreement, it is stated at Article 1 that the Bank should through its activities assist *in raising productivity, the standard of living and conditions of labour in* the territory of member countries. The interpretation of such provision must not be static, but instead should reflect contemporary concerns of the international community about the preservation of human rights, protection of the environment or guarantees of minimum labour conditions<sup>1082</sup>. Therefore it might be argued that provisions reflecting some generally accepted labour, environmental and social standards are not only allowed under the charter, but are in fact a duty of the organisation<sup>1083</sup>. Such provisions would bring greater accountability regarding the effects of World Bank operations in member countries and would assure all interested parties that project implementation is highly committed to improving the standard of living in all member countries.

It should be noted that the Bank does not deny its role as a development agency and supports projects that are directed at addressing environmental, social and industrial issues. As mentioned previously, it helps to finance the reform or the implementation of special legislation with practical actions such building sewage networks, etc<sup>1084</sup>. However, the use of public procurement as one of the possible methods of implementation should be justified. Just as there are doubts over the efficiency of the Bank's clauses on corruption and fraudulent practices, the Bank should determine the effects of setting minimum standards to be met on environmental and social issues. If generally accepted standards are applied it is possible that the cost of implementation would be low, and so would be the enforcement costs. In fact, the idea of raising

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<sup>1082</sup> This same line of reasoning was adopted by the Appellate Body in interpreting the WTO/GATT Agreement (See U.S. – Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, 12/10/1998). The relevance of this decision lies of the fact that the Court has found this 'evolutionary principle' as part of general principles of international law. Since the Articles of Agreement is a treaty which should be interpreted according to international law principles it is possible that a similar interpretation would apply. Note that the Appellate Body cited the decision of the ICJ in the Namibia (Legal Consequences) Advisory Opinion [1971] ICJ Rep 31 in its support.

<sup>1083</sup> For further discussion on the legitimacy of the pursue of human rights concerns in World Bank operation see Darrow (2003). Also see Moris (1997); Ciorciari (2001); Shihata (1988).

<sup>1084</sup> In particular see OP 4.02 regarding environmental policies and OP 4.20 regarding gender issues.

the standards of private firms' practices might convert into benefits for them as they will work in a more constructive and cooperative environment<sup>1085</sup>.

The difficulty lies in determining the limits of the 'generally accepted standards'. It has been argued that such provision could reflect an 'emerging international public policy of human rights' or the well established international norms agreed on a multilateral basis<sup>1086</sup>. As mentioned in Chapter II, the Loan Agreement, and by consequence the Guidelines, is subjected to international law and its general principles. Therefore, international agreements and general practices of the international community might be relevant in determining the limits of the provisions that might be included in the Guidelines. However, it is not clear which principles can already be considered as part of customary international law, or even which of them are so widely accepted that their implementation should be straightforward<sup>1087</sup>.

## 4.2 Substantive Policies

### 4.2.1 Social Policies

Under labour law, the efforts of the International Labour Organization in indentifying such principles deserves particular attention<sup>1088</sup>. The ILO has diverted attention to a limited set of conventions that were seen as defining 'fundamental rights at work'<sup>1089</sup>. Those would include the right to non-discrimination<sup>1090</sup>, the right to freedom from forced and compulsory labour<sup>1091</sup>, the

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<sup>1085</sup> See the idea of Global Corporate Citizenship for the importance of cooperation between corporations and the rest of society. Oestreich, (2004) and Post, (2002).

<sup>1086</sup> McCrudden (1999).

<sup>1087</sup> See Powell (2004) and Oestreich (2004).

<sup>1088</sup> The International Labour organization is one of the specialized agencies of the United Nations. It formulates international labour standard in the form Conventions and Recommendations. In addition it helps promoting labours standards by providing technical assistance to member countries. For the inclusion of ILO provisions on World Bank projects see comments made by AID WATCH, in [www.aidwatch.org.au/news/13/index.htm on 22/02/02](http://www.aidwatch.org.au/news/13/index.htm on 22/02/02). For comments on the inclusion of ILO provisions in international trade agreements see McCrudden and Davies (2000) and McCrudden (1999).

<sup>1089</sup> McCrudden (2004). McCrudden also explains that transnational corporations have already taken the challenge of trying to enforce them in practice.

<sup>1090</sup> Equal Remuneration Convention, 1951 (Convention 100) and the Discrimination (Employment and Occupation) Convention, 1958 (Convention 111).

<sup>1091</sup> Forced Labour Convention, 1930 (Convention 29) and Abolition of Forced Labour Convention, 1957 (Convention 105).

right to freedom of association and collective bargain<sup>1092</sup> and the abolition of the worst forms of child labour<sup>1093</sup>. The number of ratifications of those conventions are extremely high (around 160 members have ratified the convention), which might imply that there is widespread acceptance for the principles stated there. If such principles are in fact recognised as part of international law, the Bank could take those ‘core’ principles as a general standard for World Bank contracts and enforce them through procurement regulation<sup>1094</sup>.

One argument that could be brought against this imposition is that the Bank must not interfere in the political affairs of the borrowing country<sup>1095</sup>. Any imposition of such clauses could be seen as an unlawful interference since it will not be directly linked to the economy and efficiency of financed projects. As seen in Chapter II, for the Bank to consider an economic effect within the meaning of the charter, the economic effect must be (1) clear and unequivocal; (2) preponderant; and (3) when the issue is associated with political actions or flows from political events, the economic effect “must be of such impact and relevance as to make [it] a Bank concern”<sup>1096</sup>.

A growing body of research indicates, however, that compliance with international labour standards often accompanies improvements in productivity and economic performance. Higher wage and working time standards and respect for equality can translate into better and more satisfied workers and lower turnover of staff<sup>1097</sup>. In addition, the Bank also has a responsibility as a development institution to sponsor projects that are not carried out at the expense of the labour conditions of the workers involved<sup>1098</sup>. In this context, the requirement of observing core labour rights in financed contracts might be seen as lawful and desirable.

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<sup>1092</sup> Freedom of Association and Protection of the Rights to Organise Convention, 1948 (Convention 87) and Right to Organise and Collective Bargaining Convention, 1949 (Convention 98).

<sup>1093</sup> Minimum Age Convention, 1973 (Convention 138) and Worst Forms of Child Labour Convention, 1999 (Convention 182).

<sup>1094</sup> Note that a significant criticism made is that the Bank acknowledges that international law should drive its operation but it does not effectively incorporate such law in its operational policies. See Mac Darrow (2003).

<sup>1095</sup> See discussion on Chapters II and VII.

<sup>1096</sup> See Bradlow (1996).

<sup>1097</sup> See World Bank: *World Development Report 2005: a better investment climate for everyone* (Washington, DC, 2005), pp. 136-156.

<sup>1098</sup> Articles of Agreement Article I (iii).

In fact, the ILO Committee of Experts has expressed the desirability of the use of government contracts for the promotion of equality of opportunity and treatment<sup>1099</sup> and, regarding the implementation of the Conventions on non-discrimination<sup>1100</sup>, ILO bodies provided in the Recommendation R111 that each member should promote the observance of the principles of non-discrimination ‘where practicable and necessary’ by such methods as making eligibility for contracts involving the expenditure of public funds dependant on observance of the principle<sup>1101</sup>. In this context, a further discussion that needs addressing is whether the Bank could have a more prominent role and through loan agreements enforce the international obligations undertaken by member states.

We have argued above that national policies should be allowed for procurement of financed contracts when they reflect an international standard. This suggestion was justified by the assumption that, when external standards are applied, the risks of abuse by setting policies that will exclude contractors is minimised. However, in this context, the Bank could go one step further and require their effective implementation from countries which have signed agreements on international labour standards. In fact, for labour conditions, it is suggested that the Bank should require from members countries which have signed the ILO (International Labour Organisation) Convention N° 94<sup>1102</sup> the effective incorporation into the bidding documents the mandatory labour clauses of the Convention<sup>1103</sup>. The Convention provides for the insertion of labour clauses into contracts between private parties and central public authorities and requires that wages, hours of working and other conditions of work under those contracts are not less favourable than those established for work of the same character in the trade industry concerned

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<sup>1099</sup> ILO 1986.

<sup>1100</sup> Discrimination (Employment and Occupation) Convention, 1958 (Convention 111).

<sup>1101</sup> Paragraph 3 (a) (iii).

<sup>1102</sup> The ILO Convention has received ratification from 60 member countries and thus is only legally binding on them. However, note that the Convention is not self executing and each member state should enact national legislation to give practical effect to the Convention. The mere ratification does not bring its rules binding on the government or private parties.

<sup>1103</sup> See MacCrudeen (2004) for the linkage between procurement and the ILO standards and for a historical approach on the inclusion of social policies into procurement provisions. This article also comments on the assistance given by the ILO to members in drafting projects financed by the World Bank. In this case the ILO has help by drafting projects using labour intensive techniques.

in the district where the work is carried out<sup>1104</sup>. Although the convention has a limited application<sup>1105</sup>, it guarantees a standard of work that goes beyond that of the legal requirements. If there are any agreements between workers and employers of the trade industry concerned, the requirement of equal conditions with the other workers in the same industry implies that those will have to be observed. Also note that the ILO convention on public contracts does not establish the number of hours or the value of wages. What it says is that people working on government contracts should be guaranteed the same conditions as those established for work of the same character in the trade industry concerned *in the district where the work is carried out*. Therefore, the inclusion of the ILO provision will not significantly alter the labour conditions in member states, but it does guarantee that lower prices will not be paid at the expense of labour rights<sup>1106</sup>.

In this context, it is notable that despite the fact that many of the EC members, and some of the GPA members, have ratified the ILO Convention N° 94, neither the EC Directives nor the GPA considers the inclusion of labour standards as contract conditions in a clear way<sup>1107</sup>. As seen in Chapter VI, under the EC it is probably unlawful to exclude suppliers on the basis of their general labour policies, but it might be possible to include labour standards as a contract condition<sup>1108</sup>. Under the GPA, the use of contract conditions related to work conditions is also unclear, but many have advocated for a broad interpretation of the agreement and the permission

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<sup>1104</sup> Article 2 (1) of the ILO Convention No. 94. Also see Nielsen, (1995) at 101.

<sup>1105</sup> Only 60 countries out of 178 have ratified the convention so far. In addition certain contracts are excluded such as contracts for sales of goods. Moreover, the Convention only applies to contracts above a certain threshold defined by each national government, and so far there is no available data on the limits usually set by member countries. In fact, many members have not yet fulfilled their obligation of including labour clauses into public contracts. See Nielsen (1995). For more recent observations see: CEACR: Individual Observation concerning Convention No. 94, Labour Clauses (Public Contracts), 1949 Burundi (ratification: 1963) Published: 2005; CEACR: Individual Observation concerning Convention No. 94, Labour Clauses (Public Contracts), 1949 Central African Republic (ratification: 1964) Published: 2005; CEACR: Individual Observation concerning Convention No. 94, Labour Clauses (Public Contracts), 1949 Ghana (ratification: 1961) Published: 2005.

<sup>1106</sup> In fact there is no evidence that countries with poor labour standards perform better in the global market. See Kucera (2002).

<sup>1107</sup> For the compatibility with the EC Directives see Nielsen (1995). For compatibility with the GPA see Arrowsmith (2002) (b).

<sup>1108</sup> See Case 31/87 *Gebroeders Beentjes B.V. v The Netherlands* [1988] ECR 4635. Also see new procurement directives Article 26.

of using such conditions in support of international legislation<sup>1109</sup>. However, it was discussed above that under the loan agreement the World Bank could help countries overcoming political constraints that could deter the effective implementation of the Convention. In this context, the imposition of the Convention's requirements to those who have freely undertaken the obligation to follow them cannot be seen as an imposition in the political affairs of the borrower, but a respect for the international commitment of borrowing countries in raising the labour standards for those working in public contracts.

#### *4.2.2 Environmental policies*

In determining the appropriateness of the implementation of secondary environmental policies into financed contracts, a distinction should be made between policies leading to economy and efficiency in government purchasing and those where the government is prepared to pay an additional price for the environmental requirement. We have discussed under section 3.3 above that national policies of the first type should generally be allowed and that the Guidelines should clearly state that. However, in improving efficiency in government purchasing, the Bank could go further and require observance of certain factors - such as those relating to overall economic costs - when purchasing under financed projects. It has been identified that government officials sometimes make poor decisions which not only damage the environment but which also cost more in the long term<sup>1110</sup>. This happens for various reasons, such as lack of information about efficient products or dissociation of budgeting and operating decisions<sup>1111</sup>. In this context, it is desirable to drive the attention of purchasing authorities to correct such deficiencies and to make well informed procurement decisions.

One option in implementing such requirements would be the adoption of eco-labelling, standard codes, etc. As noted above, the cost of life cycle analysis is high and establishing standards could minimise those costs. However, care should be taken in adopting those standards as a requirement for all financed procurement. Firstly, such standards might become quickly

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<sup>1109</sup> See Arrowsmith (2002) (b) and McCrudden (1999).

<sup>1110</sup> See Marron (2003).

<sup>1111</sup> See Siemens (2003).

outdated and might not take into account recent technologies<sup>1112</sup>. Secondly, they will not provide the necessary incentive for suppliers to over-perform and bring innovations. Thirdly, the adoption of strict standards might create an indirect trade restrictive effect<sup>1113</sup>. Thus, countries which lack resources to raise their production up to the required standard might be excluded from the competition. Suppliers which are subjected to slight variations under their national standards requirements might also think that a shift in production to comply with the World Bank's accepted standard might not be worthwhile.

In the context of considering whether the Bank should promote more use of whole life cycle costing, it is not suggested that the Bank should apply rigid standards, but that it should make mandatory requirements for procuring agencies to make the necessary evaluation of the long term impact of the products it is procuring, and to access possible alternatives<sup>1114</sup>. Since the Bank provides help for borrowers during the identification and preparation of the projects, the Bank could provide simple and concrete tools to guide procuring authorities in their choices. This would include guidebooks, environmental criteria, databases, reports of best practices, etc. In addition, it could provide training and stimulate awareness of alternative solutions and products. Perhaps specific attention could be directed to the Environmental Assessment made during the project's preparation<sup>1115</sup>. This would improve the chances of success of the long term impact of the projects it helps to finance by making procuring authorities more informed of the options they have and how to calculate the effects of their choices. Moreover, at the domestic level, it might

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<sup>1112</sup> See OECD (2000) (b).

<sup>1113</sup> See discussion on technical standards in Chapter VI, section 2.5.2.

<sup>1114</sup> Note that the Bank does that to a certain extent in assessing the Project impact. Thus OP 10.4 on the Economic Evaluation of investment operation states on paragraph 1 that *For every investment project, Bank staff conduct economic analysis to determine whether the project creates more net benefits to the economy than other mutually exclusive options for the use of the resources in question*. In this analysis particular attention is taken to domestic and cross-border externalities (including environmental impact of projects in the borrowing country, in neighbour countries and even at a global level)- see paragraph 8. However, although those considerations are taken into account at the identification and draft of the project, it is not clear the extent that procurement decisions could take environmental factors into account.

<sup>1115</sup> See OP. 4.01The Bank requires environmental assessment (EA) of projects proposed for Bank financing to help ensure that they are environmentally sound and sustainable, and thus to improve decision making. EA takes into account the natural environment (air, water, and land); human health and safety; social aspects (involuntary resettlement, indigenous peoples, and cultural property); and transboundary and global environmental aspects. However, it is not specifically mention than in the procurement of items for the implementation of the project such issues could be taken into account.

lead to the dissemination of a sense of awareness of the environmental issues and stimulated private parties to develop new solutions for local problems<sup>1116</sup>.

Finally, consideration should be given to whether the Bank should only take into account the international environmental obligations of the borrower, or should in fact provide a useful enforcement mechanism for them. It seems that considerations of this matter will resemble those on the enforcement of international agreements on labour policies. Thus, if environmental agreements require from members the implementation of such measures through public procurement, the Bank could require from borrowers the observance of the provision in financed contracts. A clause could be included into the Guidelines stating that the Bank requires observance of the international environmental commitments of the borrowers regarding the implementation of procurement measures, when imposed by those agreements. In this context, the Bank will also be respecting the borrowers' international obligations and, at the same time, helping the borrowers to overcome national constraints.

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<sup>1116</sup> One of the main objectives in introducing environmental concerns into public procurement is to stimulate innovation. See Marron (2003).

## **CONCLUSION**

The challenge of this thesis was to provide a critical analysis of two the key areas of the World Bank procurement regulation, namely the enforcement mechanisms and the use of secondary polices. Although those issues have been considered under many national and international systems, there was no in-depth examination of the enforcement mechanism or the possibility of using secondary polices in the World Bank procurement context. Therefore this study has tried to provide a comprehensive analysis of the existing system and to offer suggestions for the reform of such system, based on the particular character and status of the World Bank procurement rules.

### *Background analysis (Chapters II and III)*

In order to determine the distinctive features of the procurement regulations which an international financial organisation would have a role, a number of issues needed to be considered. Firstly, it was determined that the Bank is an international organisation that enjoys a legal personality under both domestic and international law. The objectives and principles by which its functions and powers will be guided are defined in its constitutive agreement. It is this document that provides the basic rules for the Bank's operation and determines how the legal relationship between the institution, member states and third parties will develop.

One important consideration was the broad privileges and immunities usually enjoyed by international organisations. The Bank, however, in its constitutive agreement, has waived its immunity if the particular type of suit passes the test of furthering the Bank's objectives. For establishing that a waiver would apply in the procurement context it would be necessary to prove that such claims will not impair the Bank's objectives, but in fact will contribute to the better operation of the institution. Following these lines, it seems that the Article of Agreement provides some principles that could be regarded as a basis for those claims, such as the particular relevance of economic considerations, the high standard of efficiency required in the projects, and the need to provide opportunities for contractors from all countries, etc.

Since the procurement rules were incorporated into the Agreement entered into by the Bank and the borrower, before analysing their substance, it was necessary to determine to which set of rules the loan and guarantee agreement were subjected. Analysing this issue it was seen that the loan and guarantee agreements bring an express provision denationalising the governing law of the contract, which appear to have the effect of submitting the agreement to international law. However, such effect does not prevent national law from being relevant in regulating some issues, such as the validity of the consent to enter into the loan and guarantee contract. Therefore, in order to be sure that all the domestic requirements have been met, the Bank insists that the borrower provides satisfactory evidence that the loan and guarantee agreements have been duly authorised before making it effective. Moreover, the Bank recognises that some other issues are more effectively dealt with under the domestic law, and appeal to *dépeçage* techniques to do that.

Since international law is the governing law of the agreement, international rules on interpretation and performance of international agreements were examined, as those would be the basis for the decision of an arbitral tribunal, should a dispute arise. Moreover, customary international law and general principles of law may also have an important role as sources of law applicable to the parties. Nonetheless the enforceability of those decisions against member states might be limited to the domestic rules of the forum regarding issues of sovereign immunity.

Further, it was recognised that the implementation of the projects financed by the Bank could harm third parties that are involved in the process. Hence, it was necessary to determine the accountability of the institution on those instances. Under this issue, the most difficult challenge is defining a balance between the need to preserve the necessary autonomy in decision-making for the organisations and to provide affected parties with the means to seek reparation for the damage caused by their operation. However, there are some principles that could serve as guidance to the standard of performance that could be expected from international organisations.

On determining the elements that must be present for a claim to be pursued we have said that there must be a breach of an international legal obligation (illegal act) and that this must be attributed to an act of the organisation. An illegal act will happen whenever the organisation breaches one of the duties imposed by an international agreement, a rule of customary law or a

general principle of law. Under the second element it is important to determine who in fact had the power to control the decision and its impact on the affected party. If the organisation has this power, and under the procurement process it seems that it does, it should be the responsible for the consequences of its acts.

However, there was still the question of whether contractors were a legitimate party to bring complaints against the organisation. Looking closely at the procurement provisions and at other internal rules and practices of the organisation, the legal framework under which the relationship between borrowers, bidders, and the Bank develops was determined. The Bank is the financing institution while the borrower is the one responsible for the implementation of the project. However, besides providing the funds, the Bank assists the borrower with the identification, preparation, and implementation of the project. Moreover, it will reserve a significant degree of power to interfere in the process and might cancel the loan if the borrower does not follow its guidance. The procurement planning and implementation is also strictly monitored by the Bank. The use of the Procurement Guidelines is mandatory and borrowers must comply with the rules in order to have the expenditure financed by the Bank. The Guidelines will set rules on procedures, specifications, qualifications and award criteria, while Standard Bidding Documents will serve as a basis for awarding the contract. The use of such detailed external procurement regulation might prove to be a major constraint to the contracting agency, especially in co-financed projects, where a significant number of external rules will have to be applied.

#### *Enforcement (Chapters IV and V)*

In enforcing the Guidelines' provisions the Bank reserves for itself two major roles. The first is a supervisory role in which it will review the procurement procedure, either before the award of the contract or after it. The second is an informal role in accepting complaints either through its local office or through an interested Executive Director. Under the current system the Bank does not recognise any legal relationship with bidders and contractors. It is the borrower who will enter a legal relationship, first guided by the bidding documents and later bound by the contract. However, there is no rule in the Guidelines imposing the duty to have a complaint mechanism set under the borrower's national system. Even more significantly, many borrowing

countries have been concerned with the weaknesses of their systems and have approached the World Bank for financing reforms. So, even when there is a system in place, it tends to be weak.

The right given to private parties to bring procurement complaints is recognised under many national systems and international agreements. This seems to be linked with strong rule-based procurement systems that settle disputes primarily through judicial means. Although it is recognised that the Bank's loans operate in a different environment, it is advanced that private parties could still have a significant role in guaranteeing compliance with the rules and improving procurement performance. Thus, the reform of the current system to a more formal and effective complaint mechanism seems to be in line with strengthening procurement principles of efficiency and transparency. Regarding the adequacy of the lender's involvement as a party in such review mechanism, it is suggested that there is a need to recognise that the rights reserved to the Bank must have the correspondent obligation of acknowledging responsibility for any unlawful decision taken during the procedure.

In drafting a new proposal for a formal review mechanism to be applied under the World Bank procurement system there is a need to have in mind that such mechanism will have to take into account not only the relationship of bidders/contractors and the lender and the borrower, but also the correspondent effect of apportioning accountability to the relationship between the lender and the borrower. Considerations over the burden of proof and the availability of evidence, the speed of the procedure and remedies that might be available, must be carefully analysed.

Three possible ways to set a review mechanism were analysed and its advantages and disadvantages assessed. First, the possibility of submitting procurement complaints to an internal organ of the Bank was analysed. Although this system would bring uniformity to the interpretation of the Guidelines' provisions, it is expected that it will also bring concerns over the capacity to deal with a large number of complaints, the possibility of enforcing decisions on member countries and the independence of the review body in determining the accountability of the lender.

The possibility of setting a review mechanism under a domestic system was also assessed. It was determined that there were three possible ways to set a review under domestic

systems; two under the borrower's national system and one under a foreign domestic system. The latter, although being largely used in commercial contracts because of its reliance on experienced courts and for bringing the issue away from the political pressure of the borrowing country, would encounter several problems if applied by the World Bank Guidelines. Some of those concerns are the costs of bringing a claim, the limitation on foreign courts in accepting jurisdiction based on *forum non conveniens* doctrine, and the enforcement of the decisions over the borrower and the lender.

Under the borrower's national system a review mechanism could be set either within the administration or through judicial bodies. This could be an appropriate system, especially regarding complaints against the borrower's conduct, if the borrower has an efficient and transparent mechanism in place. However this seems not to be the case in many borrowing countries, and although a great effort has been made to reform those systems it will be still some time before most borrowing countries could provide a reliable review mechanism under their national system. Moreover, even when such mechanisms are in place, there will still be concerns over the possibility of relying on national courts for the attribution of the lender's accountability.

The third mechanism discussed was the possibility of submitting complaints to arbitration. This system seems to provide many advantages over the others, such as an independent and experienced review panel, flexibility over the procedures, speed of the solution, a reasonable degree of uniformity and certainty over the decision, etc. However, it is not free from problems. In fact there are concerns over enforceability of such decisions, especially if the lender's responsibility is determined.

Although none of the choices were free from potential problems, it is argued that a conciliatory suggestion could be drafted in order to meet the requirements of this particular procurement system. It is argued that under the World Bank Procurement Guidelines the Bank should provide for complaints to be brought before a review panel. Such panel would not reach binding decisions, but would make recommendations regarding the best course of action. This would function like an ombudsman system but with all the necessary flexibility of procedure that procurement dispute requires. This would enhance the system in place and would improve the

reliability of the rules. Moreover, it could help borrowers in building strong procurement expertise in handling complaints.

The suggested mechanism, however, takes into account the situation of procurement regulations both nationally and internationally, at the time of the research. However, it has been acknowledged during this work that many changes are expected over the coming years. Of particular importance for the enforcement of procurement regulations would be results of the reform of national procurement systems and the harmonisation effort made at the international level. If a comprehensive regulation for procurement in financed projects is agreed, at least among MDBs, it is also possible that a consultation body could also be set up in order to provide guidance on the interpretation of such rules. Moreover, if in most borrowing countries there is an effective review mechanism available for procurement complaints, then the relationship between bidders and borrowers would be guaranteed, while a different mechanism would be envisaged specifically for determining the accountability of the lender.

*The use of secondary policies (Chapters VI, VII and VIII)*

The examination of use of secondary policies started with a description of the substantive polices and methods of implementation found in certain national and international regimes. It was determined that many governments have used procurement as an instrument of policy to address concerns over economic development, environmental protection and social inequalities. In this context, international instruments have acknowledged the existence of such policies, and have tried to balance the implementation of such policies through procurement tools and the need to further other procurement objectives such as economy, efficiency and transparency. In this exercise, international agreements aimed at liberalising procurement markets have imposed limitations, especially for the use of discriminatory policies. Nonetheless, those agreements have recognised, in one way or another, the possibility of national government in keeping a role in including secondary concerns into procurement regulations. Under the World Bank procurement context, it was envisaged that the Guidelines could also be affected by such secondary concerns. However, the distinct features of the World Bank procurement system might have to take into

account other factors such as the charter obligations of the lender, the political pressure of stakeholders, and the developments of international law.

In this context, first, the specific provisions of the Guidelines were reviewed in order to determine the current possibility of using secondary policies in the context of financed procurement. Both the possibility of having rules pursued by the Bank and imposed upon borrowers, and the possibility of having discretion to apply national concerns to the procurement process were taken into account. It was determined that the Bank seldom imposes policies upon borrowers, although the imposition of anti-corruption measures is a significant departure from this general statement. Fraud, corruption, collusive and coercive practices are not tolerated in financed projects and the Bank not only repudiates such practices during the procurement procedure, but debars firms caught under such circumstances from future contracts.

Regarding the possibility of using national secondary policies in financed procurement, there are many unclear provisions. The lack of clear guidance brings doubts over the limits of negotiation between the borrower and the Bank during the procurement preparation and implementation. Are secondary concerns lawful, provided that their implementation is agreed by the Bank, or are they generally limited during the procurement process? The answer is unclear.

There are, however, provisions directed at secondary concerns which are set by the Bank and that could be used at the discretion of the borrower. It is notable that the Bank does not allow the use of the borrower's own policies, but requires the use of its own provisions. Probably the most striking example is the domestic preference system provided under the Guidelines, where the Bank establishes the substance of the policy and the method through which it should be implemented. It was determined that by using such mechanism the Bank retains the power to limit the impact of the application of such policies in other procurement objectives, such as economy, efficiency, transparency and open competition.

In providing a critical review of the mechanism adopted by the Guidelines concerning the use of secondary criteria under financed projects, three main lines were followed. Firstly, it was reviewed whether or not it would be possible to improve the provisions and mechanisms already in place. A review of the main provisions addressing secondary concerns was carried out

and it was determined that some deficiencies and limitations could be corrected. However, possibly the most important concern is to establish a clear and objective procurement environment where each part involved in the procurement process knows the extent of its responsibilities and scope of discretion.

Secondly, whether or not further scope could be foreseen for the use of national policies was discussed. A distinction had to be made between various substantive polices, and while the use of discriminatory policies should generally be discouraged, the Bank could allow for the use of polices which are seen as less restrictive than those established in the Guidelines. In addition, although the use of national, social, and environmental polices should be generally be restricted, their use could be subject to a justification mechanism, and when their impact on other procurement objective is evaluated as minimal, they should be allowed. In addition, there seems to be scope for the use of national polices when they reflect international accepted standards and agreements. The use of such policies is justified on the basis of the limited impact they usually have in diverting efforts from other procurement concerns.

Thirdly, the possibility of using the Bank's power in loan agreements to impose other concerns on the procurement process was examined. In determining this possibility it was borne in mind that the Bank's charter prohibit the interference of the lender into the political affairs of the borrower. Thus, the Bank should not generally be allowed to determine which policy the borrower should follow. However, by giving the charter a dynamic interpretation, greater care regarding the living standards and labour conditions in member countries might be required from the lending institution. In this context, social and environmental concerns which reflect internationally accepted policies might be applicable to the Bank's operation, and more specifically, could require specific measures to be incorporated into the procurement mechanism. In addition, the lending institution could have a more prominent role in enforcing international agreements to which the borrower has signed. At the moment, the Bank already takes into account international obligations of the borrower in identifying and preparing projects. However, it seems that procurement documents should also reflect this concern and determine the

implementation of the borrower's international obligations if such obligations require measures in the procurement context.

#### Final remarks

During the analysis of those two particular procurement issues, namely the enforcement mechanism and the use of secondary policies, the special nature of the relationship that develops under the World Bank procurement context became evident. The complexity of the analysis is determined by the role and interests of all those involved in projects financed by the Bank. The World Bank procurement activities exceed the regular procurement relationship, where the governments want to buy something and must secure the best way to achieve this objective. Under the World Bank system, the lender has a dual role. If, on one hand, it must secure the resources being allocated efficiently and effectively for the purpose for which it was intended, on the other hand, as a development institution, it will have to take into account the impact of its actions on the lives of those involved in its activities. In this context, the Bank will have to take into account the interest and responsibilities of suppliers, national governments, borrowers (which might not be governments), local communities affected by the project, other member countries, the demands of the international community and the pressure of shareholders and bond holders. All those actors might have common and conflicting interests and the Bank will have to be prepared to address them in the best possible way.

The procurement process should reflect those multiple functions and interests and try to address them accordingly. While it is expected that discretion will be needed in some instances, it is better to regulate and to determine the limits and responsibilities of each part than to live open to uncertainties. This does not mean that discretion should necessarily be limited, but that responsibilities for decisions are allocated to those in a better position to take them. In this context, accountability for wrongful acts should also be allocated accordingly. In addition, the worldwide impact of the implementation of its activities and the determinant power it enjoys brings an intrinsic role of leadership to the Bank. Thus, the Bank might be the vehicle for new alternatives and provide useful tools to overcome old indigenous constraints.

Thus, although this work has tried to shed some light on particular aspects of the World Bank procurement regulation, it acknowledges that the continued process of procurement systems, both nationally and internationally, will require further work in these fields. Moreover, as has been explained in the introductory chapter, there are a number of other aspects of the regulations that need closer attention given their importance under both national and international procurement regulations. Therefore, it is expected that this work has contributed to the legal literature by triggering the debate over the enforcement mechanism and over the use of secondary policies in financed projects, and also has stimulated further research in other areas of the World Bank procurement regulation.

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