



## Best Practice Guidelines for Promoting Small Businesses in Public Procurement Markets

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# Promoting Small Businesses in Public Procurement Markets<sup>1</sup>

## Executive Summary

Public procurement constitutes a large part of total government expenditure, generating significant economic activity. In the EU, public procurement amounted to €1.8 trillion and in the US US\$1.7 trillion in 2012. The WTO estimated that the total value of additional market access commitments that would result from GPA accession by the full range of WTO Members is in the range of \$US 380-970 billion annually. The accession of the five "BRICS" countries – Brazil, China, India, Russia and South Africa – would, by itself, add in the range of US\$ 233-596 billion annually to that value.

Yet while MSMEs account for a large proportion of businesses, this is not reflected in the levels of direct participation in undertaking public tenders. There is greater MSME involvement when taking account of the delivery of public contracts through other channels, such as in a consortium or joint bid arrangement, as a subcontractor or as a generic supplier not named as a subcontractor.

An overview of the obstacles MSMEs face, include:

- Lack of information / transparency. MSMEs have fewer resources to spend seeking out new tenders to bid for than large and incumbent firms.
- Bidding firms incur threshold administrative or 'fixed' costs disproportionately affecting MSMEs
- Onerous supplier and contractor registration requirements
- Detailed bid information and documentary requirements
- Costs of supplying a performance bond or guarantee
- Costs of inspection requirements during bidding
- Protracted bid qualification, evaluation and award procedures
- Lengthy payment intervals after contract award require interim cash flows
- Complex contract dispute resolution procedures
- Government procurers are risk averse when dealing with MSMEs
- Untrained or poorly trained workforces
- Inadequate accountability for government decisions

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Given the large sums spent on public purchasing, the government of every state is itself an actor in the market. Government activities in the marketplace, such as the purchase of goods and services impact, can shape the market itself. Many governments have explored the possibility of using government purchases to promote industrial strategies that target MSMEs. There is empirical evidence to support policies that promote MSMEs promotion. MSMEs are more adaptable and responsive to the needs of purchasers, can support the creation of new supply markets, respond well to supply market dominance and fragmentation. Increased MSME participation in public procurement can decrease the influence of established networks of larger firms that may seek to exclude MSMEs through collusive or corrupt bidding practices.

Policies promoting MSMEs range from de jure measures such as bid price preferences and offsets, to softer capacity building and transparency initiatives. The most common measures identified from this survey were the use of set-asides, dividing tenders into smaller lots and financial incentives. Measures such as streamline processes, framework agreements, prompt payment and access to information were less common.

The existing research suggests that the following policies have demonstrated benefits:

- Lot splitting and aggregation
- Contracting agency professionalism: late payments, fairness
- Transparency & standardization – e-procurement procedures
- Insurance against late payment
- MSME Leaders programme – finance

The EU does not permit offsets or price preferences in public procurement tender requirements. The EU's 2014 public procurement reform introduced other legislative measures to improve MSMEs' access to public procurement markets. These include an encouragement to divide contracts into lots and the limitation of the turnover required to participate in a tender procedure.

The EU Small Business Act also seeks to promote a more transparent, streamlined and accessible tender process, through e-procurement, lot-splitting, increasing access to finance and fast payments. The country reporting from the SBA in France, Greece, Italy, Portugal and Spain indicates that all these countries have introduced measures to promote small businesses in procurement markets.

There are mixed results in MSME performance among the five EU Member States. In **France**, the single market indicators for France remain below the EU

average and the volume of public contracts secured in the rest of the EU is less than have the average. **Greece's** performance is the second weakest area is MSMEs' internationalization. Nevertheless, measures such as lot splitting has increased MSMEs' share in the total value and volume of public contracts, to be the highest in the EU. **Italy** currently performs below the EU average. Nevertheless, Italy has made progress in the area of internationalization, and now scores above the EU average in this indicator, securing almost double the share of the EU average. **Portugal's** SBA profile on State aid and public procurement and Access to Finance is behind the EU average, along with the time it takes for MSMEs to be paid. However, Portugal's performance in the Single Market and Internationalization is broadly in line with the EU average and has improved significantly over the past decade. **Spanish** MSMEs underperform in the area of State aid and public procurement. Access to finance is still limited and the average delay in payment from public authorities was the second highest in the EU. In terms of internationalization, Spain performs well in its involvement with the trade community, its formality procedures and its MSMEs with extra-EU exports of goods.

MSMEs in Brazil are currently supported by measures such a lot splitting and offsets. The Complementary Federal Law creates a preference margin for MSME up to 10% of price advantage regarding the best offer.

It also *obliges* the Public Administration to promote exclusive biddings proceedings for MSMEs up to BRL 80 thousand (EU 18,3 thousand) for goods, services and work. It also *allows* the Public Administration to impose for its contractors the duty to subcontract MSMEs, and in biddings proceeding for divisible goods acquisitions, the Public Administration *shall* also preserve a portion of 25% solely to MSMEs.

Micro and small businesses in Brazil make up a relatively small portion of government expenditure on public procurement. Brazilian small businesses seeking to enter procurement markets could further benefit from greater legal certainty and a more simplified procedure to monitor the lawfulness of the tendering procedure and the achievement of each contract obligation.

Brazil could reinforce a competition approach to public procurement. This can increase small business participation in public procurement contracts, due to increased enforcement and legal certainty. Competition laws address cartels or bid rigging, and can also be applicable to public procurement bodies when they are undertaking an economic activity. A more transparent, coherent and competitive framework for potential bidders would particularly benefit smaller companies wishing to enter the lucrative internal Brazilian procurement market.

The complementary policy measures to build such capacity and competitiveness domestically are:

- Transparency
- Standardization
- Due process
- ITC
- Prompt payment
- Access to finance

In Brazil, there are very few exporting firms. There is little market dynamism so few firms become new exporters. Brazil is also largely absent from global production networks and value chains. This can be caused partly by geography but also the result of on-going national policy decisions on trade and local content. To compete on the international arena and reap the gains from international trade, Brazilian small businesses must build up their competitiveness within the large internal Brazilian procurement market. Some of the main obstacles to cross-border participation in public procurement markets are:

- Lack of competitiveness to win
- Lack of access to finance to support bid
- Lack of information
- Lack of capacity
- Cultural linguistic obstacles

The option of negotiating RTAs or acceding to the WTO GPA with *de jure* market access commitments could, if well-prepared, complement the primary challenge of supporting the development of competitive small businesses to win more domestic public procurement contracts. Using RTAs or the WTO GPA to implement necessary domestic procurement law reforms can serve this objective through exposure to international know-how and technology, as well as legislative push, good governance and policy lock-in. This means that comprehensive economic reform policies need to be implemented domestically in order to harness the potential benefits of trade agreements effectively.

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# 1. Introduction

## 1.1 Public Procurement on a Global Level, in Brazil and the EU

Public procurement is no longer overlooked as a “back office” clerical function but recognized as a critical tool of public policy and economic governance. It is through public procurement that governments can deliver essential goods and public services to meet the needs of citizens and society. And in doing so, public procurement constitutes a large part of total government expenditure, generating significant economic activity. Public procurement amounts to €1.8 trillion in the EU and US\$1.7 trillion in the US alone in 2012.<sup>2</sup> The World Trade Organization (WTO) estimated that the total value of additional market access commitments that would result from WTO Government Procurement Agreement (GPA) accession by the full range of WTO Members, is in the range of US\$ 380-970 billion annually. The accession of the five "BRICS" countries – Brazil, China, India, Russia and South Africa – would, by itself, add in the range of US\$ 233-596 billion annually to that value.<sup>3</sup>

General government spending, as a share of GDP and per person, provides an indication of the size of the government across countries. General government spending generally consists of central, state and local governments, and social security funds. While public procurement spending as a percentage of GDP and total government expenditure has declined slightly in many countries since 2007, Figure 1.1 indicates that general government procurement spending still captures an important share of representing approximately 12% of GDP in OECD countries, ranging from 5.1% in Mexico to 20.2% in the Netherlands. In Brazil, IMF data for 2014 estimate that general public procurement as a percentage of GDP stood at 8.2%, slightly above the global average of 7.7%.<sup>4</sup> This variation highlights the variety of countries' approaches to delivering public goods and services and providing social protection, not necessarily differences in resources spent.

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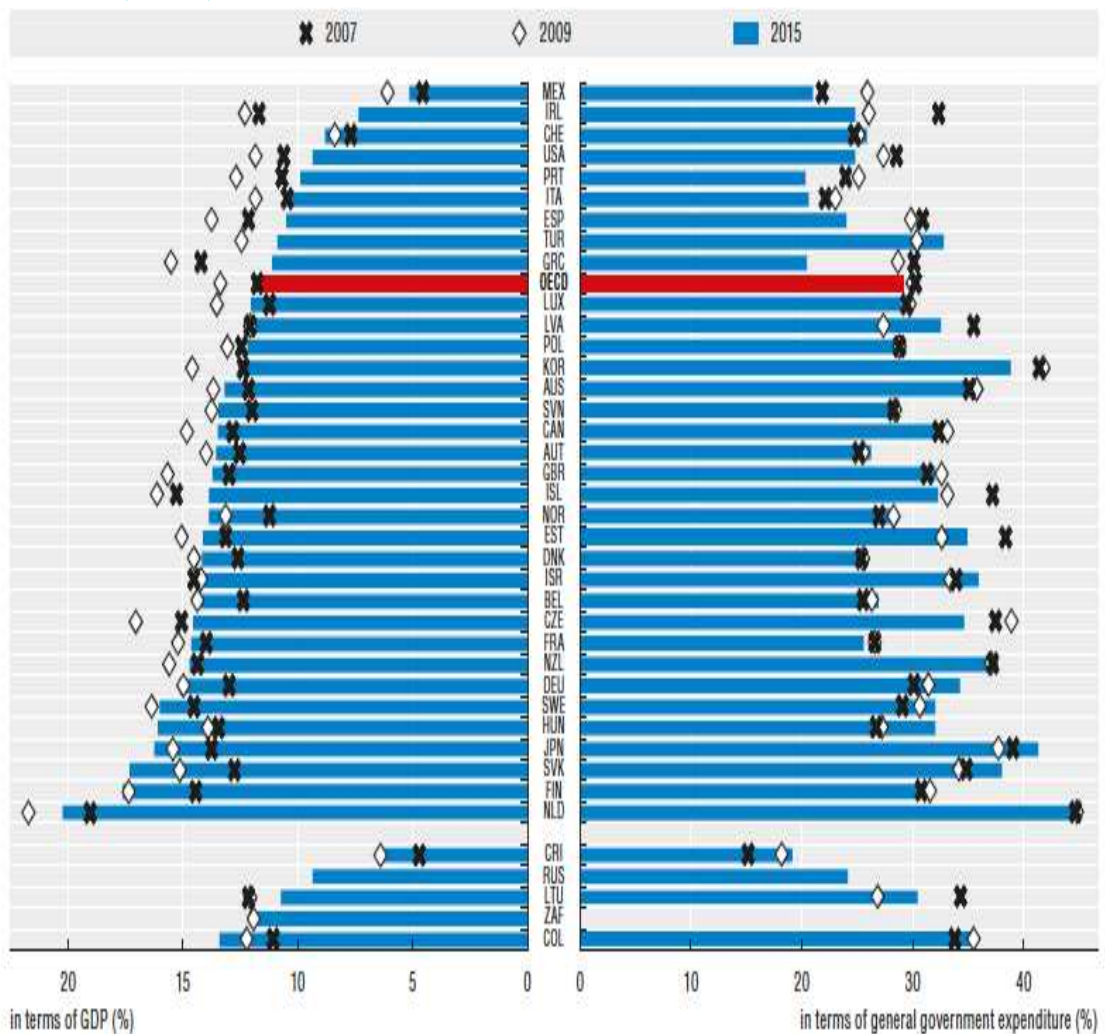
<sup>2</sup> Lucian Cernat and Zornitsa Kutlina-Dimitrova. International Public Procurement: From Scant Facts to Hard Data. European Commission Chief Economists Note. Issue 1. April 2015.

<sup>3</sup> Robert D. Anderson, Philippe Pelletier, Kodjo Osei-Lah and Anna Caroline Müller. Assessing the Value Of Future Accessions To The WTO Agreement On Public procurement (GPA): Some New Data Sources, Provisional Estimates, and an Evaluative Framework for Individual WTO Members Considering Accession. WTO Staff Working Paper. 6 October 2011.

<sup>4</sup> IMF Government Statistics Database, 2014.

OECD data also indicate different structures of public procurement spending by function across countries. Within the EU there are notable divergences. France, for example, spends significantly more on health and social protection than the OECD average, and significantly less on defense and public order and safety. Greece spends significantly more than the OECD average on general public services, while less on most other categories and significantly less on social protection. Portugal prioritizes economic affairs and health above the OECD average, while Italy has a significantly higher than OECD average for environmental protection and health, but a lower than average spending on education and social protection. While social spending is the highest in Brazil among LAC countries, amounting to 31.3% of general government expenditures in 2014, it is below the OECD average of 40.5%.<sup>5</sup>

*Figure 1.1 General Public Procurement Spending as % GDP and total government expenditures, 2007, 2009 and 2015<sup>6</sup>*



<sup>5</sup> Government at a Glance Latin America and the Caribbean 2017 OECD Country Fact Sheet.

<sup>6</sup> OECD National Accounts Statistics Database. The above estimates include central, state, and local public procurements, but exclude social security funds. <https://www.oecd.org/sd->

Figure 1.2 presents country level data covering central government expenditure in Brazil and in selected EU Member States, and the EU Member States' weighted average. It indicates that while Brazil's central government expenditure has been volatile over the past few decades, spending is now comparable with the high level of the late 1980s and early 1990s, nearly meeting the EU Member States' weighted average of approximately 38%. Within the EU, the pattern is variable given the constitutional differences in terms of degrees of decentralization in the Member States' governing structures. Centralised countries such as Greece have steadily increased their central government expenditure as a share of GDP to peak at over 60% in 2013. On the other hand, Spain, as a highly decentralized country, has decreased its central government expenditure over the past two decades and is now the lowest of the sample countries at just over 20% of GDP. Portugal, Italy and France all have above EU weighted average levels of government expenditure as a share of GDP. In another highly centralised state, France, the share of central government expenditure was just under 50% of GDP, which is approximately 10% above the EU weighted average since the late 1990s.

*Figure 1.2 Central government expenditure as a share of GDP, in selected countries.<sup>7</sup>*

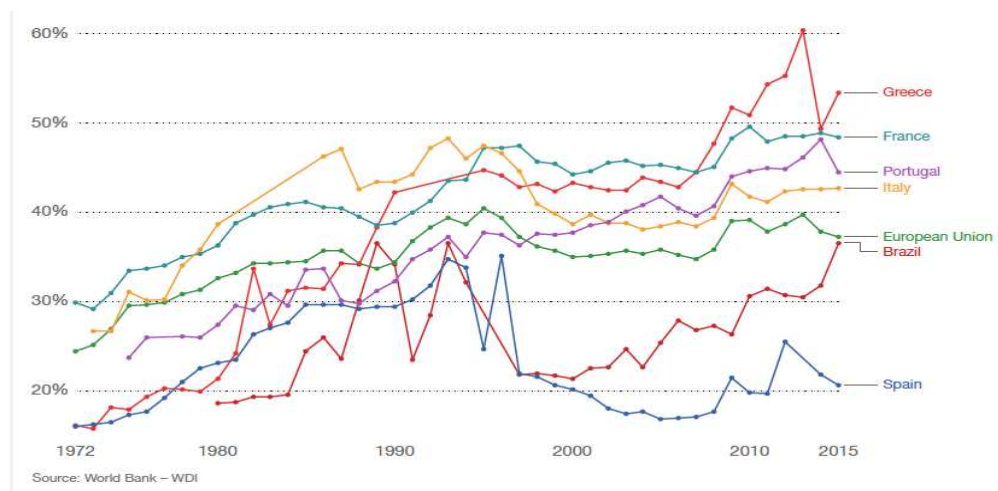


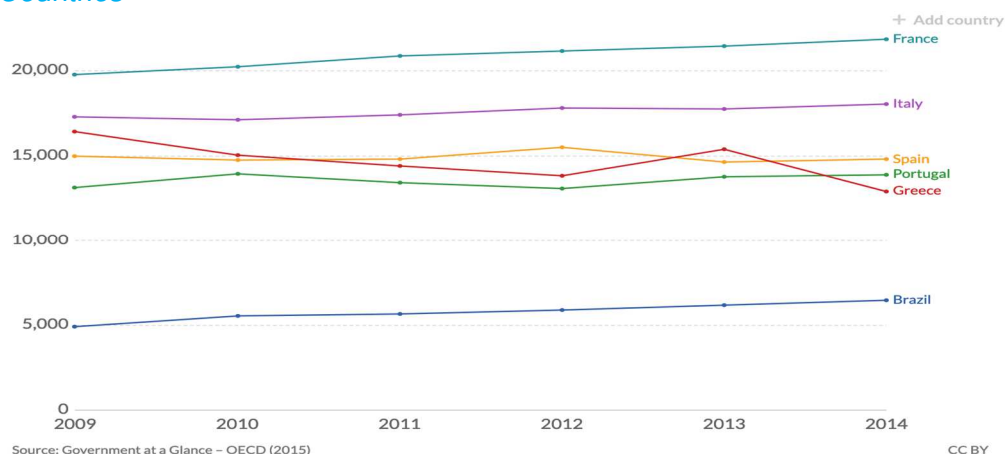
Figure 1.3 highlights the difference in total government expenditure per capital spent in the different case study countries. Between 2009 and 2014, France spent the largest sum per capita, around US \$20,000, followed by Italy. Brazil has

roundtable/papersandpublications/The%20Role%20of%20Public%20Procurement%20in%20Low-carbon%20Innovation.pdf

<sup>7</sup> Total government spending, including interest government expenditures, as share of national GDP. <https://ourworldindata.org/government-spending#> See limitations, sources and methodology: <https://ourworldindata.org/government-spending#limitations>. <http://data.worldbank.org/data-catalog/world-development-indicators>.

consistently spent less than these five EU Member States, averaging just over US\$5,000 per capital.

*Figure 1.3 Total Government Expenditure per capita (US\$ PPP) in Case Study Countries<sup>8</sup>*



## 1.2 An Overview of Public Procurement Policies and Laws

A public procurement system can be prescribed in the national constitution or determined through procurement laws and regulations and through policy and budget decisions by legislators and the executive branch. Generally, there two main government models of procurement – unitary and federal. The unitary system is characterized by a central government that exercises various levels of control over local governments, for example in the EU. The federal system provides sub-central states and local governments a high level of autonomy to design their own procurement structure, methods, and processes, such as the US and Canada.

A domestic public procurement law is typically comprised of a series of detailed rules on tendering procedures and technical specifications, along with deadlines for the preparation, submission and receipt of tenders. It will also include guidelines on the evaluation of tenders and award of contracts, rules on post-contract information and publication and a domestic bid challenge system or dispute resolution mechanism to support compliance. Most procurement systems aim to promote competition and value for money. However, there are often other contending objectives at work operating in a procurement system.<sup>9</sup> These

<sup>8</sup> Total government expenditures across all levels of government. Expenditures include intermediate consumption, compensation of employees, subsidies, property income and social benefits. *Ibid.*

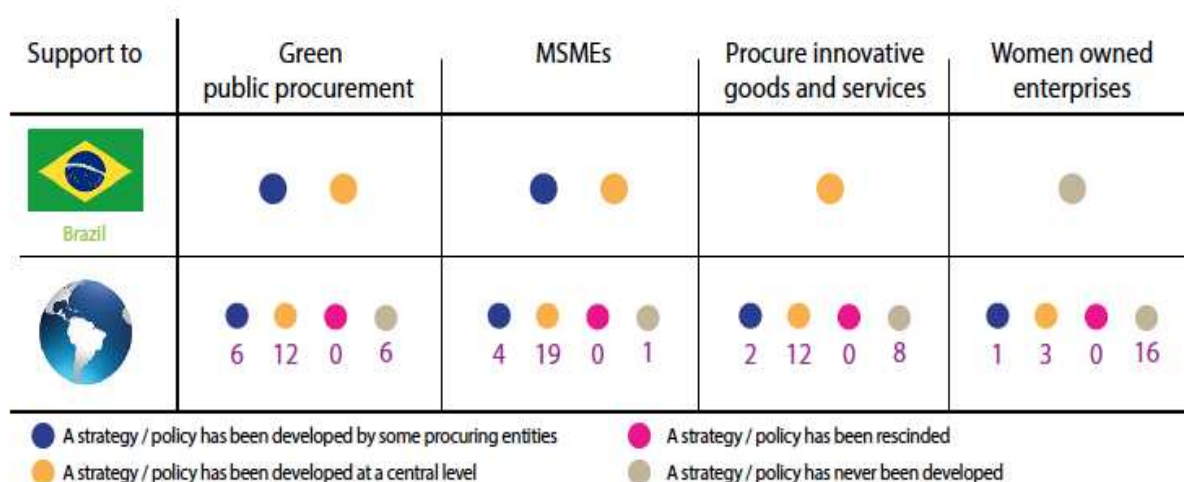
<sup>9</sup> S. Schooner, “Desiderata: Objectives for a System of Government Contract Law” 11 *Public Procurement Law Review*. (2002)

contending policy objectives range from aims as diverse as promoting allocative efficiency, customer satisfaction, and integrity; to distributing wealth, avoiding risk, building local capacity and promoting uniformity. Consequently, there is often a degree of trade-off between the different objectives and it is important to find the correct balance between promoting different policy goals.

Given the large sums spent on public purchasing, the government of every state is itself an actor in the market, and typically a relatively large one. Government activities in the marketplace, the purchase of goods and services or sometimes the marketing thereof, impact and shape the market itself. Many governments have explored the possibility of using government purchases not only to promote redistribution among different segments of the population, but also to develop an industrial strategy, to introduce innovation technologies or foster environmental protection through products or services that have a reduced environmental impact. Procurement policy is generally viewed as a legitimate tool to stimulate domestic production and consumption. By concluding contracts that target particular sectors or groups in society, the government can push forward policies that aim to redistribute wealth, ensure sustainable development or promote industrial strategies that target small businesses.

As Figure 1.4 below indicates, by 2015 most governments were employing public procurement processes to pursue secondary, or horizontal, policy objectives. In Brazil, a strategy has been developed at the central level for the promotion of small businesses in public procurement, along with some procuring entities. Women owned enterprises have never been addressed through a policy or strategy in Brazil.

*Figure 1.4 Development of Public Procurement Strategies/Policies to Support Secondary Policy Objectives, in Brazil and the Rest of the World*



Source: 2015 OECD Survey on Public Procurement

### 1.3 The Promotion of Small Businesses

Figure 1.4 highlights that public procurement policies and strategies are increasingly used in OECD countries<sup>10</sup> to incorporate economic policies fostering participation and development of small businesses. Overall small businesses<sup>11</sup> constitute the overwhelming majority of all enterprises in both developed and developing countries. They are seen to be the engine of an economy. In the EU, 99.8% of enterprises in the non-financial sector are stated to be small businesses and 92% of the total business sector is estimated to be micro-enterprises, with fewer than 10 employees.<sup>12</sup> Criscuolo et al, show that micro firms and small businesses account for over 95 % of all enterprises in 17 OECD countries, plus Brazil. Figure 1.4 shows that the share of small businesses in the total enterprise population can be expected to be even higher in developing countries.<sup>13</sup>

In the OECD countries, small businesses provide the main source of employment, accounting for about 70% of jobs on average, and are major contributors to value creation, generating between 50% and 60% of value added on average. In emerging economies, small businesses contribute up to 45% of total employment and 33% of GDP.<sup>14</sup> Yet, when taking the contribution of informal businesses into account, small businesses constitute more than half of employment and GDP in most countries irrespective of income levels.<sup>15</sup>

<sup>10</sup> There are currently 36 OECD countries, covering the industrial countries including the EU. However, Brazil is not an OECD country. <http://www.oecd.org/about/membersandpartners/list-oecd-member-countries.htm>

<sup>11</sup> There are varying definitions of small businesses, : OECD/UNIDO (2004) note that small businesses are defined in the literature most commonly by reference to employment, due to the simplicity of the measure and the ease of collection of data (the OECD and US generally use a measure of under 500 employees, the EU 250).

<sup>12</sup> de Kok, J. et al. (2011). “Do small businesses Create More and Better Jobs?” [Online]. Available at [http://ec.europa.eu/enterprise/policies/small-business/facts-figures/analysis/performance-review/files/supporting-documents/2012/do-smes-create-more-and-better-jobs\\_en.pdf](http://ec.europa.eu/enterprise/policies/small-business/facts-figures/analysis/performance-review/files/supporting-documents/2012/do-smes-create-more-and-better-jobs_en.pdf).

<sup>13</sup> Chiara Criscuolo, Peter N. Gal, Carlo Menon. The Dynamics of Employment Growth: New Evidence from 18 Countries. CEP Discussion Paper No 1274 June 2014

<sup>14</sup> OECD (2016), Entrepreneurship at a Glance 2016, OECD Publishing, Paris.

<sup>15</sup> IFC (2010), Scaling-Up small business Access to Financial Services in the Developing World, International Finance Corporation, World Bank Group, Washington D.C., [http://www.enterprise-development.org/wp-content/uploads/ScalingUp\\_SME\\_Access\\_to\\_Financial\\_Services.pdf](http://www.enterprise-development.org/wp-content/uploads/ScalingUp_SME_Access_to_Financial_Services.pdf).

Figure 1.5 Share of micro, small and medium-sized firms in total number of small businesses (%)<sup>16</sup>

	% of micro firms	% of small firms	% of medium sized firms
Developed	87.1	10.7	2.2
Developing	80.5	15.5	3.9
- G20 developing	82.1	13.2	4.7
- Other developing	80.5	14.9	4.5
- LDCs	78.5	20.7	0.5
Total	82.9	13.8	3.3

Given the high value of public procurement contracts, the public sector should be an important market for small businesses.<sup>17</sup> And while public procurement is often thought of as high-value contracts and projects that may be difficult to obtain for small businesses, evidence suggests that this should not necessarily be the case. Certain characteristics of procurement markets make them potentially attractive for small businesses, and increasingly so. Public procurement at the sub-central government and local levels accounts on an average for 63% of total procurement spending across OECD countries, with the share going up to 87% in federal countries, such as Canada. This may mean that "local" small businesses that are familiar with the condition prevailing in the relevant regions may have a competitive advantage over larger firms located elsewhere. Furthermore, even when public demand is aggregated through centralized purchasing, the increased use of framework agreements, which allow for smaller "call-offs", may mean that procurement markets are still attractive for small businesses.<sup>18</sup>

However, the existing data suggests that small businesses' direct share of the public procurement market is relatively low. In the EU, for example, small and medium-sized businesses (SMEs) secured 31%-35% of contracts by value in 2006 and 2007, and 42% in 2008 (EU, 2009); and between 53% and 78% of total

<sup>16</sup> IFC's small business Country Indicators. Country Groups defined in Appendix Table 8.1 of WTO (2014).

<sup>17</sup> *Ibid.*

<sup>18</sup> Caroline Nicholas, Anna Caroline Müller. SME Participation in Public procurement Markets. Legal and Policy Considerations under the WTO Agreement on Public procurement and the UNCITRAL Model Law on Public Procurement, in Thilo Rensmann. Small and Medium-Sized Enterprises in International Economic Law. Oxford University Press. 2017.



contracts.<sup>19</sup> However, a more recent EU study of the 2009-2011 period finds that European small businesses directly secured a lower 29% share of the procurement market. This is 29 percentage points lower than it would have been (that is 58%) if the share of public procurement that they won equaled the small businesses' share of total gross value added produced in the business economy.<sup>20</sup>

This snapshot of direct procurement does not take account of small business involvement in the delivery of public contracts through other channels, such as in a consortium or joint bid arrangement; as a subcontractor or as a generic supplier not named as a subcontractor. A 2014 analysis of survey results among EU small businesses suggests that small businesses benefit from public procurement above the EU-thresholds through channels other than only being awarded a contract directly. See Figure 1.6. Small businesses are much more involved in public procurement above the EU-thresholds than their share is among companies that were directly awarded such contracts. The survey results suggest that small businesses' share in the actual performance of above-threshold contracts is 16 percentage points higher than the share they directly secure in terms of total value of contracts which set the total participation of small businesses at approximately 45 % for the EU-27.<sup>21</sup> In below threshold public procurement, the breakdown of the headline figure to the three main channels confirms that when taking account of the indirect participation of small businesses as partners under joint bids and through subcontracting, small businesses enjoy a greater access to public procurement below the EU-thresholds as well.

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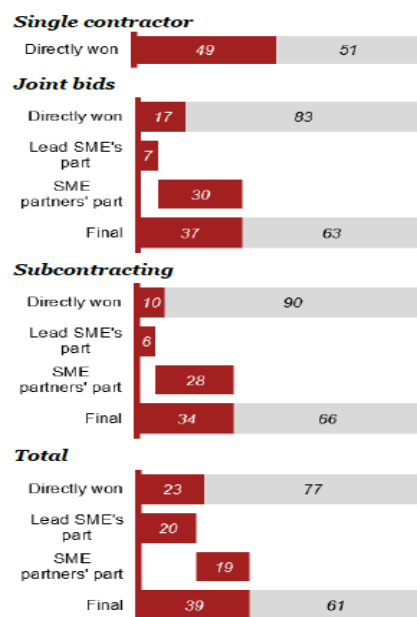
<sup>19</sup> Caroline Nicholas and Michael Fruhmann. Small and Medium-Sized Enterprises Policies in Public Procurement: Time for a Rethink? *Journal of Public Procurement*, Volume 14, Issue 3, 328-360 Fall 2014.

<sup>20</sup> Caroline Nicholas, Anna Caroline Müller. *Op cit.*

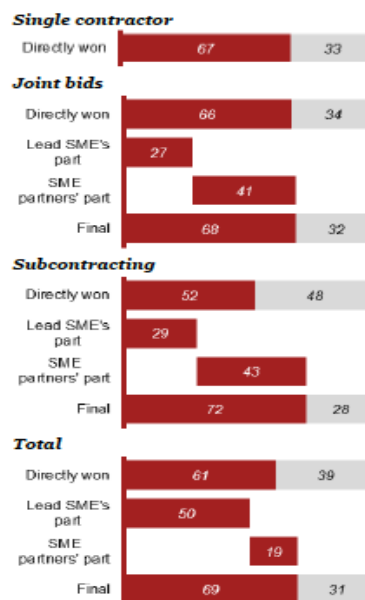
<sup>21</sup> PwC, ICT, GHK, Ecorys (2014), small businesses' access to public procurement markets and aggregation of demand in the EU, a study commissioned by the European Commission, DG Internal Market and Services, February 2014.

Figure 1.5. Part of contract allocated to small businesses under different delivery arrangements<sup>22</sup>

i) above thresholds %



ii) below thresholds %



Various reasons account for the relatively low levels of small business participation in bidding for public procurement contracts. They include:

- Lack of information / transparency. Small businesses have fewer resources to seeking out new tenders
- Bidding firms incur threshold administrative or 'fixed' costs disproportionately affecting small businesses<sup>23</sup>
- Onerous supplier and contractor registration requirements
- Detailed bid information and documentary requirements
- Costs of supplying a performance bond or guarantee
- Costs of inspection requirements during bidding
- Protracted bid qualification, evaluation and award procedures
- Lengthy payment intervals after contract award require interim cash flows
- Complex contract dispute resolution procedures

<sup>22</sup> PwC, ICT, GHK, Ecorys (2014), small businesses' access to public procurement markets and aggregation of demand in the EU, a study commissioned by the European Commission, DG Internal Market and Services, February 2014.

<sup>23</sup> A 2010 study concluded that in the US, costs per employee due to regulation appear to be at least 36% higher in small firms than in medium size and large firms, a disproportion in compliance costs that is particularly true in the manufacturing sector. W. Mark Crain and Thomas D. Hopkins. The Impact of Regulatory Costs on Small Firms

A report for The Office of Advocacy, U. S. Small Business Administration RFP No. SBAHQ-00-R-0027 2010.

- Government procurers are risk averse when dealing with small businesses<sup>24</sup>
- Untrained or poorly trained workforces
- Inadequate accountability for government decisions

## 1.4 Approaches to Promoting Small Businesses in Public Procurement Contracts

A review of the available literature indicates there is empirical evidence to justify small business support policies. In developed countries, small businesses are generally considered to have the edge over their larger competitors in terms of innovative solutions, better customer care and after-sales service, as well as a more flexible and responsive approach to changing needs of customers.<sup>25</sup> Small businesses are more adaptable and responsive to the needs of purchasers,<sup>26</sup> can support the creation of new supply markets, respond well to supply market dominance and fragmentation,<sup>27</sup> and there are also benefits to local economies from local sourcing.<sup>28</sup> There are other potential benefits from small business participation in public procurement, such as decreased influence of established networks of larger firms that may seek to exclude small businesses through collusive or corrupt bidding practices or otherwise. In developing countries, the role of the small businesses is equally crucial for contributing to the rejuvenation of local businesses and the provision of local access to services, as well as employment opportunities for remote communities.<sup>29</sup>

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<sup>24</sup> Government procurers may specify more stringent financial or experience requirements that exclude newer and financially weaker small businesses. Through application of such qualification criteria, procurers also reduce work for themselves by not having to evaluate a larger number of bids from small businesses.

<sup>25</sup> Cited in Caroline Nicholas and Michael Fruhmann. Small and Medium-Sized Enterprises Policies in Public Procurement: Time for a Rethink? *Journal Of Public Procurement*, Volume 14, Issue 3, 328-360 Fall 2014.

<sup>26</sup> Zheng, J., Walker, H. & Harland, C. (2006). "The Role of small businesses in Public Procurement: A Review of Literature and Research Agenda." [Online]. Available at <http://www.ipsera.com/assets/documents/57.pdf>.

<sup>27</sup> Caldwell, N. D. et al. (2004). "Promoting Competitive Markets: The Role of Public Procurement." In K. V. Thai et al. (Eds.), *Challenges in Public Procurement: an International Perspective* (pp. 315- 334). Academics Press.

<sup>28</sup> Caroline Nicholas and Michael Fruhmann. Small and Medium-Sized Enterprises Policies in Public Procurement: Time for a Rethink? *Journal of Public Procurement*, Volume 14, Issue 3, 328-360 Fall 2014.

<sup>29</sup> *Ibid.*

Figure 1.7 divides the promotion of small businesses in public procurement markets into different policy measures, ranging from de jure measures, bid price preferences to softer capacity building and transparency initiatives. The most common measures identified from this survey were the use of set-asides, dividing tenders into smaller lots and financial incentives. Measures such as streamline processes, framework agreements, prompt payment and access to information were less common. This section focuses on some of these initiatives.

*Figure 1.7 Small Business Specific Assistance Policies<sup>30</sup>*

Types of Support	Stage of Support	Objective of Support
Training and technical assistance	Preparation stage & supplier eligibility; bidding process and bid submission	Providing a range of services to small businesses to enable their better participation in procurement processes
Financial assistance	Preparation stage & supplier eligibility; bidding process and bid submission; institutional procedures; post award & execution	Providing access to capital &/or advanced payments
Performance guarantee flexibility	Preparation stage & supplier eligibility; bidding process and bid submission; institutional procedures; post award & execution	Reforming requirements of performance guarantees to reduce difficulties for small businesses
Framework agreement for small businesses	Preparation stage & supplier eligibility; bidding process and bid submission	Use of predetermined agreements to facilitate continued and more engagement by small businesses
Subcontracting requirement of small business consortia formation	Preparation stage & supplier eligibility; bidding process and bid submission;	Promote small business engagement even when the size of the contract is not suitable for a single small business to pursue
Smaller lot sizes	Preparation stage & supplier eligibility	Splitting contract sizes into smaller sizes to allow more small businesses to bid
Award criteria	Bid opening & evaluation; preparation stage & eligibility of suppliers	Providing opportunities for small businesses to improve their bid based on characteristics of their firm/work
Set asides	Preparation stage & eligibility of suppliers	A designated portion of the procurement budget reserved for small businesses

<sup>30</sup> World Bank Group Technical Report: Policies that Promote small business Participation in Public Procurement. The Business Environment Working Group (BEWG) of the Donor Committee for Enterprise Development (DCED). 2017.

Contract thresholds and reserved products	Preparation stage & supplier eligibility	Either contract sizes or specific products are reserved for small businesses to bid on
Bid price preferences	Bid opening & evaluation	Discounting bids by small businesses to make them more competitive with larger firms

*Bid Price Preferences & Set Asides / offsets:*

Under a bid price preference scheme, those bids from eligible small businesses are given a margin of preference and, if the lowest evaluated bidder is a small business, it is awarded the contract. Other bid preference schemes incorporate evaluation criteria that provide additional points or weightings as part of a *bid scorecard*, depending on the extent to which the preference targeted group is integrated into the bid submission

A set aside or offset is essentially a quota, as a percentage of designated public procurement contracts or total spending, which is reserved or ‘set aside’ for a targeted category of domestic bidders that meet the preferential qualification criteria, such as small business status. Set asides are an attractive option for both developing and developed country governments and a permanent fixture of international trade. The benefit of an offset is visible, while the costs are masked. Yet, despite their growing importance, an overview of the literature indicates that for all the attention surrounding them, little is known regarding the effectiveness of these policies in meeting their stated aims.

Opinion on price preferences and offsets is polarized. On the one hand, proponents argue that preferential public procurement can achieve local social policy goals to assist the local economy. One study on local procurement preferences in 2005 established an economic case for promoting revitalization through public spending. A New Economic Foundation Report indicates that local preference laws kept money circulating in the local economy by fostering local economic linkages and raising the capacity and expertise of local residents and suppliers<sup>31</sup> Other research suggests that although procurement expenditures may rise in response to a local preference program, the additional costs are outweighed by the support for the development, enrichment, growth, expansion and the retention of the local business community, thereby keeping any tax dollars spent on contracts in the area.

<sup>31</sup> *Public Spending for Public Benefit*. New Economics Foundation Report, 2005 cited in Seim, E. K. (April 2009). Bid Preference Programs and Participation in Highway Procurement Auctions. Philadelphia.

There are also studies that have shown that certain types of offsets can be economically advantageous for less advanced countries, in some cases contributing to knowledge transfer and other efficiency gains. One 2015 study of procurement preference programmes in Brazil found that small businesses benefited as a result of this type of intervention, as measured by their involvement and success rates in contract competitions.<sup>32</sup> An earlier, 2008 study, *Local Preference in Municipal Audit Markets*, concluded that a local preference law could serve its purpose, in that it always increases the likelihood that the local firm wins.<sup>33</sup> The model used “demonstrates that insiders benefit from a local preference at a cost to the outsider through a lower chance of winning and a cost to the municipality through higher average prices.” A further study examining the impact of local procurement preferences on the local economy as well as the market impact also identified an increase in employment in the local economy.<sup>34</sup>

However, there is also evidence to suggest that the positive effects stemming from local preferences can be undermined by their associated costs.<sup>35</sup> Depending on cost differentials between local and non-local firms, the policy creates the potential for higher consumer prices, decreased demand, reduced spending, and job loss. Procurement offsets are often viewed as inefficient and counter-productive, diverting trade away from highest value uses.<sup>36</sup> Offset arrangements are also associated with corruption, particularly when contract negotiations are initiated by suppliers, rather than governments. Small businesses seem to be more vulnerable than large firms to corrupt practices in their effort to win government contracts. Corruption can be particularly harmful for small businesses in developing countries, where procurement opportunities

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<sup>32</sup> *Local Preference In Public Procurement*. A position paper from NIGP: The Institute for Public Procurement. 2015. [www.nigp.org/docs/default-source/New-Site/positionpapers/localpreferencepositionpaper2015cap.pdf?sfvrsn=2](http://www.nigp.org/docs/default-source/New-Site/positionpapers/localpreferencepositionpaper2015cap.pdf?sfvrsn=2)

<sup>33</sup> Shor, K. H. (July 2008). *Local Preference in Municipal Audit Markets*. Owen Graduate School of Management at Vanderbilt University.

<sup>34</sup> Lorelli, R. S. (June 2003). *The Economic Effects of Local Purchasing Preferences: A Case Study of Computer Systems West in Lane County*. University of Oregon.

<sup>35</sup> Travis K. Taylor, “Countertrade Offsets in International Procurement: Theory and Evidence” in Murat A. Yulek and Travis K. Taylor, eds., *Designing Public Procurement Policy in Developing Countries* (New York: Springer, 2012); Mark J. Nackman, “Critical Examination of Offsets in Defense Procurement: Policy Options for the US” (2010–11) 40 *Public Contract Law Journal* 511 at 516. Ryan J. Lambrecht, “The Big Payback: How Corruption Taints Offset Agreements in International Defense Trade” (2013) 70 *Air Force Law Review* 73 at 76; Carola Hoyos, Daniella Tsar, and Antoine Amann, “Q&A: What are Offsets?” *Financial Times* (9 October 2013), online: <<https://www.ft.com/content/87728d1e-197a-11e3-afc2-00144feab7de>>

<sup>36</sup> Travis K. Taylor, “Countertrade Offsets in International Procurement: Theory and Evidence” in Murat A. Yulek and Travis K. Taylor, eds., *Designing Public Procurement Policy in Developing Countries* (New York: Springer, 2012).

are often held hostage by obscure bidding procedures shielded by vested interests.<sup>37</sup>

There is also opposition to local preference policies from procurement agents themselves.<sup>38</sup> The Institute for Public Procurement in the US maintains the position that local preference policies are in conflict with the fundamental public procurement principles of impartiality and full and open competition. They therefore do not support the use of local preference policies as an appropriate tool for improving local economies. However, acknowledging that governments may, in fact, adopt local preferences as a tool for improving local economies unless otherwise prohibited by federal court preferences, they recommend that local procurement preferences be reflected as one of many criteria in a 'best value' evaluation and award process. Best value means the most advantageous balance of price, quality, and performance identified through competitive procurement methods in accordance with stated selection criteria. There is no uniform statutory or regulatory definition, but it generally refers to a source selection based upon a cost/benefit analysis.

Local content requirements usually include a combination of mandates to investing companies to develop and employ local people, to procure local goods and services, develop local suppliers and to transfer technology through licensing arrangements, joint ventures, training or other means. There is an increased fiscal burden on local taxpayers and transaction costs for government to implement such a program but also it is a complicated and potentially burdensome administrative processes.<sup>39</sup> The actual impact of offsets in terms of job creation or diversion, technology transfer, and increased international competitiveness of the domestic industry tends to be much smaller than expected.<sup>40</sup> Any benefits incurred by the domestic economy are difficult to quantify. This is in part because offset agreements are often spread over many years, and may be characterized as more political in terms of satisfying particular lobby groups, rather than economic in benefiting the general public. Few firms report these expenses to their shareholders, and countries are reluctant to publicize such arrangements. Accordingly, the magnitude of offsets may be considerably more than is realized. Comprehensive empirical research is rare. Indeed, although most OECD

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<sup>37</sup> Lea Kaspar & Andrew Puddephatt. Benefits of transparency in public procurement for small businesses: General lessons for Egypt. Global Partners and Associates, March 2012

<sup>38</sup> Richard Pennington. Comparative Review of State IT Procurement Practices prepared for the NASPO IT Procurement Work Group. 2010.

<sup>39</sup> Local Preference in Public Procurement A position paper from NIGP: The Institute for Public Procurement On the Importance of Applying a Best Value Analysis When Government Has Adopted Local Procurement Preferences, 2015.

<sup>40</sup> D. Collins. Public procurement with Strings Attached: The Uneven Control of Offsets by the World Trade Organization and Regional Trade Agreements. Asian Journal of International Law

countries make policy interventions to assist small businesses in public procurement, only a minority actively monitor and evaluate their policies. Not only is there difficulty in securing survey access to populations of public buyers and small business suppliers, but public procurement is a relatively new field of academic inquiry, which has hitherto tended to prioritize large firms over small businesses.<sup>41</sup> Part of the reason maybe that policy objectives for small businesses in public procurement themselves lack specificity, which in itself does not lend itself to conducting policy impact assessments.

#### *Simplified contract awards process*

The technical, financial and administrative costs required to develop a competitive bid for a government contract can easily result in an advantage for large businesses over smaller ones. Upfront cost-related barriers such as registration requirements can be minimised, through measures such as the European Single Procurement Document, based on self-declarations. Only in the event of winning does a bidder need to provide the original documentation. It is estimated that this could reduce administrative burden on companies by over 80%.<sup>42</sup> Streamlining the bidding documentation and information, particularly for small bids, can help to further reduce transaction costs, while waiving or reducing registration costs for small businesses will also serve to increase participation.

#### *Increasing Transparency*

Promoting transparency promotes competition by ensuring that potential suppliers are aware of the procedures and specific calls for tender. It can also help to ensure the integrity of the procurement process and contribute to an opening of the procurement market. Transparency further encourages *indirect* supply since foreign investors are much more likely to invest in local facilities if they have knowledge of the procurement conditions.

The use of digital technology in the public sector is a driver of efficiency and supports the effectiveness of policies by enabling more open, transparent, innovative, participatory and trustworthy government. In this light, the use of e-procurement, defined as the use of information and communications technologies in public procurement, not only increases efficiency by facilitating access to public tenders, thereby increasing competition and decreasing administrative burdens, but can also improve transparency by holding public authorities more accountable.

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<sup>41</sup> *Ibid.*

<sup>42</sup> World Bank Group Technical Report: Policies that Promote small business Participation in Public Procurement. The Business Environment Working Group (BEWG) of the Donor Committee for Enterprise Development (DCED). 2017.



However, as Figure 1.7 shows, the spread of IT in procurement is not without challenges. Low knowledge of ICT skills is acknowledged in Italy, Spain, Portugal and Greece, while a low innovative organizational culture is a noted challenge in Italy, Spain and Greece. The challenges in Brazil for both potential bidders and procurement agencies include both low ICT skills and low knowledge of the economic opportunities raised by the tool. The procurement agencies face a low innovative organizational culture. Potential bidders also faced difficulties understanding or applying the procedure and difficulties when using the functionalities.

Figure 1.7 Main Challenges to the Use of e-procurement Systems, 2014

	Low knowledge/ ICT skills	Low knowledge of the economic opportunities raised by this tool	Low innovative organizational culture	Difficulties to understand or apply the procedure	Difficulties in the use of functionalities	Do not know
Australia	○	○	○	○	○	X
Austria	X	X	X	X	X	+●
Belgium	○	○	+●	○	○	X
Canada	+●	●	●	●	●	X
Chile	○	●	○	●	●	+
Denmark	○	○	○	●	●	+
Estonia	○	+●	○	○	○	X
Finland	X	X	X	X	X	+●
France	X	X	X	X	X	+●
Germany	+	+●	+	○	●	X
Greece	●	+●	+●	○	○	X
Hungary	+●	○	+	●	●	X
Iceland	X	X	X	X	X	+●
Ireland	○	○	○	●	○	+
Italy	+●	○	+●	●	●	X
Japan	+●	+●	○	●	●	X
Korea	+●	○	+●	○	○	X
Luxembourg	X	X	X	X	X	+●
Mexico	+	+	+	○	○	●
Netherlands	+●	+●	○	●	●	X
New Zealand	+●	+●	○	○	○	X
Norway	○	+●	●	●	○	X
Poland	+●	○	+	●	●	X
Portugal	+●	○	○	●	○	X
Slovak Republic	●	+	○	○	●	X
Slovenia	+●	+●	+●	●	●	X
Spain	●	+●	+●	○	○	X
Sweden	X	X	X	X	X	+●
Switzerland	X	X	X	X	X	+●
Turkey	○	○	+●	○	○	X
United Kingdom	+	●	+	○	●	X
United States	+●	○	+●	●	●	X
<b>OECD total</b>						
+ Procuring entities	14	11	13	X	X	10
● Potential bidders/suppliers	14	12	10	13	13	8
○ Not a major challenge	8	11	10	12	12	X
Brazil	+●	+●	+	●	●	X
Colombia	+●	+●	+●	○	○	X
Russia	○	○	○	●	○	X

Source: OECD (2014) Survey on Public Procurement.

StatLink  <http://dx.doi.org/10.1787/888933249082>

### *Advance and prompt payments to qualifying small businesses*

Ensuring prompt payment is a basic requirement to ensure that small businesses do not suffer from resource constraints and being pushed into bankruptcy, which deter further small business involvement in government contracts. Within sub-contracting, small businesses are the first group negatively impacted by a delay in payment to the lead contractor.<sup>43</sup> Prompt payment reforms work to limit the amount of time needed to receive payment as well as ensure that payments are made on time without delays.

Payment reform can take place through simplifying the documents necessary for making payments, simplified controls, or even providing advanced payments to qualifying small businesses. For example, in North Macedonia, procurers can give advance payments of up to 20% of the total value of the contract, although this is not mandatory. To further encourage governments to make payments on time as well as to compensate suppliers for waiting, some jurisdictions require the procuring entity to pay penalties to suppliers. One study found that in about two-thirds of economies surveyed, procuring entities must pay a penalty to the supplier. For example, in Canada a supplier will automatically receive interest on overdue accounts.<sup>44</sup>

### *Small business supporting financial loan schemes*

Financial assistance can take multiple forms including access to capital offered by governments. Governments can provide unique financing opportunities specific to small businesses they engage with in an effort to help them access capital they might otherwise struggle to receive. Low interest loans are a frequently used tool – providing low cost financing opportunities that would otherwise not be available in the private market.<sup>45</sup> Finance assistance is particularly important in light of documented widespread delays in payment to small businesses.

### *Capacity building and awareness raising*

Independent of the actual tendering process or in tandem, governments, international organizations and NGOs can provide technical assistance and training services specific to small businesses interested in participating in the procurement process. This could include managerial training, financial management, understanding the public procurement process, access contract

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<sup>43</sup> World Bank Group Technical Report: Policies that Promote small business Participation in Public Procurement. The Business Environment Working Group (BEWG) of the Donor Committee for Enterprise Development (DCED). 2017.

<sup>44</sup> World Bank Benchmarking Public Procurement 2016 Report.

<sup>45</sup> World Bank Group Technical Report: Policies that Promote small business Participation in Public Procurement. The Business Environment Working Group (BEWG) of the Donor Committee for Enterprise Development (DCED). 2017.

opportunities, etc. This support can be provided independent of the actual tendering process or in tandem.

As a policy measure, technical assistance does not influence the cost competitiveness of the bidder – only supporting the bidder’s ability to participate in the procurement process. It does require effective assistance and specialized training efforts for both small businesses and procurement officials, in both the procedures to be implemented and in professionalism. While important, its impact is also difficult to assess.

## **1.5 Small Businesses: Eligible Criteria**

There is no single harmonized definition of small businesses. Indeed, they are categorized in the EU as Small and Medium Sized enterprises – SMEs, while in Brazil as Micro and Small Enterprises – MSEs. This divergence is at both an international institutional and domestic level. Although typically viewed as private sector and independently owned, the nomenclature differs depending on employee number, revenue and industry. The different definitions used by national governments and international organizations generally set thresholds on the number of employees and/or annual turnover. In some cases, these thresholds are sector-specific, further complicating comparisons across countries.

### *1.5.1 The EU Definition*

The EU policy definition covers small and medium-sized business (SMEs). It is set out in a 2003 Recommendation of the Commission.<sup>46</sup> The Recommendation establishes that small and medium-sized enterprises are those which employ fewer than 250 persons and which have an annual turnover not exceeding €50 million, and/or an annual balance sheet total not exceeding €43 million. The EU has no discriminatory policies in public procurement between EU and non-EU small businesses. Within the small business category, a small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed €10 million. Small businesses are further broken down to micro, small and medium-sized enterprises, forming three nested categories, with the larger categories including the smaller ones.

The respective thresholds are set out in Figure 1.8

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<sup>46</sup> Adopted on 6th May 2003, which came into effect as from 1st January 2005

Figure 1.8 Definitions of Small Businesses under Article 2 Code of Good Practice 2003 (2003/361/EC)

Size class	Employee number	Annual sales (euros)	or	Balance sheet total (euros)
Micro	< 10	≤ 2 million		≤ 2 million
Small	< 50	≤ 10 million		≤ 10 million
Medium-sized	< 250	< 50 million		< 43 million

The EU emphasizes clarity and simplicity in its approach to small business definitions, which is a substantial advantage in the administration of small business assistance. However, this must be balanced against accurately reflecting industry conditions, since small business assistance could simultaneously be denied to deserving firms in some industries and extended to firms that would be considered large in other industries.

### 1.5.2 The Brazil Definition

In Brazil, there is only one legal source for defining a micro or small business. It is set out in the Federal Complementary Law 123/2006:

Micro enterprise:	Small sized enterprise:
Art. 3.I up to BRL 360.000 (annual gross income previous year)	Art 3.II between BRL 360.000 up to BRL 4.800.000 (annual gross income previous year)

### 1.5.3 The US Definition

In the US, the Office of Federal Procurement Policy (OFPP) in the Office of Management and Budget (OMB) has primary responsibility for public procurement policies and regulation. However, the US federal procurement system is fragmented, both geographically and sectorally, and subject to several different statutes and international agreements. The principal body of law regulating federal procurements is the Federal Acquisition Regulation (FAR). This law applies to all executive departments, military departments, independent establishments and wholly owned government corporations, alongside other more specific applicable procurement rules. In the U.S, roughly 65% of procurement is conducted at the state/municipality level, as compared to around 35% in the EU.<sup>47</sup> Each US State has its own procurement access rules. While 37 States participate in the WTO GPA, among those that do not, some restrict

<sup>47</sup> A Harastasanu. How Buy American is jeopardizing TTIP. <http://globalriskinsights.com/2016/07/buy-american-jeopardizing-ttip/>

foreign participation in biddings, others offer preferences to in-state suppliers, or apply domestic purchase requirements. Some states, such as New Jersey, do not grant specific state preferences, but may grant them on a reciprocity basis, depending on what the state of origin of the out-of-state bidder grants. Others grant in-state preferences only when there is a tie in the bid, or for some specific products. A few states, including New Hampshire and New York, do not grant any preferences whatsoever.

In defining a small business for purposes of public procurement, the US has generally considered industry-specific trends and conditions, which are reflected in indicators of economic activities (such as, employment or revenue) and varying size caps for each industry as a basis for measurement. This diversity makes sense, assuming the purpose behind small business definitions is to target relief and assistance to companies most struggling to establish themselves and most vulnerable to anti-competitive pressures by large businesses or government officials. However, the objective of accurately reflecting industry conditions can be in conflict with the objective of avoiding red tape and legal uncertainty through clear and simplified rules.

In addition to promoting predictability and transparency in small business definitions, Congress and the Small Business Administration have established safeguards to protect small business size definitions from fraud and manipulation. These safeguards include (1) process measures such as appeals and protests; (2) regulations concerning small business affiliation with large businesses and recertification of former small businesses that have become large through growth, mergers, or acquisitions; (3) prohibitions on subcontracting the majority of the work on small business set-asides to large businesses.<sup>48</sup>

The Federal Government has specified annual prime contracting goals for designated small businesses. The Small Business Act (PL 85-536) requires every federal government purchase with an anticipated value above the micro-purchase threshold of US\$3,500, and up to the simplified acquisition threshold (SAT) of US\$150,000, to be automatically and exclusively set-aside for small businesses. There must be at least two or more (Rule of Two) responsible small business concerns that are competitive in terms of market prices, quality, and delivery for an automatic set-aside to occur. Contract opportunities above US\$150,000 must also be set aside if the Rule of Two is met. Moreover, contract opportunities over US\$700,000 or US\$1.5 million for construction awarded to Other-than-Small-Businesses (OTSBs), must include small business subcontracting plans to the extent there are subcontracting opportunities.

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<sup>48</sup> 42 US Code 2010. 43 US Code 2010. 44 US House 1993. 45 SBA 2009a. 46 Code of Federal Regulations (CFR) 2010. 47 CFR 2010. 48 CFR 2010. 49 SBA 2006. 50 US Code 2010.

Pursuant to the SBA, the Small Business Administration is responsible for defining the specific size standards for each industry to determine which businesses qualify as small.<sup>49</sup>

#### *1.5.4 The Mercosur Definition*

No common Mercosur definition of small businesses has been identified; each of the Mercosur members define small businesses according to their domestic policies.

#### *1.5.5 Summary of small business definitions*

On the one hand, the complexity of non-simplified small business definitions, such as in the US, could be seen as a necessary evil. It reflects considerations of industry-specific conditions and fair competition among similarly situated firms in the same industries. US businesses must use these definitions in order to qualify for preferential treatment in procurement markets. The EU does not permit offsets or price preferences for small businesses in its procurement legislation; nor does the EU discriminate between EU and non-EU small businesses. This is a more simplified definitional approach. In general, it has larger size caps across all industries, although the US has larger overall size caps in some of its industries. Brazil takes a hybrid approach. It does offer Brazilian small businesses preferential treatment in procurement markets, but takes a simplified definition of what constitutes a micro and small business.

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<sup>49</sup> Small Business Administration online information. [www.sba.gov/contracting/government-contracting-programs/what-small-business-set-aside](http://www.sba.gov/contracting/government-contracting-programs/what-small-business-set-aside).

## 2. EU Public Procurement

### 2.1 The Regulatory Environment for EU Public Procurement

The EU Public procurement framework is based primarily in the free movement provisions of the Treaty on the Functioning of the European Union (TFEU)<sup>50</sup> and legislative measures in the form of directives, which are updated periodically. Member states must issue national legislation (regulations) to implement the EU rules into domestic law. The Court of Justice of the EU (CJEU) has held that national law must provide for measures that are effective to secure the objectives of the particular directive. Given that most of the rules in the procurement directives governing award procedures, such as obligations to advertise procurements, are intended to be enforceable by aggrieved firms, EU Member States typically implement the procurement directives by enacting legislation in domestic law that is legally binding on procuring entities, and enforceable by affected firms.<sup>51</sup>

The CJEU also refers to “general principles of law” derived from the national law of Member States and considered part of EU law: proportionality, legal certainty and equal treatment are also used to inform interpretation of EU law<sup>52</sup> in addition to secondary legislation such as procurement directives.<sup>53</sup> The most important procurement directives are 2014/23/EU on the award of concession contracts; 2014/24/EU on public procurement; and 2014/25/EU on procurement by entities operating in the water, energy, transport and postal services sectors. These Directives stipulate that in the EU, all above-threshold public procurement must be advertised EU-wide and must follow uniform procedures.

However, only one-fifth of total public expenditure on goods and services is covered by the EU Directives.<sup>54</sup> See Figure 2.1 It was further estimated that in 2009, over 150,000 invitations to tender were published (by 35,000 authorities) in conformity with EU Directives. The estimated value for these contracts was

<sup>50</sup> The four freedoms of the European Union are: goods, services, people, capital

<sup>51</sup> In Case C-433/93, *Commission v the CJEU* ruled that Germany had not implemented the procurement directives in the required form.

<sup>52</sup> TFEU provisions can override these principles.

<sup>53</sup> See, for example, Joined Cases C-21/03 and C-34/03, *Fabricom v Belgium* (“Fabricom”) para.27 of the judgment, in the context of public procurement)

<sup>54</sup> PwC, ICT, GHK, Ecorys (2014), small businesses' access to public procurement markets and aggregation of demand in the EU, a study commissioned by the European Commission, DG Internal Market and Services, February 2014.

€420 billion. This represents approximately 20% of total public expenditure on goods, works and services. Consequently, the bulk of total public expenditure on goods, services, and works is not organized in accordance with EU procurement legislation.<sup>55</sup> This may take the following forms:

- Large amounts of public expenditure on goods and services to provide health, education and social services are spent in ways which are not covered by the EU public procurement Directives.
- Public contracts below the EU thresholds fall outside the scope of the EU public procurement
- EU procurement Directives provide certain explicit exemptions for expenditure on fuel, water and a separate Directive for defense equipment

EU public procurement policy aims to achieve the best value for money through open, transparent and non-discriminatory procedures, consistent with the underlying objectives of the internal market. Nevertheless, the EU legislative framework contains a series of provisions regarding the incorporation of other public policy objectives. First, to favour social inclusion, the current contracts' reservation is in favour of economic operators whose main aim is the social and professional integration of disabled and disadvantaged workers; and the minimum required percentage of disabled or disadvantaged employees is 30%. Second, regarding innovation, all procedures may now take account of the total life-cycle cost of purchases when tenders are being evaluated. Thus, innovative bids may be awarded more points in the light of their long-term financial benefits. Third, regarding the environmental aspects of procurement, the concept of “life-cycle costing” introduced in the Directives is aimed at encouraging public authorities to consider the full life-cycle of products in their purchasing decisions.

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<sup>55</sup> *Ibid.*



Figure 2.1 Main EU Procurement Instruments

Legal measure	Main content
Public Contracts Directive (2014/24/EU)	Award procedures for most major public contracts (not concessions, utilities, and defence and security contracts)
Utilities Directive (2014/25/EU)	Award procedures for major contracts of entities in certain utilities sectors (water, energy, transport and postal services); includes contracts of public undertakings and entities with special or exclusive rights
Concessions Directive (2014/23/EU)	Award procedures for most types of major concessions (including utilities and defence)
Defence and Security Contracts Directive (2009/81/EC)	Award procedures and remedies for major contracts in defence and security fields
Remedies Directive (89/665/EEC)	Remedies for contracts covered by Public Contracts Directive and Concessions Directive (other than concessions in the utilities sectors)
Utilities Remedies Directive (92/13/EEC)	Remedies for contracts covered by Utilities Directive and, for entities in utilities sectors, Concessions Directive
Passenger Transport Regulation (1073/2009/EC)	Award procedures for services concessions for the award of services concessions for passenger transport services by bus, tram, rail and metro
Licensing Regulation (1008/2008/EC)	Award procedures for concessions for air transport procedures
Standardisation Regulation (1025/2012/EU)	Designation of certain IT standards as available for use within the rules on drafting specifications in the procurement directives (Art.14)
E-invoicing Directive (2014/55/EU)	Provision for developing a European standard on e-invoices to be used in contracts covered by all the procurement directives
Thresholds Regulation (2015/2172/EU)	Sets the threshold values for rules in the procurement directives, including the rules on which contracts are covered
Regulation on standard form of notices (2015/1986/EU)	Sets out the standard form for submitting procurement notices to the <i>Official Journal of the European Union</i> (OJEU)
Utilities Exemption Decision (Commission Decision 2016/1804)	Lays down rules on application of the exemption mechanism of the Utilities Directive under Art.34 of that directive for entities operating in competitive markets
Energy Efficiency Directive (2012/27/EU)	Requires entities of the central government to purchase energy-efficient versions of certain products, services and buildings
Clean Vehicles Directive (2009/33/EC)	Requires certain entities regulated by the procurement directives to take account of pollution and energy-efficiency aspects when purchasing certain vehicles

Figure 2.2 EU Procurement Thresholds under 2014 Directives

**THE EUROPEAN PUBLIC CONTRACTS DIRECTIVE (2014/24/EU)**

	Supply, Services <sup>1</sup> and Design Contracts	Works Contracts <sup>2</sup>	Social and other specific services <sup>3</sup>
Central Government <sup>4</sup>	£118,133 €144,000	£4,551,413 €5,548,000	£615,278 €750,000
Other contracting authorities	£181,302 €221,000	£4,551,413 €5,548,000	£615,278 €750,000
Small Lots	£65,630 €80,000	£820,370 €1,000,000	n/a

<sup>1</sup>With the exception of the following services which have different thresholds or are exempt:

- Social and other specific services (subject to the light touch regime) Article 74.
- Subsidised services contracts specified under Article 13.
- Research and development services under Article 14 (specified CPV codes are exempt).

<sup>2</sup>With the exception of subsidised works contracts specified under Article 13.

<sup>3</sup>As per Article 74. Services are listed in Annex XIV.

<sup>4</sup>Schedule 1 of the Public Contracts Regulations lists the Central Government Bodies subject to the WTO GPA. These thresholds will also apply to any successor bodies.

	Supply, Services and Design Contracts	Works Contracts	Social and other specific services
Utility authorities	£363,424 €443,000	£4,551,413 €5,548,000	£820,370 €1,000,000
	Supply, Services and Design Contracts	Works Contracts	Social and other specific services
Defence and Security authorities	£363,424 €443,000	£4,551,413 €5,548,000	n/a

## 2.2 EU Public Procurement and Small Business Promotion

Small businesses are seen as an important component of European public policy with one of the objectives being the facilitation of their access to public procurement. The main instrument promoting small businesses in the EU is **Directive 2014/24/EU** which sets out the rules for the procurement procedures of works, supplies or services regarding public contracts as well as design contests. It is especially relevant to small, micro and medium sized firms because it provides guidance on how to adapt the procurement process to the needs of small businesses by applying the ‘European Code of Best Practices Facilitating Access by SMEs to Public Procurement Contracts’, for example dividing large contracts into multiple smaller contracts. **Directive 2014/23/EU** sets rules for the award of concession contracts. It notes that due to the absence of regulations on the award of concession contracts, small businesses are being left out business opportunities. Therefore, it calls for a balanced and adequate legal framework that ensures equal access to all economic operators.

**The European Small Business Act:** “Think Small First.” The Small Business Act (SBA) is a comprehensive framework for the EU policy on Small and Medium Enterprises (small businesses). It aims to improve the approach to entrepreneurship in Europe, simplify the regulatory and policy environment for small businesses, and remove the remaining barriers to their development. It encompasses ten principles and several concrete policy and legislative actions to implement them. It requires Member State monitoring through annual SBA reports, which are used as an important source of country case study data in this report.

**Principle V of the European Small Business Act** aims to adapt public policy tools to small business needs, facilitate small businesses’ participation in public procurement and better use State Aid possibilities for small businesses. It calls upon the EU and the Member States to make use of the Code of Best Practice providing guidance to contracting authorities on how they may apply the EC public procurement framework in a way that facilitates small businesses’ participation in public procurement procedures. Pursuant to Principle VI, the EU and Member States should facilitate small businesses’ access to finance, in particular risk capital, micro-credit and mezzanine finance, and also to develop a legal and business environment supportive to timely payment in commercial transactions.

**The European Code of Best Practices Facilitating Access by SMEs to Public Procurement Contracts** aims to create fairer access to public procurement for all the economic operators, particularly for small businesses. Under Recital V, the Code states that the EU and the Member States should adapt public policy tools

to small business needs, using the Code of Best Practice to provide guidance to contracting authorities on how they may apply the EC public procurement framework in a way that facilitates small businesses' participation in public procurement procedures. The Code acknowledges and seeks to address a series of obstacles for the entering of small businesses to the market of European public procurement, which could be applied to the reality of Brazil:

- i) difficulties related to the size of the contracts;
- ii) access to relevant information;
- iii) improvement of the quality and understandability of the information provided;
- iv) setting of training levels and proportionate financial requirements;
- v) relief of the administrative burden;
- vi) highlighting of the quality-price relationship, and not just in the price;
- vii) grant enough time to prepare quotations; and
- viii) make sure payment terms are complied with.

**The Green Book** on electronic public procurement in the EU (2010) represents the first approximation of regional integration scheme for the reform of national regulations, and the modernization of the public procurement systems.

**The Action Plan of Electronic Administration for Europe 2011-2015** aims to extend the use of the electronic government, including public procurement in the region to 50% of the population and to 80% of the business people by 2016. It complements the implementation of the Directive 2014/55 (2014) related to electronic billing in public procurement.

## **2.3 The Application of EU Competition Law to Public Procurement**

A significant number of cartel offences take place in public procurement markets. This situation is not surprising, in light of some of the features of public procurement regulation that could be seen as pro-collusive. For example, the public procurement Directives increase the transparency of the market and set out a clear set of rules. This can facilitate businesses monitoring competitors and formulating a collective response, particularly in repeated interaction amongst bidders.

There is EU clear case law on the enforcement of the prohibition in Article 101(1) of the Treaty on the Functioning of the European Union (TFEU) against economic

undertakings that collude to alter the outcome of a tender for a public contract.<sup>56</sup> Additionally, within the EU, any entity engaged in an economic activity that consists of *offering* goods or services on a given market, regardless of its legal status and the way in which it is financed, is to be considered an undertaking. No intention to earn profits is required, nor are public bodies by definition excluded.<sup>57</sup> In effect, this term is used to describe nearly anyone that is engaged in an economic activity,<sup>58</sup> except employees<sup>59</sup> and public services based on "solidarity" for a "social purpose." A *public undertaking*, on the other hand, is an undertaking over which public authorities directly or indirectly exercise dominant influence by virtue of their ownership, financial participation, or the rules that govern it. A dominant influence of public authorities is in particular presumed when they: a) hold the major part of the undertaking's subscribed capital, b) control the majority of the votes attached to shares issued by the undertaking; or c) appoint more than half of the members of the undertaking's administrative, managerial or supervisory body.

The Court of Justice of the EU (CJEU) has interpreted the concept of an undertaking for the purposes of the application of EU competition law to encompass economic agents engaging in a combination of both economic and non-economic activities. In the *EasyPay* case, the CJEU determined that an activity will be considered as economic - unless it has links with another activity that fulfils an exclusively social function based on the principle of solidarity and entirely non-profit making. Moreover, such an activity must, by its nature, aims and the rules to which it is subject, be 'inseparably' connected to its social function.<sup>60</sup> The *EasyPay* Judgment was significant in confirming that for the purposes of the application of EU competition law, a procurement agency that is engaged in an economic activity, irrespective of its legal status and the way in which it is financed, will be covered by competition law prohibitions. This includes collusion, abuse of dominance and State aid control.<sup>61</sup> This is of relevance if public authorities are found to be routinely paying the invoices of small businesses late, or excluding certain companies from bidding for contracts without a permitted justification.

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<sup>56</sup> Most notably, *Schindler Holding and Others v Commission*, C-501/11 P, EU:C:2013:522

<sup>57</sup> The Commission published this definition on DG Competition's web-site at: [http://ec.europa.eu/comm/competition/general\\_info/u\\_en.html#t62](http://ec.europa.eu/comm/competition/general_info/u_en.html#t62)

<sup>58</sup> *Höfner and Elser v. Macrotron GmbH* [1991] ECR I-1979 (C-41/90).

<sup>59</sup> See AG Jacobs, *Albany International BV* (1999).

<sup>60</sup> Judgment in *EasyPay and Finance Engineering*, C-185/14, EU:C:2015:716

<sup>61</sup> *Stadt Halle* (C-26/03)

## 2.4 Constraints on Facilitating Small Business Participation

In the legislative procedure leading to the adoption of the 2014 Procurement Directives, the main focus was to improve the possibilities and conditions for participation of small businesses in public procurement covered by the EU rules.<sup>62</sup> Recital 2 notes that, '*Public procurement plays a key role in the Europe 2020 strategy ... For that purpose, the public procurement rules adopted pursuant to [the 2004 Directive] should be revised and modernized in order to increase the efficiency of public spending, facilitating in particular the participation of small and medium-sized enterprises.*' In clearer terms, Recital 78 states that: '*Public procurement should be adapted to the needs of small businesses.*' Article 83(3) of the 2014 Directive provides for increased monitoring at the national level and for an obligation on Member States to transmit to the Commission every three years a monitoring report covering information on *inter alia* the level of small business participation (see also Recitals 124 and 134).

The EU's public procurement reform in 2014 also introduced specific legislative measures to improve small businesses' access to public procurement markets. These measures include in particular an encouragement to divide contracts into lots and the limitation of the turnover required to participate in a tender procedure. The sub-division of public purchases into lots facilitates access by small businesses both quantitatively (the size of the lots may better correspond to the productive capacity of the small business) and qualitatively (the content of the lots may correspond more closely to the specialised sector of the small business). The division of contracts into lots is encouraged through the "apply or explain" principle. That is, when contracting authorities deem that the division would not be appropriate, an individual report or the procurement documents should contain an indication of the main reasons for the contracting authority's choice. Such reasons could be that the contracting authority finds that the division could risk restricting competition, or rendering the execution of the contract excessively technically difficult or expensive, or that the need to coordinate the different contractors for the lots could seriously undermine the proper execution of the contract.

As far as proof of financial capacity of the economic operator is concerned, the turnover requirements are limited to a maximum of twice the estimated value of the contract, except in duly-justified cases. For its part, the new Directive on

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<sup>62</sup> This focus was initiated in the Commission's Europe 2020 A strategy for smart, sustainable and inclusive growth, COM(2010) 2020 final, and was clearly visible in the Green paper on the modernisation of EU public procurement policy, Towards a more efficient European Procurement Market, COM(2011) 15 final.

concessions is also for the benefit of small businesses, inter alia, through improving access to information and favoring their participation in consortia and as subcontractors. In the area of electronic government and public procurement, the EU has made significant and important progress.

However, despite the small business focus of the EU, and the numerous references to small businesses in the 2014 Directive recitals, it does not provide small businesses off-sets or price preferences to increase their participation in public contracts covered by the Directives. This policy choice has also been transposed into the market access commitments that the EU has made under the WTO Public procurement Agreement.

#### *2.4.1 European Union Obligations under the WTO GPA and Small Business Promotion*

The EU has historically been active in seeking to expand the level playing field in world procurement markets. It has perceived these efforts to be in the face of an entrenched reluctance from many countries to allow for the participation of EU operators and products in their procurement tenders. The EU was a major advocate of public procurement liberalization under the GATT Procurement Codes, while the 1994 WTO GPA was itself based on key EU concepts surrounding the appropriate design and execution of procurement contracts. This was in part because at the time the EU had one of the most developed public procurement regulatory frameworks internationally. The Revised GPA further displays the influence of the EU in the design of the right to appeal clauses, the judicial review mechanism, and e-procurement, for these were all part of previous EU legislation. The WTO Revised GPA's newly adopted Works Programmes were also included at the request of the EU after it had successfully negotiated this with other parties' delegations. The Works Programme reflects the EU's policy priorities, such as promoting small businesses in procurement, see below.<sup>63</sup> As such, the EU has been very successful in promoting its public procurement agenda to the WTO through the GPA, as well as in its attempt to transfer EU practices in the globally lucrative market of public procurement.

As a plurilateral agreement, the WTO GPA is a voluntary agreement, currently operating among 45 Members of the 161 Membership of the WTO. The WTO GPA establishes a legal framework relating to public contracts covered under each of the signatory parties' Annexes set out under Appendix 1 to the GPA. Article II Coverage notes that the WTO GPA is applicable to any measure regarding covered procurement, which means procurement for governmental

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<sup>63</sup> The WTO Committee on Public procurement, 2012, Annex 7.

purposes of goods, services, or any combination thereof, moreover, as specified in each Party's annexes to Appendix I - and for which the value equals or exceeds the relevant threshold specified in a Party's annexes to Appendix I. The EU's 'covered' procurement scheduled in Appendix 1 sets out the coverage of the GPA in addition to setting out those sectors and entities that are not covered by the GPA commitments.<sup>64</sup> The Notes to Annex 1 additionally clarify what *shall not be considered* as covered procurement for the EU.<sup>65</sup>

As a result of the EU's membership of the WTO GPA, for a portion of nearly €2.5 billion worth of procurement contracts, those EU contracting agencies whose procurements are covered by the WTO GPA must apply the Directive to both EU and third country operators that are signatories of the WTO GPA. For pursuant to the WTO GPA Article IV General Principles, non-discriminatory treatment is unequivocally required of the signatory parties' procurement suppliers, as provided for in the parties' Annexes falling under Appendix 1:

1. With respect to any measure regarding covered procurement, each Party, including its procuring entities, shall accord immediately and unconditionally to the goods and services of any other Party and to the suppliers of any other Party offering the goods or services of any Party, *treatment no less favourable* than the treatment the Party, including its procuring entities, accords to:
  - (a) domestic goods, services and suppliers; and
  - (b) goods, services and suppliers of any other Party.
  
2. With respect to any measure regarding covered procurement, a Party, including its procuring entities, *shall not*:
  - (a) treat a locally established supplier *less favourably* than another locally established supplier on the basis of the degree of foreign affiliation or ownership; or

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<sup>64</sup> For example, the EU's Appendix 1 Annex 7 explicitly states that the agreement does not cover: The procurement of agricultural products made in furtherance of agricultural support programmes and human feeding programmes (e.g. food aid including urgent relief aid); The procurement for the acquisition, development, production or co-production of programme material by broadcasters and contracts for broadcasting time. The procurement by procuring entities covered under Annexes 1 and 2 in connection with activities in the fields of drinking water, energy, transport and the postal sector are not covered by this Agreement, unless covered under Annex 3.

<sup>65</sup> The procurement by procuring entities covered under this Annex of air traffic control equipment in regard of suppliers and service providers from the US; The procurement by procuring entities covered under this Annex of good or service components of procurement which are not themselves covered by this Agreement in regard of suppliers and services providers from the US and Canada; And until such time as the EU has accepted that the Parties concerned provide satisfactory reciprocal access for the EU goods, suppliers, services and service providers to their own procurement markets.



(b) *discriminate against* a locally established supplier on the basis that the goods or services offered by that supplier for a particular procurement are goods or services of any other Party.

### 2.4.2 EU Compliance with the WTO GPA and Small Businesses Promotion

While the EU Procurement Directive 2014/24/EU has made various efforts to promote the participation of small businesses, it has had to remain within the boundaries of its legal obligations negotiated under the WTO GPA. The WTO GPA provides *ex ante* options for the parties to promote their small businesses and, moreover, various parties to the WTO GPA have employed these possibilities to encourage small business participation in procurement markets in their Annexes included in Appendix 1, which is integral to the Agreement, however, not the EU.

At the very outset of the negotiation of the Public procurement Code in 1979, the EU did not seek to negotiate carve out protections from the GPA's obligations for small businesses. Consequently, despite the more recent focus on small business promotion across the EU, the Directives do not include price preferences or set asides to favour small businesses, as in the US, Japan and Korea. Instead the European Community procurement directives were promulgated to liberalize the internal market among the Member States of the Community. The European Commission's official policy was to promote trade liberalization and oppose set-asides and other procurement preferences for small businesses.<sup>66</sup> It did not therefore list any exceptions or exemptions for small businesses within the WTO GPA schedules set out in its Annexes under Appendix 1. The rationale underlying both the directives and the principles embodied in the directives, are based on trade liberalization. The Directives are trade-liberalizing mechanisms. The available evidence tends to show that the benefits of trade liberalization within the Community far outweigh national policies favouring domestic firms.<sup>67</sup>

On the contrary, EU negotiators rather sought reciprocity with the US, Korea and Japan. The EU's Notes to Annex 1 stipulate that:

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<sup>66</sup> Communication from the Commission to the Council, The European Parliament, the European Economic and Social Committee and the Committee of the Regions, "Think Small First"; A "Small Business Act" for Europe', COM(2008) 394 final.

<sup>67</sup>The Cecchini Report, 1998.

The provisions of Article XVIII requiring Domestic Review Procedures *shall not* apply to suppliers and service providers of Japan, Korea and the US in contesting the award of contracts to a supplier or service provider of Parties other than those mentioned, *which are small or medium sized enterprises under the relevant provisions of EU law, until such time as the EU accepts that they no longer operate discriminatory measures in favour of certain domestic small and minority businesses.*

The EU Directive 2014/24/EU instead includes specific legislative measures to improve small businesses' access to public procurement markets by encouraging contracting authorities to divide contracts into lots and the limitation of the turnover required to participate in a tender procedure. The sub-division of public purchases into lots facilitates access by small businesses quantitatively because the size of the lots may better correspond to the productive capacity of the small business. Yet also qualitatively, the content of the lots may correspond more closely to the specialized sector of the small business. Moreover, given the requirement for proof of financial capacity of the economic operator, subdividing large contract also promotes small business participation because the turnover requirements are set at twice the estimated value of the contract, except in duly justified cases.

Directive 2014/24/EU seeks to promote small business participation in procurement markets through the policy of awarding a contract in the form of subdividing it into smaller lots. Under Article 46, contracting authorities are not obliged but encouraged to award a contract in the form of separate lots and may determine the size and subject matter of such lots. The contracting authorities must set out the objective and non-discriminatory criteria for determining lots, and may *ex ante* limit the number of lots awarded to one tenderer. This encouragement is strengthened by the requirement under Article 46.2, for contracting authorities to include in the procurement documents the main reasons for their decision *not to subdivide* into lots. Pertinent reasons could be that the contracting authority finds that the division could risk restricting competition, or rendering the execution of the contract excessively technically difficult or expensive, or that the need to coordinate the different contractors for the lots could seriously undermine the proper execution of the contract.

At first blush, sub-dividing lots would appear to be bid splitting and may be actionable under the WTO GPA Article 2.6 threshold valuation obligations. Consequently, the Directive also includes so-called aggregation rules concerned with below-threshold procurement. Contracting authorities are explicitly required

to aggregate the value of separate contract lots for works or services to be awarded at the same time for a particular project.

Where a proposed work or a proposed provision of services may result in contracts being awarded in the form of separate lots, account shall be taken of the total estimated value of all such lots.

Where the aggregate value of the lots is equal to or exceeds the threshold laid down in Article 4, this Directive shall apply to the awarding of each lot.<sup>68</sup>

As a result, the Directive 2014/24/EU will generally apply to the award of each sub-threshold contract value of each of the individual contracts that may be less than the relevant EU financial threshold, yet the aggregate or total value of these contracts exceeds the threshold. This formula is similar to that applied to framework agreements for example, which establish the contractual terms that will apply to subsequent orders made for a period of time.

#### *Timeframes*

Directive 2014/24/EU Recital 80 states that the time limits for participation in procurement procedures should be kept to the minimum without creating undue barriers to access for economic operators from across the internal market and *in particular small businesses*. Consequently, Article 27 stipulates that for open procedures,<sup>69</sup> the minimum time limit for the receipt of tenders must be 35 days from the date on which the contract notice was sent. However, Article 48 provides that if the contracting authorities have published a prior information notice (PIN) within the 12 months prior to the contract notice, which included all the necessary information for the contract notice, the minimum time limit for the receipt of tenders may be shortened to 15 days. In the rare situation of a state of urgency that renders these time limits impracticable, the contracting authority may fix a time limit, which shall be not less than 15 days from the date on which the contract notice was sent. While a contracting authority may reduce the time limit by five days for those tenders submitted by electronic means, as long as they are in accordance with the specifications set down in Article 22(1), and Article 22(5) and (6).

#### *Award Criteria and the Social aspects of PPMs – facilitating small businesses involvement*

The award criteria for the ‘most economically advantageous tender’ (MEAT) set out under Directive 2014/24/EU Recital 92 and elaborated upon in Article 67

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<sup>68</sup> Directive 2014/24/EU Article 5(8).

<sup>69</sup> An open tender is defined as one where any interested economic operator may submit a tender in response to a call for competition.

provides the basis for public authorities to put more emphasis on quality, social aspects, innovation and life-cycle costs while considering environmental considerations and price. It aims to encourage evaluation of bids offering the best price-to-quality ratio. This would appear to help small businesses being considered for contracts, as firms will be judged not only on the front-end price determined by economies of scale that small businesses often cannot reap, but also on the life-cycle cost.

However, the use of these criteria is ring fenced by Recital 98 states:

It is essential that award criteria or contract performance conditions concerning social aspects of the production process *relate to* the works, supplies or services to be provided under the contract. [Emphasis added]

This link has been criticized because it effectively removes the ability to integrate small business policies to the extent that these address matters beyond the specific needs of the contracting authority.<sup>70</sup> However, such social requirements might conflict with the WTO GPA Article X covering technical specifications obligations. These requirements prohibit a procuring entity from preparing, adopting or applying any technical specification or prescribe any conformity assessment procedure with the purpose or the *effect* of creating unnecessary obstacles to international trade.

## 2.5 The Proposed EU International Procurement Instrument (IPI)

The European Commission estimates that more than half of the world's procurement market is currently closed due to protectionist measures. As a result, only €10 billion of EU exports (0.08% of EU GDP) reach foreign procurement markets, leaving an estimated €12 billion of unrealized EU exports because of such third-country restrictions.<sup>71</sup> These restrictions affect competitive EU sectors such as construction, public transport, medical devices, power generation and pharmaceuticals.

To address this perceived imbalance, the European Commission issued a proposal to encourage greater reciprocity on the part of trading partners, vis-à-vis access to the public procurement contracts. The 2016 IPI Amended Proposal

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<sup>70</sup>Abby Semple. The Link to the Subject-Matter: A Glass Ceiling for Sustainable Public Contracts? *Working paper presented at the University of Oslo as part of the European Law Conference 2014.*

<sup>71</sup> See [http://trade.ec.europa.eu/doclib/docs/2012/march/tradoc\\_149242.pdf](http://trade.ec.europa.eu/doclib/docs/2012/march/tradoc_149242.pdf) pp8-9

applies to the procurement covered under the revised EU procurement directives.<sup>72</sup> Article 1 provision specifically provides that the regulation shall apply *only with regard* to restrictive and/or discriminatory procurement measures or practices implemented by a third country in respect of purchases of *non-covered goods and services*, and its application shall be *without prejudice to any international obligations of the Union*. An additional safeguard is offered pursuant to the exceptions set out under Article 12 which provides EU contracting bodies the discretion to decide not to apply the price adjustment measure with respect to a procurement or a concession procedure if there are no EU and/or covered goods or services available which meet the requirements of the contracting authority or contracting entity, or if the application of the measure would lead to *a disproportionate increase in the price or costs of the contract*.

The proposed price adjustment measure can be applied to bidders or products or services from that country following a Commission investigation determining that a third-party country is applying barriers to EU participation in its procurement market. However, there is a presumption that a negative price preference will be imposed to level out the playing field of that particular procurement market. This presumption will be upheld unless the bidder can prove that *less than 50%* of the total value of their tender is made up of 'non-covered' goods and services originating in this third country. The proposal also permits targeting territories at both the regional or local level, like states, regions or even municipalities.

The 2016 IPI Amended Proposal seeks to incentivize its trading partners to expand on their EU public procurement market access commitments. If an investigation determines bidders or products or services from a third-party country are applying barriers to EU participation in its procurement market, the Commission and the third-party country must undergo consultations for up to 15 months. Article 7 states that if after the initiation of consultations, it appears that the most appropriate means to end a restrictive and/or discriminatory procurement measure or practice is the conclusion of an international agreement, negotiations shall be carried out in accordance with Articles 207 and 218 of the Treaty on the Functioning of the European Union (TFEU). The Commission can terminate such consultations if the country concerned undertakes international commitments agreed with the Union either through accession to the WTO GPA or expanding its market access commitments to the EU under the WTO GPA, or otherwise through the conclusion of a bilateral agreement with the Union which includes market access commitments in the field of public procurement and/or concessions.

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<sup>72</sup> Article 1.3 The 2016 International Procurement Instrument. Amended Proposal.

If this does not result in reciprocity, Article 11.1 of the IPI proposal provides for the possibility to apply price adjustment measures to those contested tenders submitted by economic operators originating in the third country concerned or tenders offering goods and services originating in the third country concerned - if the value of those goods and services accounts for more than 50% of the total value of the tender. However, this price adjustment measure shall apply only for the purpose of the evaluation and ranking of the price component of the tenders. It does not affect the price due to be paid under the contract, for this will subsequently be concluded with the successful tenderer.

### *2.5.1 The IPI Proposal and Small Businesses*

Following the 2014 Procurement Directive, the IPI Proposal notes that because of their size and limited capacity small businesses often face particular problems because of burdensome procedures. It too seeks to promote small business participation in the economy, in line with the general policy of the EU, and wider EU Trade Policy. Consequently, pursuant to the 2016 IPI Amended Proposal *Article 5*, those tenders submitted by SMEs established in the EU and engaged in substantive business operations,<sup>73</sup> shall be exempted from this Regulation. The price adjustment mechanism operates for any domestic bidder bidding for a contract valued at above €5,000,000. The high value threshold might make it less applicable to smaller companies.

## **2.6 International Instruments Promoting Small Businesses in Public Procurement**

### *2.6.1 The WTO GPA*

The revised text of the WTO GPA, only refers to small businesses in its Article XXII:8, under the heading of "Future Negotiations" and establishes the work programme on small businesses:

The WTO Committee on Public procurement agreed on the initiation of a Work Programme on small businesses as part of the results of the renegotiation of the GPA (see WTO document GPA/113, Appendix 2, Annex C - Decision of the Committee on Public procurement on a Work Programme on small businesses). The relevant decision entered into force on 6 April 2014, together with the Protocol Amending the GPA. In the

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<sup>73</sup> This entails have a direct and effective link with the economy of at least one Member State.

decision, Parties recognize (i) the importance of facilitating the participation of small businesses in public procurement; and (ii) that Parties have agreed in Article XXII:6 of the GPA to seek to avoid introducing or continuing discriminatory measures that distort open procurement.

This Committee is given the mandate to review measures and policies for small businesses that the Parties use to assist, promote, encourage, or facilitate participation by small businesses in public procurement and to identify the measures and policies that it considers to be best practices for promoting and facilitating the participation of small businesses of the Parties in public procurement. The work is carried out on the basis of a transparency programme consisting of replies to a survey and related exchanges, questions and comments. Questions addressed in the survey relate to:

- (i) the measures and policies used to promote, encourage or facilitate participation by small businesses in public procurement;
- (ii) the definition of small businesses,
- (iii) the existence of agencies or institutions to assist small businesses with respect to public procurement;
- (iv) information (including statistics, if available) on the level of participation by small businesses in public procurement in terms of both value and number of contracts awarded to small businesses;
- (v) measures and policies related to small business subcontracting;
- (vi) facilitation of small businesses participation joint bidding;
- (vii) measures related to enhanced transparency, simplifying qualification requirements, reducing contract sizes, and ensuring timely payments; and
- (viii) measures and policies to stimulate small business innovation.

After two years, the Committee is to review the effect of the best practices on expanding the participation of the small businesses of the Parties in public procurement, and to consider whether other practices would further enhance participation by small businesses.

The decision also states that Parties shall avoid introducing discriminatory measures that favour only domestic small businesses and shall discourage the introduction of such measures and policies by acceding Parties.

## 2.6.2 UNCITRAL

UNCITRAL's non-binding Model Law on Public Procurement was primarily motivated by a wish to address inadequate or outdated legislation in many countries, which was itself impeding the efficient and effective provision of public

services by governments. It was also considered that divergent national laws hampered the ability of firms to sell to foreign governments, and that harmonizing those laws through the use of a model in practice would be beneficial. UNCITRAL Model Law is designed to ensure that the government purchaser will obtain value for money in spending public funds and, in addition, that there is integrity in the process. The text, adopted by consensus, is considered to be widely acceptable in offering solutions appropriate for all governments.

However, UNCITRAL Model Law does not take a position on whether secondary policies, such as small business promotion, are appropriately or best pursued through a procurement system, reflecting a long-standing policy approach in UNCITRAL. When first considering revisions to the 2004 Model Law, an UNCITRAL intergovernmental Working Group noted that sustainable development policy should include long-term planning and the consideration of social, economic and environmental impacts beyond the local area (regional, national and international impacts). However, when reviewing the scope of the reform programme for the 1994 Model Law, the group noted that while using procurement to achieve other policy goals might be considered appropriate, such use might in some cases undermine the main objectives of the procurement process, which are:

- Achieving economy and efficiency;
- Wide participation by suppliers and contractors, with procurement open to international participation as a general rule;
- Maximizing competition;
- Ensuring fair, equal and equitable treatment;
- Assuring integrity, fairness and public confidence in the procurement process;
- Promoting transparency.



## 3. Public Procurement Law in Brazil

### 3.1 Legislation

The Brazilian legislation on public procurement follows a tradition of strong regulation in a very detailed national law, which is the Federal Law 8.666/1993. This piece of legislation ‘establishes the general rules’ on public procurement and public contracts.<sup>74</sup> The Federal Law 8.666/1993 applies to all governmental entities (e.g. executive, legislative, and judiciary branches, including agencies, public foundations, amongst others), from all governmental levels (federal, state, and municipal governments). Additionally, the Federal Law 8.666/1993 affects all kinds of contracts between the public and the private sector (art. 1 and art. 2). For that reason, the Federal Law 8.666/1993 is also called the General Law of Public Procurement. The Congress passed the General Law on Public Procurement after a presidential impeachment for corruption and a massive scandal of deviation of public finances. This peculiar circumstance may justify the preoccupation about ethical nonconformity and explains the adoption of a strict regulation about every aspect of a public procurement system.

The General Law on Public Procurement brings a full regulation about tender procedures, public contracts (chapter III), administrative and criminal sanctions regarding the procedure and the conducts during the contract (chapter IV). The General Law contains five methods of tendering (art. 22), more than thirty cases that recognize when there is no need to tender (art. 24), and legal provisions determining the circumstances in which a tendering procedure would be impossible and the Public Administration can contract without one (art. 25). In cases where there is no requirement to tender and an impossibility of tendering, the Public Administration must formally register the ‘characterization of the situation that justify’ dismissing the normal procedure, the ‘reason for selecting’ certain supplier or service providers, and the ‘justification of the price’.<sup>75</sup>

The five methods of tendering are competitive (art. 22, I), outlet prices (art. 22, II), invitation (art. 22, III), contest (art. 22, IV), and the auction (art. 22, V). Choosing one of them depends on the object and on the reference price of the future contract. The rules concerning notification also vary depending on the method applied and the selection criteria. This can be based on the lowest price or a

<sup>74</sup> Federal Law 8.666/1993. Article 1.

<sup>75</sup> General Law. Art. 26.

combination of best price and technique. This is with the exception of competitive bidding or auction, which does not depend on the price but just on the object of the future contract. Competition serves for the selection of technical, scientific, or artistic works (art. 22, IV) (e.g. the elaboration of an architectural project for a public building), and auction applies for sale of movable goods or immovable public properties.

**Figure 3.1 Summary of provisions regarding the most common bidding procedures adopted under the General Law considering the Presidential Decree 9.412, from 18 June 2018**

	Competition	Outlet prices	Invitation
Reference price for works and services of engineering (BRL/thousand)	Over 3.300	Up to 3.300	Up to 330
Reference price for general acquisitions and services (BRL/thousand)	Over 1.430	Up to 1.430	Up to 176
Noticing of the procedure	Official Press Newspaper and daily newspaper of general circulation in the State or region	Official Press Newspaper and daily newspaper of general circulation in the State or region	Sending an invitation for at least 3 potential suppliers
Minimum period between the noticing of the procedure and the proposal delivery (selection based on the lowest price)	30 days	15 days	5 working days
Minimum period between the noticing of the procedure and the proposal delivery (selection based on the best technique and price)	45 days	30 days	5 working days
Who can participate?	Everybody	Suppliers previously registered	Invited and suppliers previously registered

The main laws applicable to public procurement contracting indicate that the regulation is fragmented as well as decentralized:

- Federal Constitution - Section XXI, Article 37: this section of the Constitution provides that unless otherwise specified by law, public works, purchases, services and disposals must be contracted by public bidding procedures. This provides the general framework for public procurement in Brazil.
- Law 8,666/93 – this is the Public Procurement Law and it regulates public procurement procedures and contracts entered by the government.

- Law 8,987/95 – the Concession Law. This Law governs the process for the award of concession contracts. The law was enacted essentially to reduce government investment in certain sectors where private companies could come in and provide the services with government regulating and performing oversight functions, thereby allowing government to focus on other important sectors. The law introduced flexibility to the concession process which would otherwise not have been the case under the Procurement Law.
- Law No. 10,520/02 – this law provides for the Reverse auction system (Pregão)
- Law 11,079/04 – this law specifically deals with Public Private Partnerships (PPPs)- It modifies and complements the Concessions Law. The PPP Law established general rules for the bidding and contracting of PPPs while creating two new types of concessions – the sponsored concession, and the administrative concession. The law also introduced the possibility of government subsidies in order to allow implementation of concessions. Using the vehicle of PPPs, the government was also able to ensure that there was no increase in the public debt.

#### Sector Specific Legislation:

- Law 9,472/97 - This law establishes the organization of the National Communications Agency (*Agência Nacional de Telecomunicações*) (ANATEL) and authorizes the agency to create its own public procurement process and system. Law 9,961/00 – this law created the National Supplementary Health Agency (ANS) and authorizes the agency to create its own public procurement norms
- Decree 7,174/10 – Under Brazilian Constitutional Law, a few specific laws can be made by Presidential decree. In this case, this decree was made in order to regulate the purchase of IT goods and services.
- Law 12,462/11 – this law provides for the “RDC” system (“RDC Law”) (a Portuguese acronym for “Special Procurement System”) This provides for a different public procurement procedure for procurements related to the sports events held in 2016 (Olympic and Paralympic games) and the related infrastructure; and the National Development Program (*Programa de Aceleração do Crescimento*) (PAC), which is a governmental program created to stimulate national development through infrastructure works such as educational institutions and the prison system.
- Law 12,598/12 – this law specifies the process and system that needs to be followed in order to deal with procurement for the purchase and development of defense systems.

During the second half of the 1990s, a state reform and the privatization process that followed it created the conditions to introduce a simple procedure for bidding. In 1997, the Government passed the Federal Law 9.472/1997 that created the regulatory National Agency for Telecommunication (ANATEL). The same law introduced a particular and simple bidding procedure through reverse auction ('pregão') solely applied to that specific new agency (art. 56). In 2001, the Brazilian President produced the Provisory Measure 2.182/2001 (a constitutional instrument that allows the President to legislate in certain cases and for a restricted period without the Congress' previous approval) to extend the reverse auction to all the Federal Government. In 2002, the Congress converted the Provisory Measure 2.182/2001 into the Federal Law 10.520/2002, that officially introduced the reverse auction to all Brazilian public entities, including by electronic systems (Executive Decrees 5.450/2005 and 7.174/2010).

The Federal Law 10.520/2002 presents a concise regulation for the reverse auction in twelve articles, which is currently the principal bidding procedure in the Brazilian Federal Government. The reverse auction is applicable for all kinds of objects and references prices, although there is a strong understanding that it is not valid for works and services of engineering. Its key features are the minimum period of eight days for receipt of tenders' proposals (art. 4, V), the examination of qualifications documents exclusively regarding the bidder that at the end of the auction procedure has offered the best economic proposal (lowest price) (art. 4, VIII), and a single review stage at the end of the procedure (art. 4, XVIII). Consequently, only the bidder that offered the best economic proposal (lowest price) will have its qualification documents examined by the procurement authority (art. 4, XI and XII). As a result, other bidders have less incentives to present their complaints on this stage as they know that they would not be awarded the contract. These characteristics have shortened the period of the bidding procedure and reduced the conflicts between bidders during it.

Nevertheless, all other provisions from the General Law are still applicable in the reverse auction. For instance, even in the reverse auction, all bidders shall present the documents regarding their qualification as stated in the General Law, likewise legal qualification, proof of technical expertise, and regular conditions under fiscal and taxes authorities (art. 27). This means that the General Law keeps its role as the most relevant piece of legislation on public procurement in Brazil.

Table 3.2 sets out Federal Government expenditure on public procurement according with the method of tendering adopted between 2013 and May 2018. It indicates that while the reverse auction method represents the largest value of contracts tendered, the values of tenders where there is no need to bid, or an impossibility of bidding are also significant.

Table 3.2 – Value (BRL) of Federal Government Purchases<sup>76</sup>

	2013	2014	2015	2016	2017	2018 (up to May)
Competition (art. 22, I, Federal Law 8.666/93)	4.799.696.400,21	2.368.991.886,61	1.236.802.676,40	1.419.857.542,73	2.352.900.362,68	156.720.457,71
International Competition (art. 22, § 3, Federal Law 8.666/93)	12.378.228,84	137.755.638,88	9.971.455,43	5.942.354,84	16.328.736,71	212.964,94
Reverse Auction (Federal Law 10.520/2002)	27.440.725,998,89	49.955.243,528,29	16.514.472,543,93	18.428.706,071,58	18.100.846,077,26	4.119.638,856,37
No need to tender (art. 24, Federal Law 8.666/93)	9.148.727,654,34	9.544.138,634,81	9.841.846,104,55	12.524.774,739,71	16.553.047,567,96	4.444.370,656,13
Impossibility of tender (art. 25, Federal Law 8.666/93)	9.668.526,105,25	8.764.319,695,93	15.934.274,958,22	18.509.219,157,94	9.811.161,855,98	2.668.695,536,39
Outlet Prices (art. 22, II, Federal Law 8.666/93)	318.143.595,33	313.191.738,46	150.617.149,53	150.986.729,85	126.181.117,83	18.446.281,93
Invitation (art. 22, III, Federal Law 8.666/93)	12.146.895,76	8.788.595,49	3.758.844,08	6.227.160,01	4.099.378,04	276.885,72
Competition (art. 22, IV, Federal Law 8.666/93)	3.326.912,50	18.591.113,46	4.089.639,47	1.618.472,85	1.065.163,00	276.885,72
Total	51.403.671,791,12	71.111.020,831,94	43.695.833,371,61	51.047.332,229,52	46.965.630,259,46	11.408.765,937,19
Quantity of purchases	159.499	145.085	105.622	105.531	98.738	23.123 (up to June)

<sup>76</sup> Ministry of Planning of Brazil, Purchasing Panel  
<http://paineldecopras.planejamento.gov.br/QvAJAZZfc/opendoc.htm?document=PaineldeCopras.qvw&host=QVS@17-0112-b-ias04&anonymous=true> accessed 14 May 2018.

## **3.2 Public Procurement Law Objectives in Brazil**

The General Law on Public Procurement follows a Constitutional prescription that fixes its basis (art. 22, XXXVII, and art. 37). First, the Constitution determines that the Federal Government has the authority to create by law the ‘general rules for all types of bidding and contracting for governmental entities’ (art. 22, XXXVII). Second, the Constitution determines that the Public Administration shall always comply with the principles of lawfulness, impersonality, morality, publicity, and efficiency (art. 37). Third, the Constitution demands that ‘public works, service, purchases, and disposals shall be contracted by public bidding proceedings.’

The Constitution declares three main objectives for that ‘public bidding proceeding’. Firstly, the procedure shall ensure ‘equal conditions to all bidders.’ Secondly, the public contract shall establish ‘payment obligations’ for the Public Administration. Thirdly, the bidding proceeding ‘shall only allow the requirements of technical and economic qualifications indispensable to guarantee the fulfilling of the obligations’ (art. 37, XXI). However, the Constitution recognizes that the law can create ‘exceptions’ to dismiss the mandatory duty for the Public Administration to contract through bidding proceeding (art. 37, XXI). The constitutional regulation on public concessions complements the public procurement regime. In accordance with it, there is no legal exception to contact concessions without public bidding proceedings (art. 175). Furthermore, the Constitution demands a particular law to regulate public concession (art. 175, Sole Paragraph), which is the Federal Law 8.987/1995.

Alongside the constitutional objectives for bidding procedures, which the General Law of Public Procurement reproduces, this piece of legislation also fixes the selection of ‘the most advantageous proposal for the administration’ (art. 3). Originally, the General Law of Public Procurement reinforced this provision prohibiting the ‘acts of clauses or conditions that compromised, restricted, or frustrated the competitive character’ of the bidding procedure, including through ‘preferences or distinctions’ or ‘other circumstance naughty or irrelevant to the specific object of the contract’ (art. 3, § 1, I).

## **3.3 The Treatment of Small Businesses under the Complementary Federal Law**

The Brazilian public procurement law adopts ‘differential treatment’ for micro and small-sized enterprises on public procurement, in accordance with the Complementary Federal Law 123/2006 (art. 42) (LC 123/2006). It does not include medium sized enterprises under the law. The Complimentary Federal

Law creates the 'statute' for micro and small-sized enterprises (MSEs) in Brazil. This piece of legislation classifies micro-sized enterprise as the ones that present an annual gross revenue equal or below BRL 360.000,00 (art. 3, I). This Complementary Law defines small-sized enterprise as the ones that show an annual gross revenue above BRL 360.000,00 and under BRL 4.800.000,00 (art. 3, II). It should also be noticed that the Federal Law 11.488/2007 introduced a legal provision to extend to the cooperatives all the benefits applied to MSEs on public procurement (art. 34). The cooperatives shall have the same annual gross revenue as stated by the Complimentary Federal Law 123/2006 to MSEs to enjoy these benefits.

Initially, the Law of MSEs created a preference margin for MSE up to 10% of price advantage regarding the best offer (art. 44). The 10% preference margin for Micro and Small Enterprises in Brazil only applies if the MSE is able to cover the best offer made by another non-MSE company. There is a requirement of a minimal number of three competitive MSEs bids, provided that they are able to perform what is contained in the call notice. Further, to get the benefits from the Law of MSEs, the company shall be established under the Brazilian law, and must not be a branch or a representation of a foreign company. There is no overpayment by the Administration, but only the benefit of guaranteeing MSE the right to an additional bid. The electronic procurement modality is used in the majority of bids, in particular those in which MSEs are competitive. As provided in Complementary Law 123/2006, under the electronic procurement modality the margin of preference falls from 10% to 5% (art. 44, § 2).

The Law of MSEs permits micro and small-sized businesses to present their financial documents only in case of awarded contract, in order to sign it (art. 43). Additionally, in case of the financial documents presented irregularity, the Law provides an extra period of three days for its ratification (art. 43, § 1). The benefit to present small businesses financial documents only in case of awarded contract is also provided to all other companies in the case of Reverse Auction System (Pregão) and in the Special Procurement System (RDE Law).

Subsequently, the Complimentary Federal Law 147/2014 amended the Law of MSEs to establishes three extra advantages. Keeping the previously mentioned benefits, i) the law now *obliges* the Public Administration to promote exclusive biddings proceedings for MSEs until BRL 80 thousand (EU 18,3 thousand) for goods, services and work (art. 48, I). Moreover, ii) for constructions and engineer services, the law *allows* the Public Administration to impose for its contractors the duty to subcontract MSEs (art. 43, II). Lastly, iii) in biddings proceeding for divisible goods acquisitions, the Public Administration *shall* also preserve a portion of 25% solely to MSEs.

Yet despite of these benefits, MSEs still represent a small portion of the Federal Government expenditure on public procurement. Between 2013 and 2017, the Federal Government spent BRL 264,2 billion (EU 60,6 billion) on public procurement, from which BRL 71,4 billion (EU 16,3 billion) (26%) contracting micro and small businesses.<sup>77</sup> With regard to this data, it is essential to have in mind that Brazil adopts a system of decentralized procurement, by which each national entity (Federal Government, states government, and municipals government) are responsible for its purchases. Federal expenditure on public procurement does not represent the amount spent by the whole country. The table below shows the Federal Government expenditure on public procurement with MSEs, considering also the method of tendering adopted between 2013 and May 2018.

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<sup>77</sup> Ministry of Planning of Brazil, Purchasing Panel  
<<http://painelcompras.planejamento.gov.br/QvAJAXZfc/opendoc.htm?document=PaineldeCompras.qvw&host=QVS@17-0112-b-ias04&anonymous=true>> accessed 14 May 2018.



Figure 3.3 Value (BRL) of Federal Government Purchase with MSE78

	2013	2014	2015	2016	2017	2018 (up to May)
Competition (art. 22, I, Federal Law 8.666/93)	380.166.486,95	208.231.128,25	137.844.777,63	74.937.984,93	62.386.185,66	13.859.482,75
International Concurrence (art. 22, § 3, Federal Law 8.666/93)	88.150,00	10.188,00	0	165.926,24	0	0
Reverse Auction (Federal Law 10.520/2002)	3.121.763.349,47	32.248.422.890,05	2.440.531.432,04	2.642.395.160,70	2.888.143.769,94	577.968.107,30
No need to bidding (art. 24, Federal Law 8.666/93)	270.267.307,28	326.393.794,15	197.304.225,34	185.486.003,79	180.624.095,71	69.293.867,99
Impossibility to bid (art. 25, Federal Law 8.666/93)	77.963.671,87	111.893.104,30	80.476.697,48	74.995.377,08	74.553.749,43	27.965.479,28
Outlet Prices (art. 22, II, Federal Law 8.666/93)	69.618.801,84	62.977.194,72	30.594.710,74	37.826.693,57	36.320.694,79	7.413.408,54
Invitation (art. 22, III, Federal Law 8.666/93)	4.606.155,61	3.043.144,93	1.194.098,75	2.508.470,75	1.523.708,16	92.135,32
Competition (art. 22, IV, Federal Law 8.666/93)	0	0	24.150,00	121.252,85	0	0
Total	3.924.473.923,02	32.964.543.164,66	2.887.970.091,98	3.018.436.869,91	3.243.552.203,69	696.592.481,18
Quantity of purchases	112.190	100.888	76.923	78.981	74.529	16.197 (up to June 2018)

<sup>78</sup> Data compiled by Guilherme Jardim.

There is no official report that consolidates the numbers above or any official report observing the effects of the Federal Complimentary Law 147/2014 on the participation of small businesses in public procurement. A PowerPoint presentation from the Brazilian Ministry of Planning, Development, and Management entitled *General Information about Public Procurement: Small and Micro Business Enterprises* includes a database from 2008 to 2013. This reveals a slightly increase in the participation of small businesses on federal public contracts during this period. There is no indication of a directly correlation between that fact and the Federal Complimentary Law 123/2006.

The Sandro Cabral, Paulo Ricardo da Costa Reis, and Adilson da Hora Sampaio study shows the behaviour of small businesses on a specific federal foundation (Fundacao Osvaldo Cruz – FIOCRUZ), engaged with scientific research for public health. The research considered the years 2005 up to 2011, 305 electronic reverse auction procedures, and 542 contracts. Small businesses participated in 93% of these bidding procedures, winning 55% of them. Despite 35% of the contracts having been signed after 2006, when the LC 123/2006 entered into force, the paper reveals that big companies achieve better results than small businesses after the LC 123/2006. Between 2005 and 2011, small businesses signed 32% of the contracts, against 42% from big companies. To explain this result, the authors ponder that bigger companies could be more prone to present better prices to exclude small businesses. The research demonstrates that the participation of small businesses in bidding procedures increases as the number of allotments increases and the reference price lowers.

The Federal Law 12.349/2010 amended the General Law of Public Procurement to introduce new purposes for the public procurement system. It includes the ‘promotion of sustainable development’ on the side of the selection of the ‘most advantageous proposal for the public administration’ (art. 3). Under this ‘new’ objective, the law creates preference rights in case of equal proposals (break-even), following this order: for goods and services produced in Brazil, for products and services produced or offered by Brazilian companies, and for goods and services produced or provided by companies that invest in research and technology in Brazil (art. 3, § 2). Furthermore, this amendment authorized ‘preference margins’ for manufactured products and national services (art. 3, § 5, I), again for goods and services produced or offered by companies that employ disabled people (art. 3, § 5, II, amended by the Federal Law 13.146/2015), and for the Mercosur countries (art. 3, § 10). This policy follows a global tendency to explore public procurement ‘to develop an industrial strategy’.<sup>79</sup>

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<sup>79</sup> Kamala Dawar and Seung Chui Oh, *The role of public procurement policy in driving industrial development* (United Nations Industrial Development Organization 2017) 5.

Figure 3.4 Product-specific preference margins in public tendering, 201780

Main products	Preference margin	Decree No.
Capital goods	20%, 15% + 5%	8,224 of 3 April 2014
Chapters 61 and 62 of TIPI + 12 products	20%	7,756 of 14 June 2012
Desktops, Notebooks, and printers	10% + 10%	8,184 of 17 January 2014
Executive airplanes	9% + 16%	8,185 of 17 January 2014
IT and communications equipment	15% + 10%	8,194 of 12 February 2014
Locomotives, train wagons and parts	20%	7,812 of 20 September 2012
Materials (HS 32) and equipment (HS 53)	8%, 15%, 20%, and 25%	7,767 of 27 June 2012 (amended 16 August 2012)
Medicines, pharmaceuticals, and biopharmaceuticals	8%, 20%, and 25% (with technological aggregation)	7,713 of 3 April 2012
Metal coin disc	20%	7,843 of 12 November 2012 (amended 5 December 2012)
Motor grader and backhoe	15% (backhoe); 25% (grader)	7,841 of 12 November 2012
Network equipment	15% (normal); 10% (innovation stimulus)	7,903 of 4 February 2013
Paper for printing paper money	20%	7,810 of 20 September 2012
Software	0% + 18%	8,186 of 17 January 2014
Toys	10%	8,823 of 3 April 2014
Tractors, implements, and drills	15% (tractor); 20% (drill and implements)	7,840 of 12 November 2012
Trucks, ambulance wagons, and trailers	17% (trucks); 15% (ambulance wagons); 14% (trailers)	7,816 of 12 November 2012
Wheel loaders, caterpillar tractors, and related products	15%, 20%, and 25%	8,002 of 14 May 2013

### 3.3.1 Electronic Procurement Auctions in Brazil

The Brazilian public administration has used reverse auctions as a procurement method for off-the-shelf goods – from pharmaceuticals to cleaning services – since 2001. Starting in 2005, it became mandatory for federal agencies to procure off-the-shelf goods through these auctions, and to conduct them online on ComprasNet, a one-stop internet portal for the federal government’s procurement of goods and services.<sup>81</sup> Each year, around 2200 public bodies scattered across the country list around 1 million lots on ComprasNet; in 2012, 0.76 % of Brazil’s

<sup>80</sup> Ministry of Planning, Development and Management online information. Viewed at: <http://www.comprasgovernamentais.gov.br/gestor-de-compras/legislacao-por-assunto#margem>.

<sup>81</sup> Off-the-shelf goods are goods that have precise and concise enough specifications, so that bids can be compared solely based on price. IT equipment for instance qualify as off-the-shelf, whereas engineering projects do not. Although the legislation does not provide a clear-cut definition of an “engineering project”, it is known, for example, to include entire road resurfacing works. On the other hand, reverse auction are sometimes used to procure small demolition work. Federal Law 8666/93 regulates public procurement in Brazil, and Federal Law 10520/2002 are specific to procurement auctions. For a detailed description of public procurement in Brazil, see World Bank (2004).

GDP – or R\$ 33.6 billion worth of contracts accounting for 46 % of the federal government’s procurement spending – was awarded through ComprasNet auctions. In short, these auctions represent a large share of federal tenders and a substantial amount is contracted through them every year. Under the Complementary Law 123/2006, the margin of preference falls from 10% to 5% (art. 44, § 2) when using the electronic procurement modality.

Over 65,000 firms have placed bids in the ComprasNet platform for contracts to supply the government with various goods and services. To encourage participation, especially among small firms, the registration process which is done online is fairly streamlined and simple. And while participation in some specific auctions may involve additional requirements – for example, in the case of service contracts, a public body may ask firms to provide proof that they have the capacity to deliver the same type of service at a similar scale – most of the documents supporting a firm’s bid are submitted *after* winning an auction, which again lowers the cost of participating.

### 3.4 The Public Procurement Market in Brazil

Brazil is the largest economy of Latin America. Its trade with the EU makes up 30.8% of the EU’s total trade with the Latin America region in 2016.<sup>82</sup> Few studies measure the size of public procurement market in Brazil, which is to the detriment of policy making.<sup>83</sup> One recent study estimates public procurement market as a percentage of GDP, including all branches and entities of the Brazilian public sector, to be 13.0% in 2007, peaking at 14.5% in 2012, comparable with most OECD countries.<sup>84</sup> This analysis finds that over the period 2006–2012, the federal direct administration expenditures represented on average 0.7% of GDP, whereas federal indirect administration acquisitions of goods and services reached a value equivalent to 7.2% of GDP.

This highlights the significant contribution of independent state-owned companies’ productive sector and particularly, the acquisitions made by Petrobras. See Figure 3.5. The spending of Petrobras alone took up 4.9% of GDP; representing

<sup>82</sup> EU website <http://ec.europa.eu/trade/policy/countries-and-regions/countries/brazil/>

<sup>83</sup> Marques, F. S. (2006). *Compras Públicas no Brasil e EUA: análise da concorrência segundo o paradigma estrutura-conduta-desempenho*. Finanças públicas: X prêmio tesouro nacional, 2005: coletânea de monografias (pp. 409–427). Sao Paulo: Ágape Editores. Ribeiro, C. G. (2009). *Compras governamentais e aprendizagem tecnológica: uma análise da política de compras da Petrobras para seus empreendimentos offshore*. Doctorate, Universidade Estadual de Campinas. Retrieved from UNICAMP: <http://repositorio.unicamp.br/handle/REPOSIP/287515>

<sup>84</sup> Ribeiro, C. G. & Furtado, A. T. 2014. Public procurement Policy in Developing Countries: The Case of Petrobras. *Science Technology & Society*, 19, 161-197.

over half of total federal government spending on purchases of goods, services and works. Petrobras' procurement activities have clear implications for the overall development of Brazil.<sup>85</sup> Overall, the study indicates that the federal government is the largest buyer in Brazil - 7.9%, followed by the municipalities, averaging 3.5%, and then by the states, averaging 2.4%. In OECD countries, the federal government is typically not the main buyer. Again, this is because the large volume of purchases made by Petrobras greatly increases the federal government's purchases. The presence of such a dominant state-owned oil company in Brazil is certainly not comparable with most OECD member countries.

*Figure 3.5 Public Procurement of Brazil, Second entity (in R\$ billion – current prices)*

Year	Federal government <sup>1</sup>		State <sup>2</sup>		Municipalities <sup>2</sup>		Total		
	Value	% GDP	Value	% GDP	Value	% GDP	R\$	% GDP	GDP
2006	176	7.4	59	2.5	85	3.6	320	13.5	2,369
2007	194	7.3	58	2.2	96	3.6	347	13.0	2,661
2008	242	8.0	76	2.5	117	3.9	436	14.4	3,032
2009	253	7.8	88	2.7	103	3.2	444	13.7	3,239
2010	305	8.1	103	2.7	121	3.2	529	14.0	3,770
2011	309	7.5	92	2.2	141	3.4	542	13.1	4,143
2012	381	8.7	94	2.1	161	3.7	637	14.5	4,392
<i>Total average</i>	<i>1,861</i>	<i>7.9</i>	<i>571</i>	<i>2.4</i>	<i>823</i>	<i>3.5</i>	<i>3,255</i>	<i>13.8</i>	<i>23,608</i>

<sup>1</sup>MPOG (2013 and 2014).

<sup>2</sup>FINBRA (2006–2012). Prepared by the authors.

Source: SIAFI Management (2006–2012). See Table 2 column Total.

<sup>85</sup> *Ibid.*

Figure 3.6 Public Procurement of federal government (in R\$ billion – current prices)

Source →	SIAFI Management				MPOG										
	Direct		Indirect <sup>1</sup>		State-owned Productive Sector—SPE										
Year			Bodies of the Indirect administration and dependent state-owned companies <sup>2</sup>		Petrobras Group		Eletrobras Group		Others		IFOF <sup>4</sup>		Total		
	Value	% GDP	Value	% GDP	Value	% GDP	Value	% GDP	Value	% GDP	Value	% GDP	R\$	% GDP	GDP
2006	20	.8	20	.9	98	4.1	17	.7	7	.3	14	.6	176	7.4	2,369
2007	18	.7	19	.7	118	4.4	18	.7	8	.3	13	.5	194	7.3	2,661
2008	20	.7	20	.7	155	5.1	22	.7	8	.3	16	.5	242	8.0	3,032
2009	23	.7	27	.8	155	4.8	21	.6	10	.3	17	.5	253	7.8	3,239
2010	30	.8	35	.9	188	5.0	23	.6	11	.3	17	.4	305	8.1	3,770
2011	29	.7	32	.8	190	4.6	26	.6	13	.3	19	.5	309	7.5	4,143
2012	32	.7	32	.7	251	5.7	29	.7	15	.3	23	.5	381	8.7	4,392
<i>Total average</i>	<i>173</i>	<i>.7</i>	<i>185</i>	<i>.8</i>	<i>1,155</i>	<i>4.9</i>	<i>157</i>	<i>.7</i>	<i>72</i>	<i>.3</i>	<i>118</i>	<i>.5</i>	<i>1,861</i>	<i>7.9</i>	<i>23,608</i>

Notes. <sup>1</sup>Sum of the indirect federal administration bodies, including state-owned companies (dependent and non-dependent).

<sup>2</sup>According to article 2 item III of complementary Law No. 101, of January 4, 2000, the **dependent state-owned companies** are controlled by the federal government, which receives funds from the National Treasury for the payment of expenses with personnel, general or capital expenditures, excluded in the latter case, those from shareholding increase. A few examples are: Centro Nacional de Technology Eletrônica Avançada S.A. (CEITEC); Brazilian Urban Train Company (CBTU); National Supply Company (CONAB); and the Brazilian Agricultural and Livestock Research Company (EMBRAPA). For a complete list see the 2013 Annual Report: Budgetary implementation of state-owned companies Base Year of 2012 (MPOG, 2013, p. 14). On the other hand, the other federal government bodies, part of the indirect administration, which are dependent, are the following: Autarchies, Foundations, State-owned Commercial and Financial companies, Mixed Economies and Funds.

<sup>3</sup>**State-owned non-dependent companies** are those controlled by the federal government that **DO NOT** receive funds from the National Treasury for the payment of expenses with personnel, general or capital expenditures.

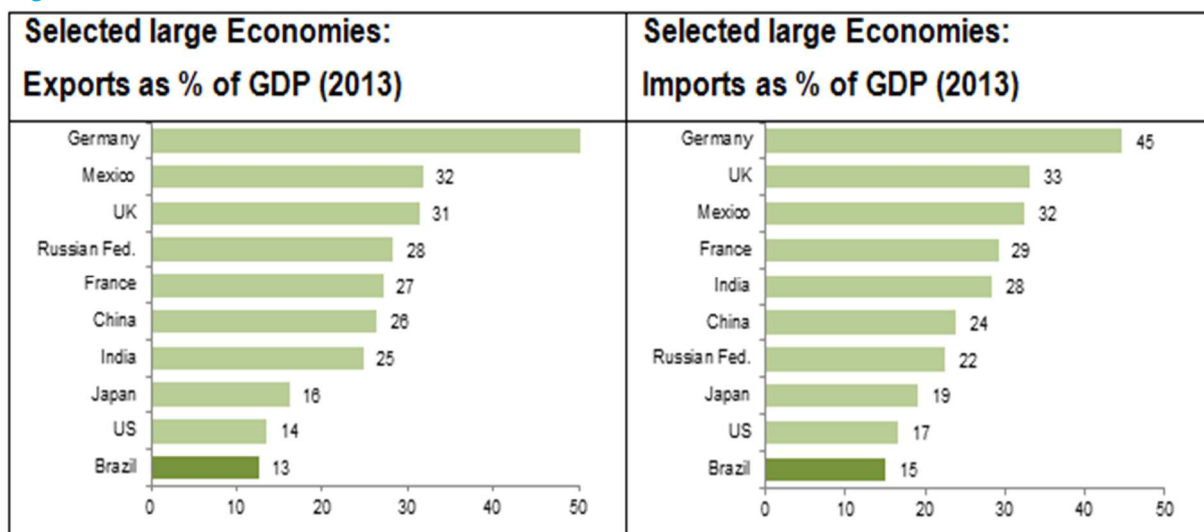
<sup>4</sup>Official federal financial institutions. Prepared by the authors.

Source: SIAFI Management (2006 to 2012); MPOG (2013; 2014).

### 3.5 Brazil's Export Opportunities

Brazil has high tariff barriers to imports, with an average (trade-weighted) tariff rate of 8.3 % in 2015. This is the highest rate in comparison to other emerging and advanced economies.<sup>86</sup> The import structure in Brazil has remained this way since 2004. According to traditional macro-level measures of trade penetration – the share of exports and imports in GDP - Brazil is a relatively closed economy, at 27% in 2013. The other BRICS countries reached trade-to-GDP ratios of at least 50% by 2013, while data from 176 countries shows that the average trade-to-GDP ratio is 96%. Even among the six countries with a larger economy than Brazil, the average is 55%.<sup>87</sup> Brazil is not alone – other Latin American countries also have a low trade penetration relative to the rest of the world (controlling for size and other characteristics).

Figure 3.7 Brazil's relative closedness to trade<sup>88</sup>



Very few Brazilian firms export.<sup>89</sup> The share of exporters among all formal-sector firms is less than 0.5%. Brazil's number of exporters relative to the population is low even when controlling for GDP per capita. Figure 3.8 highlights Brazil's relative lack of exporting firms. Out of all Brazilian exporters, a small number of

<sup>86</sup> This number considers bilateral preferences. The simple average MFN tariff rate was 13.5 for Brazil in 2016. Jose Guilherme Reis, Mariana Ito, Jose Signoret, Tanja Goodwin, Martha Licetti, Alice Duhaut, Somik Lall. Macroeconomics, Trade Liberalization and Integration of Domestic Output Markets in Brazil. World Bank. Trade and Investment Global Practice October 2018 WPS8600.

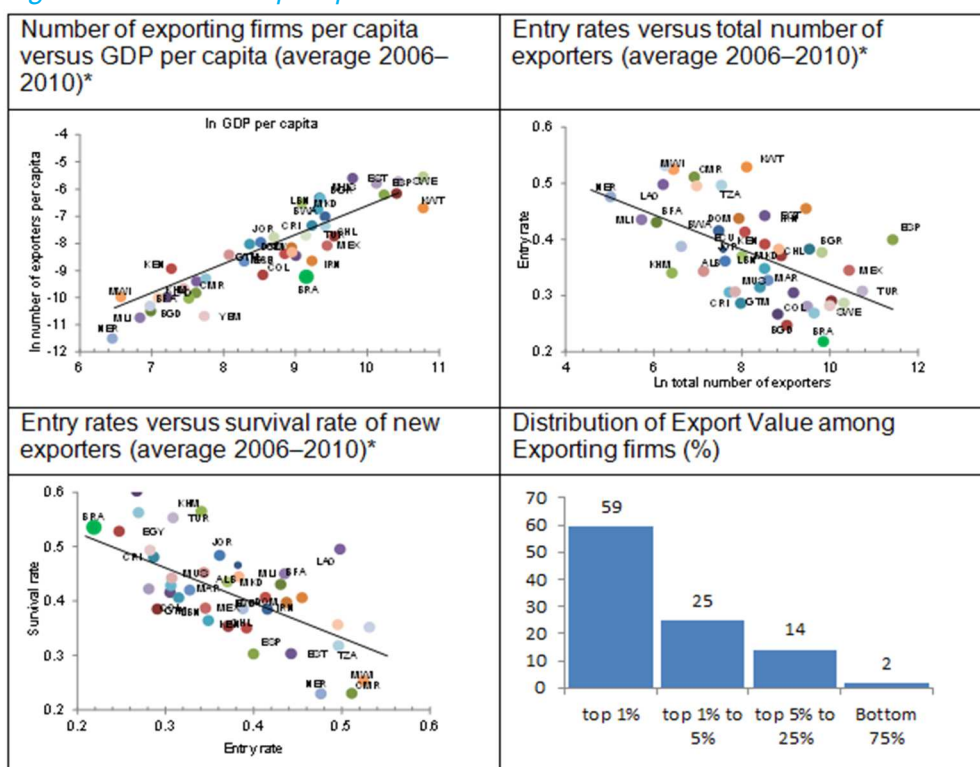
<sup>87</sup> Available through the World Bank's 2013 World Development Indicators (WDI) database

<sup>88</sup> *Ibid.*

<sup>89</sup> World Bank (2014), "Implications of a changing China for Brazil: a new window of opportunity?", World Bank Working Paper 89450.

firms make up the overwhelming share of exports – the top 1% of exporting firms generates 59% of total exports, while the top 25% of firms account for 98% of exports.<sup>90</sup> Moreover there was little dynamism among Brazilian exporters. Even given the small number of exporters, Brazil has a very low entry rate – very few firms become new exporters. Conversely, Brazilian exporters have a very high survival rate, meaning that the few firms that export are likely to continue doing so. These are long term barriers to entry that micro and small businesses must seek to overcome if they are to enter export markets.

Figure 3.8 Brazil's export performance indicators<sup>91</sup>



Brazil has a very high share of domestic value added in total exports. It is the highest among the economies covered by the OECD-WTO Trade in Value Added database. Brazil's absence from global production networks and resulting density of domestic value can only in part be explained by the relative distance, both geographical and institutional, from major economic centers. It is also seen in

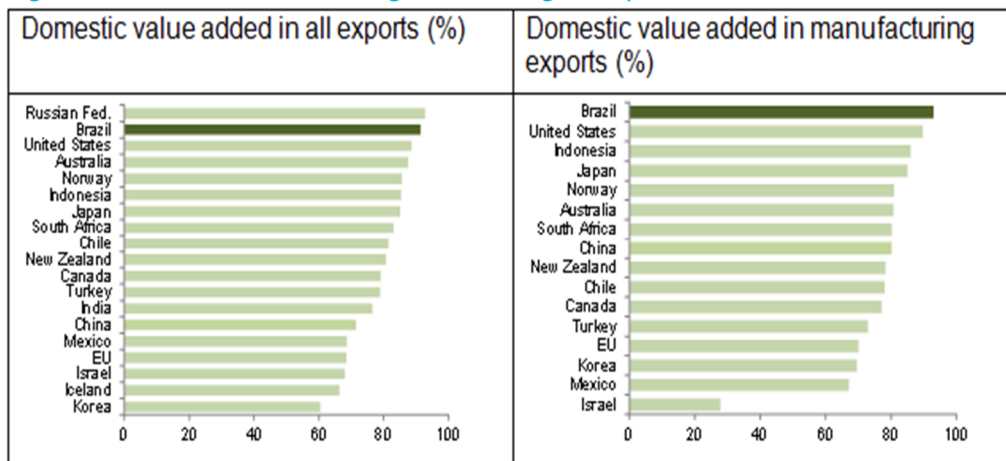
<sup>90</sup> Otaviano Canuto Cornelius Fleischhaker. The Curious Case of Brazil's Closedness to Trade. VoxEU. Exporter dynamics database. <https://voxeu.org/article/brazil-s-closedness-trade>.

<sup>91</sup> Charts and data from World Bank (2014); Data source: Exporter dynamics database



large part as a result of policy decisions past and present on trade tariffs and local content.<sup>92</sup>

Figure 3.9 Brazil's lack of integration into global production networks<sup>93</sup>



The high level of domestic value added in exports shows the fragmentation of the production process along cross-border value chains. It indicates that a very important part of the second wave of globalization has largely bypassed Brazil.<sup>94</sup> In addition to high tariff rates affecting the general economy, the widespread use of non-tariff barriers to international trade and competition has further raised the costs of goods and services. The ad-valorem equivalent of non-tariff measures (NTMs) – a measure of effective restrictiveness of NTMs – is almost 12 %.<sup>95</sup> In addition to imposing domestic preferences in public procurement, Brazil also imposes preferences or local content requirements to a growing number of products in the wider economy. For instance, in 2012, the Brazilian authorities issued regulations related to the industrial and trade regime for the automotive, oil and gas sectors. A recent study mapping the use of LCR measures applied between 2008 and April 2014 in several countries around the world indicates that during this period, Brazil was second only to Indonesia in the number of local content requirements (LCRs) used, with 17 LCRs in force.<sup>96</sup> Over the past

<sup>92</sup> Canuto, O. 2014 What's Holding Brazil Back. <https://www.project-syndicate.org/commentary/otaviano-canuto-identifies-several-growth-traps-that-have-stopped-brazil-s-ascent-to-high-income-status?barrier=accesspaylog>.

<sup>93</sup> World Bank (2014).

<sup>94</sup> Baldwin, R (2011), "Trade and Industrialisation after Globalisation's 2nd Unbundling: How Building and Joining a Supply Chain are Different and Why It Matters", NBER Working Paper 17716.

<sup>95</sup> Jose Guilherme Reis, Mariana Iotty, Jose Signoret, Tanja Goodwin, Martha Licetti, Alice Duhaut, Somik Lall. Macroeconomics, Trade Liberalization and Integration of Domestic Output Markets in Brazil. World Bank. Trade and Investment Global Practice October 2018 WPS8600.

<sup>96</sup> *Ibid.*

decade, Brazilian firms have faced serious competitiveness challenges, not only the real appreciation but from defensive trade policy reactions.<sup>97</sup> This means that only the most efficient firms or larger firms benefiting from significant economies of scale are able to overcome barriers to export. This should explain some of the concentration of exports among a small number of large firms.<sup>98</sup>

Brazil experienced a period of trade liberalization in the early 1990s. Empirical evidence indicates that the unilateral trade liberalization episode of the late 1980s - early 1990s brought positive payoffs to productivity. During this time, tariffs fell from extremely high levels of 90 % to 20 % in wearing apparel. Several studies examining 1988-1998 data indicate that the trade liberalization episode that took place in Brazil in the late 1980s and early 1990s brought positive impacts for productivity in the manufacturing industry and that the main driver of productivity growth was the reduction of input tariffs.<sup>99</sup> Recent policy simulations, obtained from a customized Computable General Equilibrium (CGE) model, point to substantial gains from trade liberalization in Brazil. The largest economy wide gains would come from coordinated trade reforms within Mercosur. The second largest economy wide gains would come from a reciprocal preferential trade agreement between Mercosur and the EU.

### **3.6 Brazilian Small Business Participation in Public Procurement Markets**

A NBER study on Brazilian procurement contract auctions<sup>100</sup> found that winning a government contract has a significant effect on firm growth both during the quarter in which they win, as well as over the medium horizon. These effects are

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<sup>97</sup> Canuto, O, M Cavallari, and J G Reis (2013), "Brazilian Exports Climbing Down a Competitiveness Cliff", World Bank Policy Research Working Paper 6302; Canuto, O, M Cavallari, and J G Reis (2013b), "The Brazilian competitiveness cliff", VoxEU.org, 27 February; Canuto, O (2014), "The High Density of Brazilian Production Chains", World Bank Let's Talk Development blog, 13 November.

<sup>98</sup> Cornelius Fleischhaker WEF VoxEU.

<sup>99</sup> This number considers bilateral preferences. The simple average MFM tariff rate was 13.5 for Brazil in 2016. Jose Guilherme Reis, Mariana Iooty, Jose Signoret, Tanja Goodwin, Martha Licetti, Alice Duhaut, Somik Lall. Macroeconomics, Trade Liberalization and Integration of Domestic Output Markets in Brazil. World Bank. Trade and Investment Global Practice October 2018 WPS8600.

<sup>100</sup> Claudio Ferraz Frederico Finan Dimitri Szerman Procuring Firm Growth: The Effects of Government Purchases on Firm Dynamics. NBER Working Paper 21219 <http://www.nber.org/papers/w21219>. This study combines the universe of procurement contracts auctioned out by Brazil's federal government over the internet during the period of 2005 to 2010 with matched employer-employee data for the universe of formal firms in Brazil.

also larger for younger firms, conditional on size. Winning at least one contract in a given quarter increases firm growth by a sizable 2.2 percentage points over the quarter. These effects persist over time as firms experience growth for at least 2 years after winning a contract, which is well beyond the time when most government contracts have expired. Firms that win a close auction participate in 30 % more auctions over the next three months compared to those firms that barely lose. Moreover, a year later, close winners participate in 20 % more auctions than close losers over a 30-day window. These participation effects translate into higher win rates, and significantly more contract winnings.

This study also finds that winning a close auction affects the markets firms enter and the products they supply. Winners are more likely to participate in auctions where the buyer is located outside of their municipality and increase the number of products they compete for in auctions. These diversification effects are present both in the short and long run. This suggests that winning government contracts through auctions increase firm growth not only because firms are more likely to get more contracts in the future, but also because they enter more valuable auctions, penetrate more markets, and also increase the variety of products they sell. In tracking whether workers that are hired come from other firms or from unemployment or the informal sector, the study indicates that 93 % of the growth in new hires comes from individuals who were either unemployed, in the informal sector, or outside the labor force. Thus, government contracts create new formal sector jobs, and do not simply induce a reallocation of workers across firms in a given locality.

The authors explain these persistent effects two ways. First, winning a government contract could be providing information to the firm about the demand for its products. As firms learn more about their demand over time, they decide to grow. By winning a government contract, firms may start to realize that their products can be sold not only to their own local government, but to governments in neighboring municipalities and states. Second, winning a government contract may encourage firms to invest more in organizational and human capital. If firms are credit constrained, then winning a government contract could allow firms to further invest in organizational upgrading and are likely to become more competitive and productive over time. These results do not necessarily imply that government purchases are an effective way to foster growth and employment. To address this question, it is necessary to have information on what happens to other firms located in the same area as winning firms, and whether the effects spill over to downstream suppliers.

## 3.7 Brazil and the International Market

### 3.7.1 The WTO GPA

Brazil is an observer but not a signatory party to the WTO GPA. It therefore does not have access to the procurement markets that have been scheduled under this agreement. Nevertheless, if a large public procurement involves significant government subsidies to a Brazilian firm, which causes adverse effects to a foreign company's legitimate market expectations, Brazil's measure may be in violation of the WTO Agreement on Subsidies and Countervailing Duties or the GATT Article III National Treatment obligations, as seen in the WTO dispute settlement body findings in the *Canada-Feed-in Tariff* and *India - Solar Cells* cases.

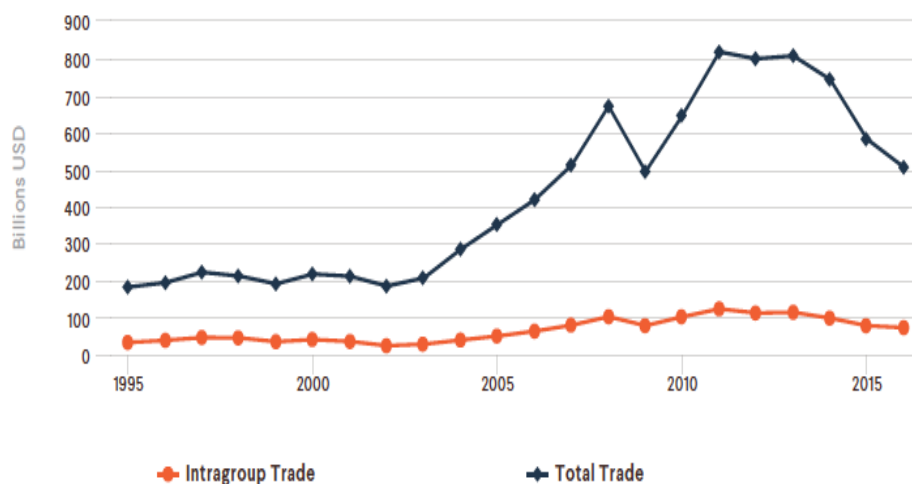
### 3.7.2 The Mercosur Protocol on Public Procurement

Of all of Brazil's regional trade agreements with procurement provisions, the Mercosur Protocol on Public Procurement is the most comprehensive treaty Brazil has signed including public procurement market access commitments. Mercosur has a sizeable market, and trade increased rapidly among Mercosur member countries, reaching 21% of their total trade in 1995 (with a peak in 1998), although by 2008 it had declined sharply to 15%. Total trade increased dramatically during the 2008-2010 global financial crisis, declining since then. Figure 3.10 sets out values for total and intragroup trade over 20 years.<sup>101</sup>

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<sup>101</sup> <https://vertigo.cfr.org/background/mercotur-south-americas-fractionous-trade-bloc>

Figure 3.10 Mercosur: Merchandise Trade



The Protocol of Public Procurement of Mercosur applies to the procurement entities scheduled in the Annexes to the agreement for goods and services and construction services that are equal or greater than the specified value thresholds.<sup>102</sup> The Protocol sets out non-discrimination, transparency and competitive tendering requirements and procedures, along with a bid challenge and dispute settlement mechanism. The objectives of the Protocol also stipulate that processes of public contracting of goods and services will be oriented to promote the sustainable development of the States Parties. Moreover, the benefits of the agreement are denied if the provider of another State Party does not conduct substantive business operations in the territory of any other State Party.<sup>103</sup>

Article 27 is dedicated to the facilitation of the participation of the micro, small and medium enterprises (MIPYMES). It calls for transparent objective criteria when according preferential treatment to small businesses, providing information on such measures where available. However, other than access to information and

<sup>102</sup> Under the market access commitments set out in the annexes to the Protocol, Brazil has listed entities related to Executive Power, including the Presidential procurement; most Ministries, including health, education, finance; nine entities under the Judicial Branch; three entities under Legislative branch, the Chamber of Deputies, Federal Senate and Court of Auditors of the Union. Five entities are explicitly excluded, including Brazilian Space Agency, the National Institute for Industrial Property and the National Institute of Colonization and Agrarian Reform. Brazil notes to its list of entities state that the Protocol does not apply to certain IT services of the Presidência da República, Ministério das Relações Exteriores e Ministério da Justiça; certain medical procurements of the Ministério da Saúde; and some acquisitions from the Ministerio da Defesa and the Ministry of Education.

<sup>103</sup> Article 8 - Denial of Benefits.

training, the Protocol does not provide specific measures to grant preferences or offsets to small businesses in public procurement contracts. This discretion is left to the Member Parties subject to transparency requirements.

### *3.7.3 Brazil's RTAs*

Brazil has already signed RTAs with procurement agreements with Peru and Chile, and is currently carrying out negotiations with Mexico, Colombia and Canada.<sup>104</sup> Mercosur has also been active in negotiating RTAs with Chile, India, Mexico and Egypt. The proposed Mercosur – EU RTA also contemplates the inclusion of public procurement provisions.

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<sup>104</sup> [www.efe.com/efe/english/business/brazil-sees-opening-gov-t-procurement-as-tool-of-regional-integration/50000265-3617989](http://www.efe.com/efe/english/business/brazil-sees-opening-gov-t-procurement-as-tool-of-regional-integration/50000265-3617989)

## 4. EU Public Procurement Market Access

### 4.1 International Market Access Opportunities

From the 1970s, EU procurement legislation has evolved along with the development of international commitments. Prior to the single European market, legislation was initially based on OECD rules, which allowed contracting agencies within the Member States much discretion to promote national champions in procurement markets. Cross-border internal competition was low, with an estimated 4% of public contracts in Germany going to non-national suppliers, and less than 1% in Member States such as Italy and Britain.<sup>105</sup> However, even after legal barriers or the *de jure* preferences were dismantled to achieve a Single European Market (SEM), it remained difficult to introduce internal competition until national companies merged and made significant EU wide investments. The SEM development, when bolstered by harmonized transparency and award procedures, opened up procurement markets at both central and sub-central levels of government within the EU market to an unprecedented extent internationally. This regional evolution allowed the EU to shape international agreements, most notably the WTO GPA, along the lines of the EU model, because it was already more developed in its approach and experience.

The EU has included efforts to open public procurement markets in the regional and bilateral agreements it has negotiated. The scope of rules and coverage of sectors has increased over time. Earlier EU preferential agreements, such as the Association Agreements with the Euro Med partners and the Trade, Cooperation and Development Agreement with South Africa included only a short non-binding objective of opening procurement markets. More recent RTAs negotiated by the EU, such as the EU-Canada CETA, include both transparency requirements and rules governing the notification and award of public contracts that are broadly in line with the GPA rules and commitments in terms of coverage. The EU is currently contemplating an EU-Mercosur RTA. Previous attempts to negotiate an EU-MERCOSUR agreement broke down in the early 2000s, partly due to Brazil's rejection of any inclusion of public procurement.

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<sup>105</sup> Woolcock, S. Public Procurement in International Trade. INTA Committee Report. EP/EXPO/B/INTA /FWC/2009-01/Lot7/28. 2012.

## 4.2 *De Jure* Access to International Public Procurement Markets: EU RTAs

In addition to the EU's commitments under the WTO GPA, the EU has signed various RTAs with public procurement provisions. See Figure 4.1 The procurement provisions range from best endeavor principles of non-discrimination and transparency, to fully comprehensive chapters that extend market access and procedural provisions beyond the requirements of the WTO GPA. The plurilateral European Economic Area (EEA) (1994) and EU CARIFORUM (2008) agreements, as well as the bilateral agreements with Iraq (2012), Georgia (2014) and Moldova (2014) have substantial provisions on public procurement. RTAs including such comprehensive procurement chapters were first concluded with Colombia and Peru but have also been negotiated with Central America and the Andean countries.

In 2014, the **EU- Canada CETA** agreement with Canada was finalized. The CETA agreement contains a comprehensive WTO GPA+ coverage in commitments. However, it only specifically references small businesses under the provision covering the Committee on Public procurement, and the provision is non-binding best endeavor without enforcement capacity. Article 19.19 establishes that the Committee shall *upon request of a Party* meet to:

*d) consider the promotion of coordinated activities to facilitate access for suppliers to procurement opportunities in the territory of each Party. These activities may include information sessions, in particular with a view to improving electronic access to publicly-available information on each Party's procurement regime, and initiatives to facilitate access for small and medium-sized enterprises.*

The **EU-Korea RTA** expands the parties' WTO GPA commitments, and seeks to ensure that European small businesses are treated as Korean small businesses when competing for these contracts. The most recent RTA negotiated under the **EU – Japan** agreement does not reference small businesses under its public procurement chapter, it rather dedicates Chapter 20 to small businesses. This is an unusual framework within EU RTAs. The provisions seek to ensure small business contact points and dedicated websites are established by the parties to provide information relating to the agreement that would enable small businesses to further benefit from the opportunities provided by the Agreement. The provisions also stipulate that the parties shall ensure that there are linked websites to provide information on, inter alia, publication of notices for public procurement and will endeavor to make the information available in English. However, the provisions of the small business chapter are not subject to the



dispute settlement chapter of the RTA. This potentially weakens their enforceability.

*Figure 4.1 EU RTAs with Procurement Provisions*

RTA Name	Coverage	Date of entry into
EU - Albania	Goods & Services	01-Dec-2006(G) /
EU - Algeria	Goods	01-Sep-05
EU - Bosnia and Herzegovina	Goods & Services	01-Jul-2008(G) / 01-
EU - Cameroon	Goods	04-Aug-14
EU - Canada	Goods & Services	21-Sep-17
EU - CARIFORUM States EPA	Goods & Services	29-Dec-08
EU - Central America	Goods & Services	01-Aug-13
EU - Chile	Goods & Services	01-Feb-2003(G) /
EU - Colombia and Peru	Goods & Services	01-Mar-13
EU - Côte d'Ivoire	Goods	03-Sep-16
EU - Eastern and Southern Africa States	Goods	14-May-12
EU - Egypt	Goods	01-Jun-04
EU - Georgia	Goods & Services	01-Sep-14
EU - Iceland	Goods	01-Apr-73
EU - Israel	Goods	01-Jun-00
EU - Japan	Goods & Services	pending since 2018
EU - Jordan	Goods	01-May-02
EU - Korea, Republic of	Goods & Services	01-Jul-11
EU - Mexico	Goods & Services	01-Jul-2000(G) / 01-
EU - Moldova, Republic of	Goods & Services	01-Sep-14
EU - Montenegro	Goods & Services	01-Jan-2008(G) /
EU - Morocco	Goods	01-Mar-00
EU - Norway	Goods	01-Jul-73
EU ñ Overseas Countries and Territories	Goods	01-Jan-71
EU - Palestinian Authority	Goods	01-Jul-97
EU - SADC	Goods	10-Oct-16
EU - Serbia	Goods & Services	01-Feb-2010(G) /
EU - South Africa	Goods	01-Jan-00
EU - The former Yugoslav Republic of	Goods & Services	01-Jun-2001(G) /
EU - Tunisia	Goods	01-Mar-98
EU - Turkey	Goods	01-Jan-96
EU - Ukraine	Goods & Services	23-Apr-14
European Economic Area (EEA)	Services	01-Jan-94

### 4.3 EU Cross-border Procurement Markets

A 2017 European Commission study on cross-national border effects concluded that even after controlling for physical distance, currency, cultural differences, and other variables they were sizeable.<sup>106</sup> "Local" bidders were over 900 times more likely to be awarded a contract than "foreign" bidders. Moreover, substantial cross-regional border effects were also identified within countries. These border

<sup>106</sup> Benedikt Herz α and Xosé-Luís Varela-Irimia. Border Effects in European Public Procurement Chief Economist Team, Directorate General for Internal Market, Industry, Entrepreneurship and small businesses, European Commission. June 2017.

effects existed for all types of goods and services. The study also found evidence that firms' bidding decisions are already subject to border effects, and the authors could not exclude a home bias of contracting authorities in the award of public contracts.<sup>107</sup>

In the EU, import penetration in the public sector remains significantly lower than in the private sector. In 2005 public sector import penetration stood at 7.5%, compared to private sector import penetration of 19.1%. The gap between public and private sector import penetration narrowed slightly in the period 1995-2005.<sup>108</sup> Figure 4.2 sets out more recent estimations of the penetration ratio of public procurement markets. It indicates that while the EU has opened its markets consistently since 1995, its penetration ratios are roughly similar to the US, and below Turkey, India and China. Brazil is the country with consistently the smallest ratio of penetration in public procurement markets over 1995-2007. Russia's penetration ratio shrank below Brazil from 2007-2009.

*Figure 4.2 Penetration ratios of public procurement markets selected countries and years*

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Australia	5.1	5.0	5.4	5.4	5.9	5.9	5.8	6.1	5.9	5.9	6.0	5.9	6.2	5.7	5.3
Brazil	2.1	2.0	2.1	2.1	2.7	3.1	3.5	3.5	3.3	3.3	3.1	2.9	3.0	3.3	2.8
Canada	4.2	4.3	4.6	4.9	5.1	5.1	5.0	4.9	4.7	4.7	4.9	4.6	4.6	4.8	4.8
China	3.8	3.1	3.3	2.8	3.0	3.4	3.3	3.6	5.5	5.5	5.6	5.7	5.2	7.9	6.1
EU27 extra	2.6	2.7	2.8	2.7	2.8	3.6	3.7	3.5	3.7	3.7	4.2	4.6	4.5	5.3	4.5
EU2 extra	2.2	2.2	2.4	2.3	2.3	2.8	3.1	2.9	2.8	3.0	3.4	3.8	3.9	4.3	3.5
India	4.2	4.4	4.0	4.4	4.5	4.4	4.0	3.5	4.6	4.6	5.8	6.3	6.3	6.2	5.7
Indonesia	7.9	7.8	7.9	13.9	9.3	11.4	11.6	9.5	9.9	9.9	10.6	8.9	8.8	8.8	6.1
Japan	1.9	2.2	2.3	2.1	2.0	2.3	2.3	2.4	2.8	2.8	3.2	3.8	4.2	5.3	3.5
Korea	7.5	7.5	8.4	8.1	7.7	9.6	9.3	8.9	9.7	9.7	9.9	9.9	10.2	13.9	11.2
Mexico	4.8	4.9	5.2	5.1	4.9	5.2	4.9	4.5	5.6	5.6	5.8	5.9	6.3	6.4	5.7
Russia	3.3	3.5	3.6	4.6	6.2	5.3	4.7	4.2	3.7	3.7	3.8	3.3	3.1	3.1	2.5
Taiwan	9.9	10.1	10.8	11.9	10.7	10.5	10.2	11.3	12.4	12.4	11.9	12.9	13.5	12.9	11.9
Turkey	5.4	7.3	6.5	5.2	4.4	5.8	7.2	8.3	8.8	8.8	9.5	11.3	10.9	13.0	9.5
United State	2.7	2.8	2.9	2.8	3.0	3.6	3.5	3.3	4.0	4.0	4.4	4.3	4.4	4.8	3.7
Rest of Wor	6.4	6.8	6.9	6.9	6.7	7.1	7.2	7.9	8.8	8.8	9.4	9.1	9.1	10.1	8.3
World	4.2	4.5	4.6	4.6	4.6	5.1	5.2	5.2	6.0	6.0	6.4	6.7	6.8	7.6	6.3

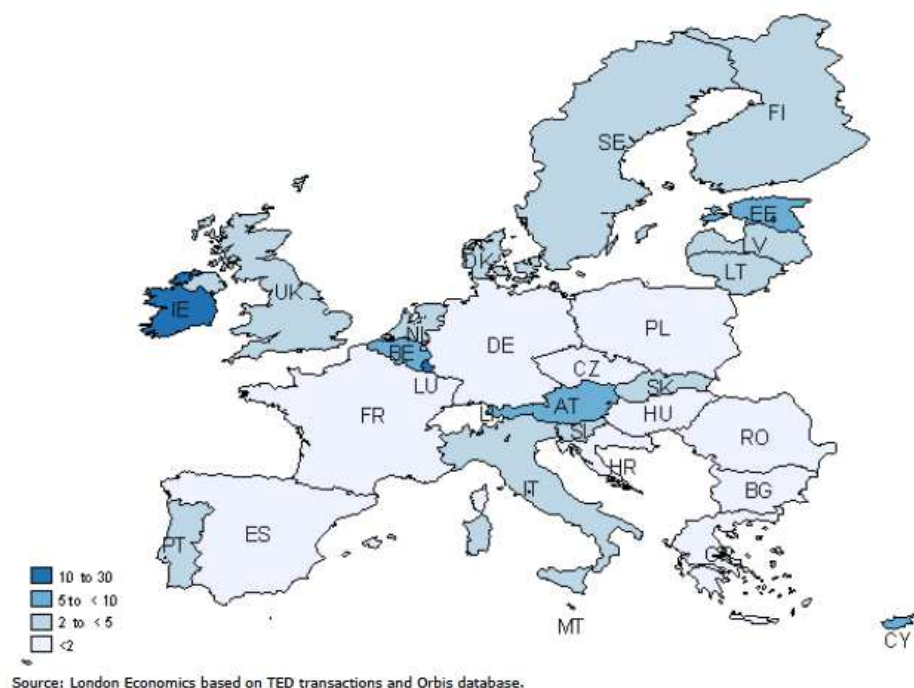
Source: World Input-Output Database 2012. Messerlin and Miroudot 2012. All the 14 individual countries show a marked decline in the penetration ratios between 2008 and 2009. The fall is huge—higher than 10 percent except for only four countries (Australia, Canada, India and Taiwan). There is little doubt that this evolution is, at least partly, related to the stimulus packages enforced during the 2007-2008 crisis peak. These packages have had a “domestic bias” for different reasons: they may have focused on public demand in sectors having relatively low foreign penetration (a mere composition effect) or they may have used procedures discriminating against foreign competitors (a protectionist effect). As the year 2009 is the only exceptional year in the current database, the text focuses on the period 1995-2008.

<sup>107</sup> Benedikt Herz and Xosé-Luís Varela-Irimia. Border Effects in European Public Procurement Chief Economist Team, Directorate General for Internal Market, Industry, Entrepreneurship and small businesses, European Commission. June 2017.

<sup>108</sup> The low level of public sector import penetration can be explained in large part by the nature of the goods and services that the public sector consumes. Public administration, education, health and social services make up more than 60% of public sector expenditure (25.3%, 14.3% and 21.2% respectively in 2005). These sectors have import penetration close to zero (0.1%).

Direct cross-border procurement accounted for 1.6% of awards or roughly 3.5% of the total value of contract awards published in TED during 2006-9.<sup>109</sup> Figure 4.3 presents Member State's share of direct cross border awards, between 2009 and 2015. The majority of EU Member states' direct cross border share in the number of awards remained under 5%, and direct cross-border shares of number of awards are above 10% in only three countries – Malta, Ireland and Luxembourg – all small countries which are relatively unprofitable for foreign companies to set up affiliates.

Figure 4.3 Direct cross border share of the number of awards between 2009-2015, EU28



In addition to direct cross-border procurement, there is a considerable volume of indirect cross-border procurement, where, for example, firms bid for contracts through their foreign affiliates or subsidiaries.<sup>110</sup> Firms can bid for contracts through their foreign affiliates or subsidiaries. This channel accounted for 11.4% of awards published in TED and 13.4% by value during 2006-9. While the share of direct cross-border procurement over 2007-2009 in terms of value amounts to 7% for supplies but only 2% for works or services, indirect cross-border procurement through affiliates makes up 25% of the total value of supplies

<sup>109</sup> European Commission Staff Working Paper: Evaluation Report Impact and Effectiveness of EU Public Procurement Legislation Part 1 SEC (2011) 853 final 27 June 2011.

<sup>110</sup> *Ibid.* pg xiv.

contracts, 6% of works and 14% of services. This suggests that supplies have the highest propensity to be traded cross-border.<sup>111</sup>

Figure 4.4 indicates that between 2007-2009, indirect cross border procurement average share of total number of awards significantly higher than direct cross border procurement at 21.9%.

Figure 4.4 Cross-border procurement (2007 – 2009)<sup>112</sup>

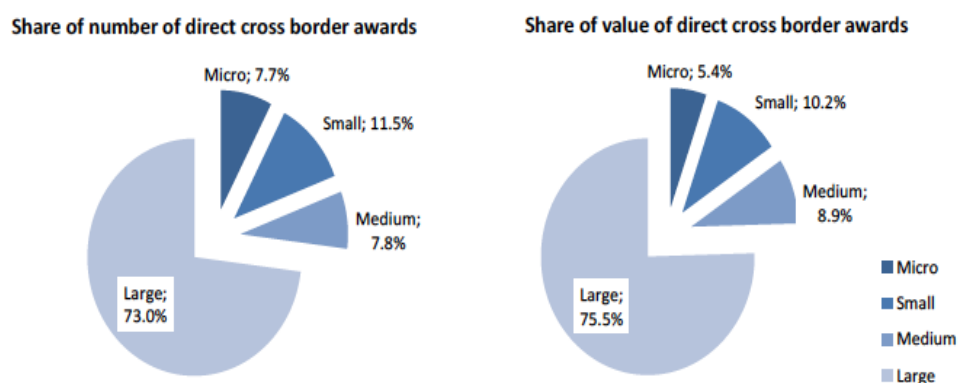


This breakdown of direct and indirect cross-border awards was further analyzed by the size of the firm. The share of small businesses is estimated at 27.0% of the number and 24.5% of the value of direct cross border awards. However, the share of small businesses in indirect cross border is much smaller and estimated at under 3% in terms of both number and value of contract awards. Among SME classes, small firms accounted for the highest share of cross-border awards. Figures 4.5 and 4.6 display more detailed results.

<sup>111</sup> Measurement of impact of cross-border penetration in public procurement. Final report February 2017. European Commission Directorate-General for Internal Market, Industry, Entrepreneurship and small businesses.

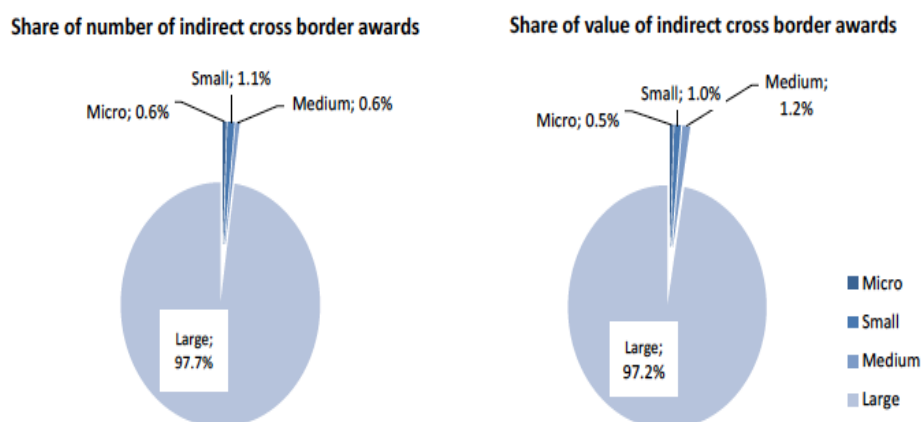
<sup>112</sup> *Ibid.*

Figure 4.5 Distribution of direct cross border procurement in % of number and value of awards by size of bidder, EU28



Source: London Economics based on TED transactions and Orbis database.  
Notes: Based on a sample of approximately 30,000 direct cross-border contract awards.

Figure 4.6 Participation in indirect cross-border procurement, in % of number and value of awards, by size of bidder, EU28



Source: London Economics based on TED transactions and Orbis database.  
Notes: Based on a sample of approximately 700,000 indirect cross-border contract awards.

This overview of the data confirms the challenges in internationalizing public procurement markets broadly, and even more so for promoting small businesses in cross-border procurement contracting.

## 5. EU Small Business Promotion

### 5.1 France

#### 5.1.1 Key Procurement Laws in France

The new public procurement regulation in France was implemented the 1st April 2016. It transposes into French Law the European Directive 2014/24/EU on public procurement. There are also several supplementing rules with regard to EU procurement directives.

The key legislation governing public procurement is as follows:

- Ordinance No. 2015-899 of 23 July 2015 relating to public procurement contracts (Public Procurement Ordinance);
- Ordinance No. 2016-65 of 29 January 2016 relating to concession contracts (Concession Ordinance);
- Decree No. 2016-86 of 1 February 2016 relating to concession contracts (Concession Decree);
- Decree No. 2016-360 of 25 March 2016 relating to public procurement contracts (Public Procurement Decree);
- Decree No. 2016-361 of 25 March 2016 relating to defense and security public procurement contracts;
- Administrative Order of 21 March 2016 laying down the template notice for the award of concession contracts; and
- Administrative Order of 29 March 2016 establishing the list of information and documents that may be requested from candidates for public procurement contracts.

The two bodies subject to public procurement regulation are the same whether they enter into a procurement contract or a concession contract: contracting

authorities<sup>113</sup> and contracting entities.<sup>114</sup> Public procurement contracts are defined as contracts for pecuniary interest concluded between one or more contracting authorities or entities and one or more economic operators, and having as their object the performance of works, the supply of products or the provision of services. Public-private partnership contracts are also subject to these rules, and are now considered to be procurement contracts.

Publication in the Official Gazette for public procurement contracts or in a legal newspaper when the amount of the contract is superior or equal to €90,000 is mandatory for certain contracting authorities or entities. When the amount of the contract is below €90,000 for certain contracting authorities or entities, and below the thresholds of the formalized procedure for the other contracting authorities or entities, publication is made according to the characteristics of the contract.

### *Foreign suppliers*

Foreign suppliers can bid as long as they comply with French procurement rules. Regarding concession contracts, the contracting authority indicates in the contract notice if the procurement procedure is open to foreign economic operators outside the EU. If it allows foreign suppliers to bid, the notice indicates the accessibility criteria that the foreign economic operators should fulfil. A foreign economic operator shall disclose all documents that will enable an assessment of its qualification to bid regarding the criteria set by the contracting authority or entity. For defense and security contracts, the contracting authority may prohibit foreign suppliers from bidding.

### *E-Procurement*

Although France was a forerunner by developing its e-procurement portal seven years ago, its overall e-procurement system continues to be characterized by slow progress. The Government has repeatedly tried to promote e-procurement in recent years, particularly in the pre-award phase. Even so, results have been mitigated, partly due to the complexity of the regulatory environment combined with administrative burdens. For example, even in the e-procurement environment there is often still a lot of actual paperwork that must be completed

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<sup>113</sup> Contracting authorities are a) bodies governed by public law (the state, local authorities, national and local bodies governed by public law); b) bodies governed by private law that have been established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character and under certain conditions (they are financed, for the most part, by the state, regional or local authorities, or by other bodies governed by public law; and they are subject to management supervision by those authorities or bodies, or they have an administrative, managerial or supervisory board, more than half of whose members are appointed by the state, regional or local authorities, or by other bodies governed by public law); and c) bodies governed by private law created by public contracting authorities to fulfil certain needs they have in common.

<sup>114</sup> These include: a) contracting authorities that pursue a network operator activity; b) public undertakings that pursue a network operator activity.

in order to conduct a procedure, which may dissuade contracting authorities from migrating to electronic processes. Contracting authorities are required to use the National Inter-ministerial Marketplace e-platform PLACE. However, a number of private service providers remain. Many provinces, municipalities and regions, such as Burgundy and Brittany, which are among the most advanced in end-to-end procurement, continue to use their own e-procurement platforms. Some of the regional platforms, notably in Bourgogne and Bretagne, are working on more interoperability at the regional level and with the national platform (PLACE).

### 5.1.2 Small and medium-sized businesses (SMEs) in France

The labour productivity of SMEs in France is 27% higher than the EU average. Between 2010 and 2015, the added value of French SMEs increased by 4%. Employment increased only in micro-companies, by 2%, while in small companies it fell by 1% and in medium-sized companies by 4%. The current moderate growth in SMEs added value and employment since 2016 is expected to accelerate. Between 2015 and 2017, added value is forecast to increase by 7% and employment by 3%. This corresponds to the creation of 281 000 jobs in SMEs within two years.

Figure 5.1 Snapshot of firms in the France and the EU28

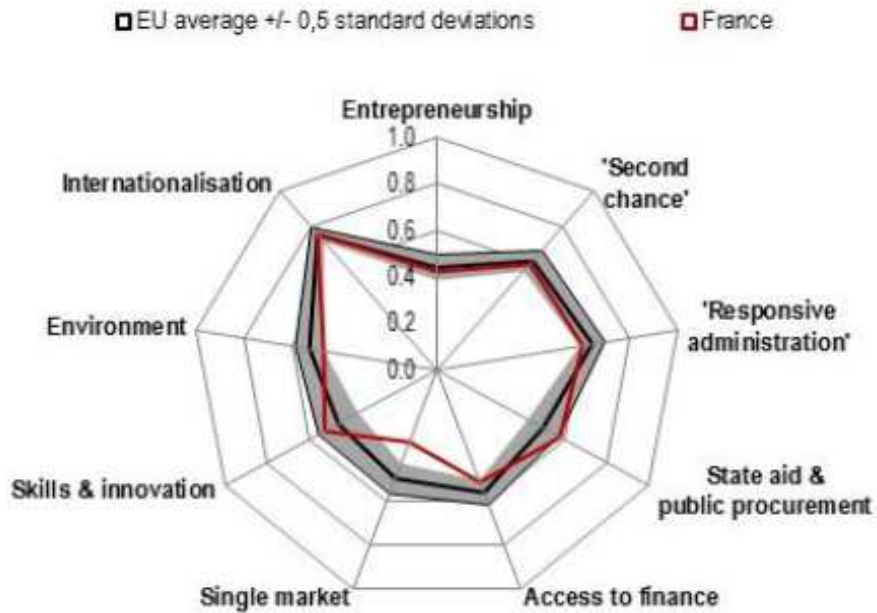
Class size	Number of enterprises		Number of persons employed			Value added			
	France		EU-28	France		EU-28	France		EU-28
	Number	Share	Share	Number	Share	Share	Billion €	Share	Share
Micro	2 858 954	95.1 %	92.8 %	4 477 703	29.5 %	29.5 %	238.3	26.1 %	21.2 %
Small	123 807	4.1 %	6.0 %	2 845 564	18.7 %	20.2 %	151.2	16.6 %	18.0 %
Medium-sized	19 755	0.7 %	1.0 %	2 255 982	14.8 %	17.0 %	138.3	15.1 %	18.2 %
<b>SMEs</b>	<b>3 002 516</b>	<b>99.9 %</b>	<b>99.8 %</b>	<b>9 579 249</b>	<b>63.0 %</b>	<b>66.8 %</b>	<b>527.8</b>	<b>57.8 %</b>	<b>57.4 %</b>
Large	4 457	0.1 %	0.2 %	5 613 950	37.0 %	33.2 %	385.5	42.2 %	42.6 %
Total	<b>3 006 973</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>15 193 199</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>913.4</b>	<b>100.0 %</b>	<b>100.0 %</b>

*These are estimates for 2015 produced by DIW Econ, based on 2008-2013 figures from the Structural Business Statistics Database (Eurostat). The data cover the 'non-financial business economy', which includes industry, construction, trade, and services (NACE Rev. 2 sections B to J, L, M and N), but not enterprises in agriculture, forestry and fisheries and the largely non-market service sectors such as education and health. The advantage of using Eurostat data is that the statistics are harmonised and comparable across countries. The disadvantage is that for some countries the data may be different from those published by national authorities.<sup>2</sup>*

The Small Business Act Profile for France indicates that in most areas, France is broadly in line with the EU average. There are good framework conditions in place, particularly for promoting SME participation in public procurement. Moreover, French policy-makers have been increasingly more attentive to SME policy, with the most significant progress made in recent years in the area of access to finance.

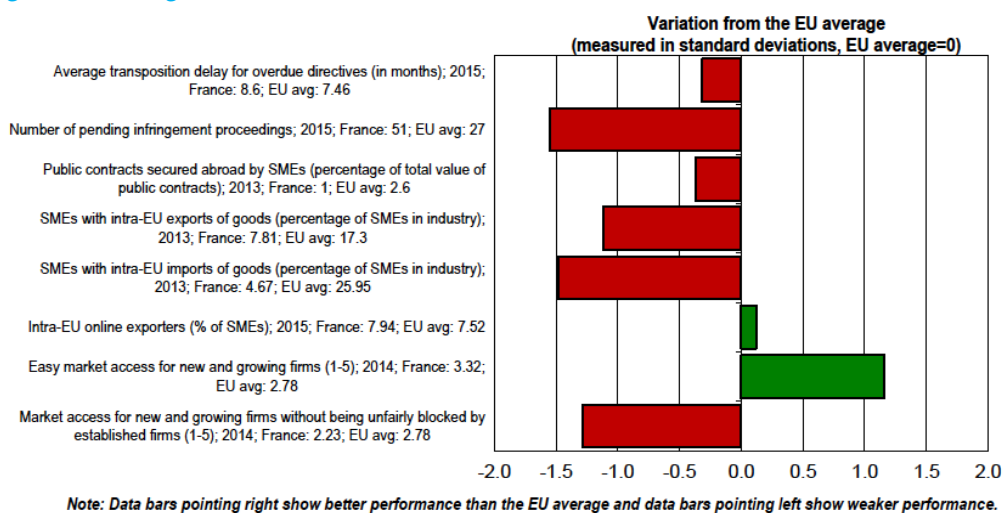


Figure 5.2 Small Business Act Profile in France



The single market indicators are low for France, relative to the EU average. The data further suggest that France lags behind the EU average in the number of French SMEs with intra-EU imports of goods – 4.67% as compared to 25.95% EU average. The number of public contracts secured abroad is 1% of the total value of public contracts, which is less than half the EU average of 2.6%.

Figure 5.3 Single Market Indicators in France



### 5.1.3 Policy Initiatives

Most notably, France has introduced a mechanism aimed at encouraging public purchasers to give preference to innovative SMEs. Moreover, to promote access to public procurement to SMEs, the government has authorized smaller firms to form consortiums to make common bids. France already included the general EU obligation to divide into lots unless this would lead to restriction on competition or make the contract difficult, expensive or impossible, contracting authorities shall, in principle, award a contract in the form of separate lots. Contracting authorities must provide the ‘*motive son choix*’ – the motivation for their choice not to subdivide the contract into lots, bundling of lots is allowed.

The ‘Think Small First’ principle is intended as a guiding principle for all policy- and law-making activities. It requires policy-makers to take small business interests into account at the early stages of the policy-making process. The principle also calls for newly designed legislation, administrative rules and procedures to be made simple and easy to apply.

The French government introduced simplification measures, such as the ‘Unique Social Statement’, ‘Remove a Standard Each Time You Create a New Standard’ and ‘Tell Us Once’. The aim of the ‘Tell Us Once’ measure is to reduce the number of times and the frequency with which government departments ask businesses for information. For example, the ‘simplified public tender’ procedure (*marché public simplifié*) started in 2014, which uses a unique identifier (SIRET number), introduced under the ‘Tell Us Once’ measure, requiring less paperwork. Since October 2014, all businesses can file their tax-related reports online. These complement the e-portals made available online in 2008 and 2009 to facilitate SMEs’ access to public procurement. This makes the process easier but does not reduce the administrative burden. This could be done by reducing the number of tax credits, tax rates and kinds of tax relief. However, several different VAT rates and new taxes were recently introduced. To address this, under the ‘Industry for the Future’ programme, the tax incentives encouraging companies to invest and the incentives to recruit have benefited French small businesses, along with measures to simplify administrative tasks for small businesses.

Without a comprehensive ‘small business test’ to assess the impact of new legislation on businesses, it is difficult to assess the success of these initiatives. Although regulatory impact assessments have been mandatory for legislative texts since 2008 and for decrees since 2011, they remain very limited. Given the high number of legislative texts and decrees, a surprisingly low number of ‘small business panels’ have been conducted so far. ‘small business panels’ complement impact assessments with more detailed information on small businesses obtained directly from the small businesses in question.

## 5.2 Greece

### *5.2.1 Key Procurement Legislation in Greece*

As of June 2016, the legal framework for public procurement is determined by law 4281/2014. This law incorporated European Directives 2004/17/EC and 2004/18/EC into the Greek legal systems harmonizing the mandatory procedures for the scheduling overseeing and awarding public procurement contracts, supplies, services and works contracts also providing specific regulation for e-procurement, i.e. the award of public contracts via an independent electronic platform named “Prometheus,” controlled by the Greek State and accessible world-wide.

Law 2286/1995 states the procurement of purchasing (goods), leasing, and the provision of services must be awarded through an announced public tender. The details of the procedures are prescribed in the Regulation of Public Procurement (Presidential Decree 394/1996) The Greek government has attempted to establish one central procurement agency to offer the country economies of scale, and optimal control and application of common technical specifications.

The General Directorate of State Procurement plans, modifies and implements Greece’s Unified Government Supply Program. Procurement actions follow three stages: stage one is the identification of the needs of all agencies and the drafting of the procurement program; stage two is publicizing the tender, selecting the best offer and awarding the contract to the winner; and stage three is the implementation of the contract. The armed forces, municipalities, public hospitals, and the Public Power Corporation carry out procurement independently, pursuant to special procurement rules and regulations. In certain instances, the General Secretariat of Commerce involvement is limited to the first phase of the tender.

In particular, Book I of Law No. 4412/2016 (articles 3-221) contains provisions that are applicable to procurement procedures with respect to public contracts of works, supplies or services as well as design contests; whereas Book II (articles 222 - 338) contains provisions that are applicable to procurement procedures in relation to public contracts of works, supplies or services by entities operating in the water, energy, transport and postal services sectors.

Law No. 4412/2016 applies to all national procurement procedures, irrespective of whether they meet or not the relevant European thresholds, although different provisions apply to above and below EU thresholds.

## 5.2.2 Small Businesses (SMEs) in Greece

SMEs are of great importance to the Greek non-financial business economy. The European Small Business Act indicators note that they provide around 87 % of all employment, compared to the EU average of about 67 %, and generate around three quarters of total value added, compared to the EU average of almost 57 %. However, small business productivity, measured as value added per number of persons employed, is less than half the EU average.

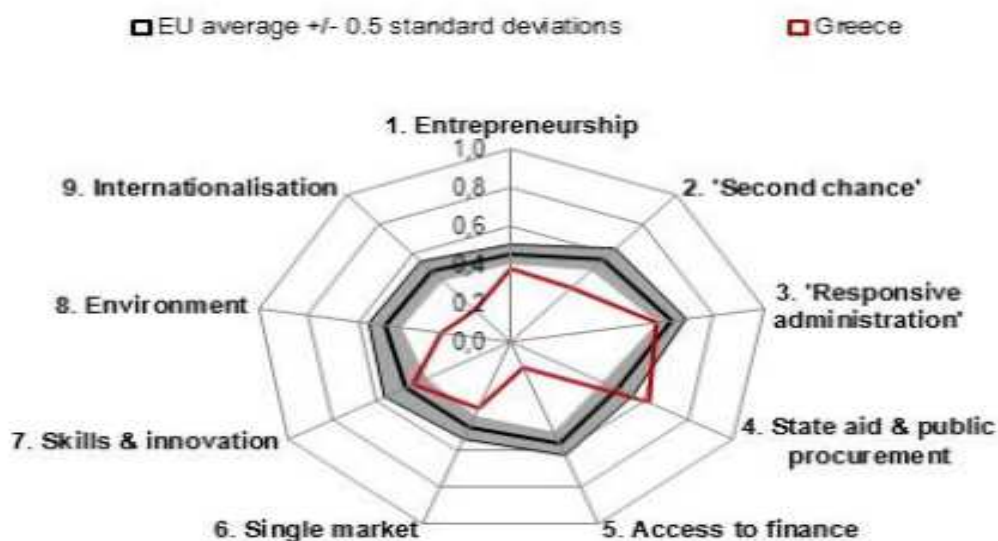
The Small Business Act for Europe (SBA) indicate that Greece's performance is largely below the EU average. State aid and public procurement is the only area where the country performs better than the EU average; in this area, Greece has the fourth best performance in the EU. However, its performance in access to finance is the lowest in the EU and the most problematic area for small businesses in Greece, affecting other areas. The second weakest area is 'internationalization', also remaining below the EU average.

Figure 5.4 Snapshot of firms in Greece and EU28

Class size	Number of enterprises			Number of persons employed			Value added		
	Greece		EU-28	Greece		EU-28	Greece		EU-28
	Number	Share	Share	Number	Share	Share	Billion €	Share	Share
Micro	678 816	96.2 %	93.0 %	1 288 988	57.3 %	29.8 %	17.0	34.3 %	20.9 %
Small	23 829	3.4 %	5.8 %	412 490	18.3 %	20.0 %	9.5	19.2 %	17.8 %
Medium-sized	2 684	0.4 %	0.9 %	254 639	11.3 %	16.7 %	9.8	19.7 %	18.2 %
<b>SMEs</b>	<b>705 329</b>	<b>99.9 %</b>	<b>99.8 %</b>	<b>1 956 117</b>	<b>86.9 %</b>	<b>66.6 %</b>	<b>36.3</b>	<b>73.2 %</b>	<b>56.8 %</b>
Large	388	0.1 %	0.2 %	294 094	13.1 %	33.4 %	13.3	26.8 %	43.2 %
Total	<b>705 717</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>2 250 211</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>49.6</b>	<b>100.0 %</b>	<b>100.0 %</b>

*These are estimates for 2016 produced by DIW Econ, based on 2008-2014 figures from the Structural Business Statistics Database (Eurostat). The data cover the 'non-financial business economy', which includes industry, construction, trade, and services (NACE Rev. 2 sections B to J, L, M and N), but not enterprises in agriculture, forestry and fisheries and the largely non-market service sectors such as education and health. The following size-class definitions are applied: micro firms (0-9 persons employed), small firms (10-49 persons employed), medium-sized firms (50-249 persons employed), and large firms (250+ persons employed). The advantage of using Eurostat data is that the statistics are harmonised and comparable across countries. The disadvantage is that for some countries the data may be different from those published by national authorities.*

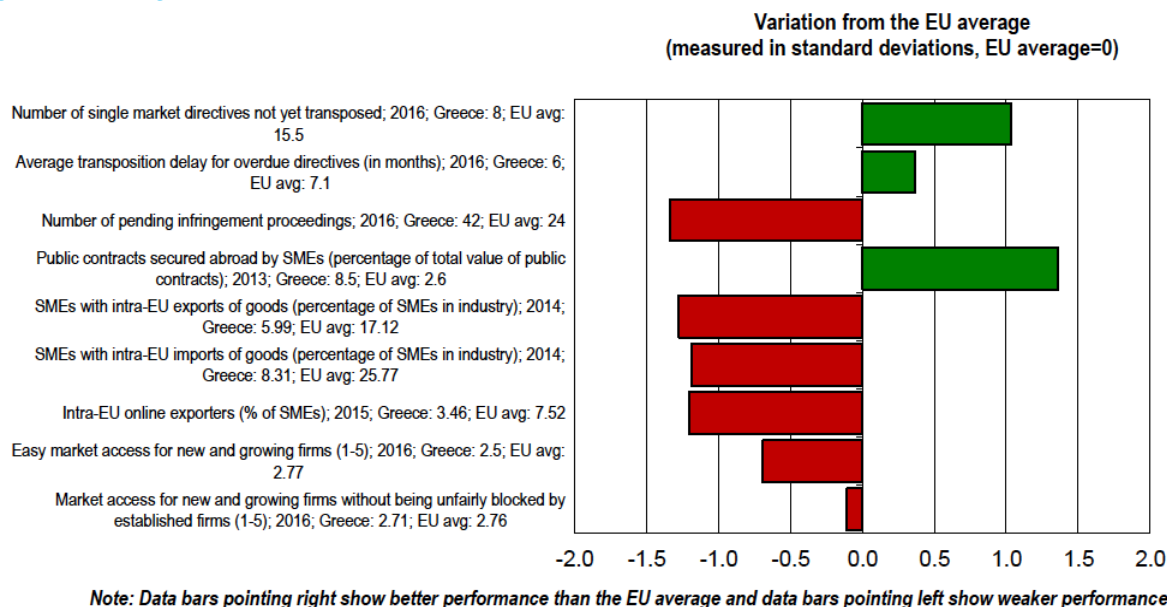
Figure 5.5 Small Business Act Profile - Greece



Greece performs relatively well in the area of *State Aid and Public Procurement*. The SMEs' share in the total value of awarded public contracts is the highest in the EU. The country also scores well above the EU average for the percentage of small businesses that participate in public tenders. However, after improvement in the average delay in payments from public authorities from 2014 to 2015, the score for 2016 has deteriorated again and now stands at 24 days. Since 2008, the Greek public procurement system has undergone comprehensive structural reform. This includes new legislation, a new remedies review system, a centralised procurement scheme and the use of e-procurement.

In the area of the Single Market, the percentage of SMEs in industry with exports of 8.3 % is among the lowest in the EU. Nevertheless, Greek SMEs are relatively very successful at securing public contracts abroad, with 8.5% of the total value of public procurement contracts, as compared to the EU average of 2.6%.

Figure 5.6 Single Market Indicators Greece



The performance of Greece in the finance policy sector is also well below the EU average and shows additional signs of deterioration, which is worrying for small businesses. Only two indicators range within the levels of the EU average: the availability of information on credit and the difference between the interest rates for small and big loans. The total time required for payment is still twice the EU average (104 days as opposed to 52), the number of lost payments is almost twice the EU average (5.9% as opposed to 3%) and there is no improvement in the ‘strength of legal rights’ indicator.

### 5.2.3 Policy Initiatives

The Single Public Procurement Authority (SPPA) was established in 2012 with significant regulatory and audit powers. In addition, in early 2017 Greece adopted a national strategy on public procurement to increase professionalization and administrative capacity in public procurement. It is now being implemented. During the current reference period, Law 4412/2016 was adopted to consolidate, codify and simplify Greek legislation on public procurement. A single electronic register was created for the publication of contract notices (KHMDHS) and the submission of e-tenders (ESHDHS). Full use of the e-submission platform for all public procurement procedures from the end of 2017.

The new legislative framework provides for a variety of measures in relation to the participation of SMEs. In particular: the possibility of separating contracts into lots: contracting authorities may decide to award a contract in the form of separate lots and may determine the size and subject matter of such lots.

Contracting authorities can, even where tenders may be submitted for several or all lots, limit the number of lots to be awarded to one tenderer, provided that the maximum number of lots per tenderer is stated in the contract notice or in the invitation to confirm interest. There is now a prohibition of selection criteria that require bidders to have an annual turnover greater than two times the estimated contract value.

The European single procurement document has also been introduced to reduce the hurdles small businesses encounter when attempting to participate in procurement procedures. Small businesses are no longer asked for detailed evidence of their compliance with certain requirements. New rules have been introduced on the use of subcontractors, for instance, permitting direct payment to subcontractors in certain circumstances.

## 5.3 Italy

### 5.3.1 Key Procurement Laws in Italy

The Code of Public Contracts (Code) Legislative Decree no. 50/2016 provides the main framework on public contracts in Italy, implementing the European legislation (2014 Concession Contracts Directive, the Public Contracts Directive and the Utilities Contracts Directive). The national bodies responsible for setting forth the procurement policy are the Italian parliament, the government and the National Anti-Corruption Authority (National Authority). The Code boosts the functions of the National Authority, providing that it shall issue guidelines and other regulatory tools to guarantee transparency, consistency and promptness to tender procedures; promote information exchange among awarding authorities; and keep a list of the members of the awarding committees. Compliance with the rules governing public contracts is essentially enforced by the regional administrative courts and by the Council of State, which are jurisdictional bodies.

Public procurement legislation mainly aims at removing unjustified obstacles to competition. The basic underlying principles of the Italian public procurement regime are the same as those that inspire the Directives and that implement, in the public procurement field, the principles of the four freedoms of movement. By removing unjustified obstacles to competition, the public procurement legislation also aims at promoting the 'best value for money' concept.

### 5.3.2 Small Businesses (SMEs) in Italy

SMEs play a more important role in the non-financial business economy in Italy than on average in the EU. The share of small business value added is two thirds compared to an EU average of 56.8 %, and the share of small business employment is 78.6 % in comparison with the EU average of two thirds. Micro firms are conspicuous by their high share of small business employment; at 46.0 % this is substantially more than the EU average of 29.8 %. Small business productivity, calculated as value added per person employed, is approximately €40,700, slightly lower than the EU average of €43,500.

Implementing the Small Business Act for Europe (SBA) indicates that Italy performs below the EU average in all SBA areas. Despite some moderate improvements in the average delay in payments from public administrations to businesses, which remains worse than the EU average, a stronger commitment is needed in the overall administrative management of the payment procedures. In skills & innovation, insufficient ICT training and ICT skills coincide with the low performance of small businesses' turnover and sales in e-commerce which is also documented in the principles single market and internationalization. Italian small



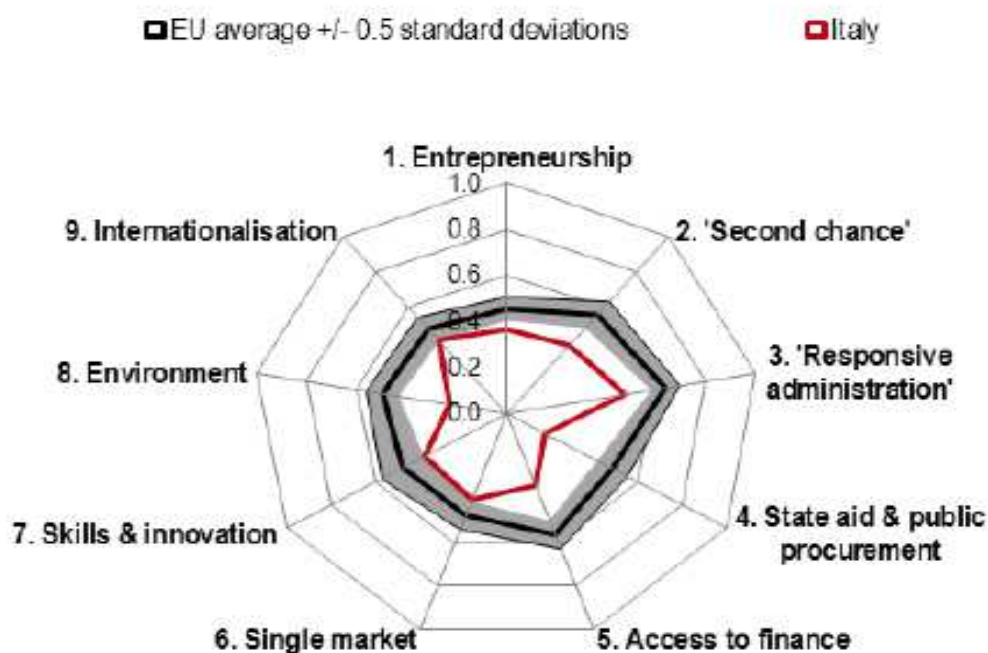
businesses would benefit the most from more investments and training in the utilization of e-commerce.

Figure 5.7 Snapshot of firms in Italy and EU28

Class size	Number of enterprises			Number of persons employed			Value added		
	Italy		EU-28	Italy		EU-28	Italy		EU-28
	Number	Share	Share	Number	Share	Share	Billion €	Share	Share
Micro	3 538 488	95.1 %	93.0 %	6 567 225	46.0 %	29.8 %	197.5	29.3 %	20.9 %
Small	159 637	4.3 %	5.8 %	2 869 837	20.1 %	20.0 %	140.5	20.8 %	17.8 %
Medium-sized	18 082	0.5 %	0.9 %	1 781 052	12.5 %	16.7 %	118.5	17.6 %	18.2 %
<b>SMEs</b>	<b>3 716 207</b>	<b>99.9 %</b>	<b>99.8 %</b>	<b>11 218 114</b>	<b>78.6 %</b>	<b>66.6 %</b>	<b>456.5</b>	<b>67.7 %</b>	<b>56.8 %</b>
Large	3 140	0.1 %	0.2 %	3 055 831	21.4 %	33.4 %	217.7	32.3 %	43.2 %
Total	3 719 347	100.0 %	100.0 %	14 273 945	100.0 %	100.0 %	674.2	100.0 %	100.0 %

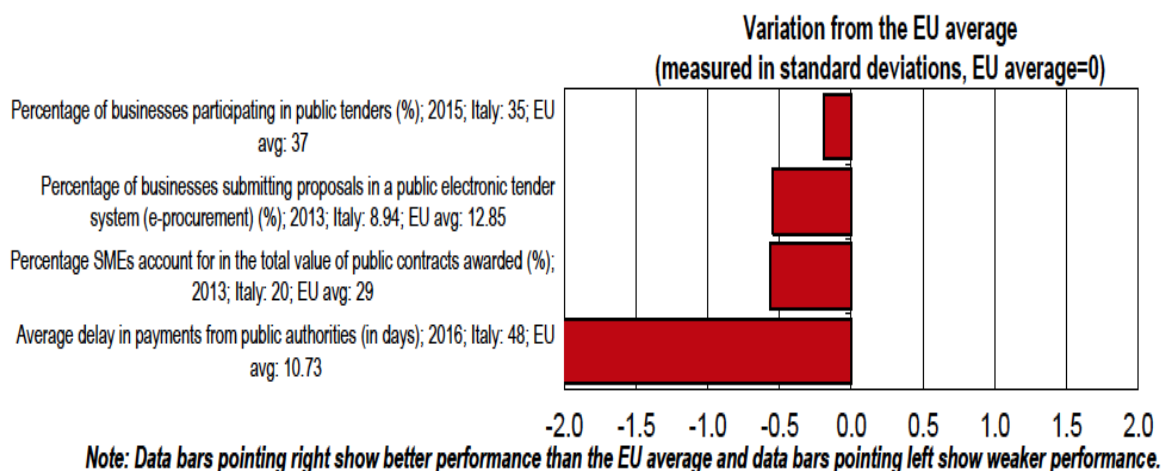
*These are estimates for 2016 produced by DIW Econ, based on 2008-14 figures from the Structural Business Statistics Database (Eurostat). The data cover the 'non-financial business economy', which includes industry, construction, trade, and services (NACE Rev. 2 sections B to J, L, M and N), but not enterprises in agriculture, forestry and fisheries and the largely non-market service sectors such as education and health. The following size-class definitions are applied: micro firms (0-9 persons employed), small firms (10-49 persons employed), medium-sized firms (50-249 persons employed), and large firms (250+ persons employed). The advantage of using Eurostat data is that the statistics are harmonised and comparable across countries. The disadvantage is that for some countries the data may be different from those published by national authorities.*

Figure 5.8 Small Business Act Profile Italy



Italy is among the three EU lowest-performing countries in the area of public procurement and state aid. At the same time, it is the principle where Italy has its lowest performance. Despite some improvements in the latest years, late payments still constitute a major obstacle for Italian small business's cash-flow and are one of the biggest problems in general.

Figure 5.9 State aid and public procurement



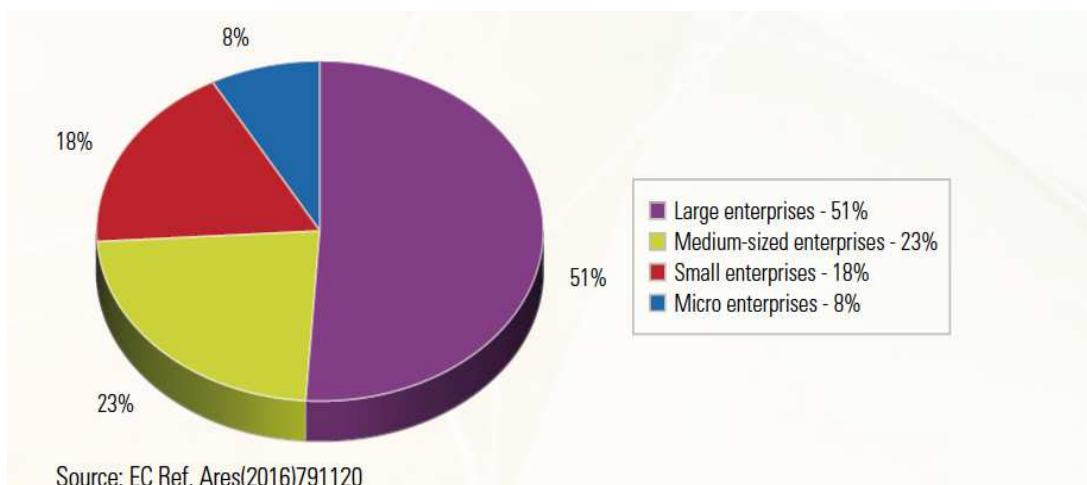
Within the area of access to finance, Italy performs below the EU average and is among the three lowest-performing countries at EU level. Since 2008, the performance has been improving, though. Difficulties in accessing credit and finance are faced by all Italian companies, but especially the smallest ones, due to the restrictions in bank lending, the scarce availability of private risk capital, and a still small venture capital market.

Italy has made progress in the area of internationalization, and now scores above the EU average in this indicator. Italy secures 2.1% share of public contracts secured abroad by number of contracts versus 1.2% for EU-27. By value of contracts secured abroad, Italy small businesses win 3.2% of value compared to 2.6% for the EU-2714.

Figure 5.10 displays the share of above threshold contracts won by number of contracts between 2009 and 2011. The data shows that large enterprises won 51% of competitions, with medium-sized small businesses winning 23%, small sized 18%, and micro 8%.<sup>115</sup>

Figure 5.10 Share of above threshold contracts won by number of contracts 2009-2011

<sup>115</sup> Gian Luigi Albano, Federico Antellini Russo, Gionata Castaldi, and Roberto Zampino, Evaluating Small Businesses' Performance in Public e-Procurement: Evidence from the Italian Government's e-Marketplace in Journal of Small Business Management 2015 53(S1), pp. 229-250.



This research found that although open competition has resulted in 49% of above threshold contracts by number won by small businesses, these results are placed into context when comparing against the EU-27 average and the best performing nations. For example, comparing the EU-27 average, 55% of above threshold contracts are won by small businesses: 17% by medium-sized enterprises, 21% by small enterprises, and 18% by micro enterprises. Therefore, the aggregate Italy small business share of above threshold contracts by number of contracts was 6% lower than the aggregate EU-27 average. Comparing micro enterprises, Italy ranks the lowest at 8% of enterprises winning above threshold contracts along with Malta and Lithuania, a full 19% behind the best scoring nation Ireland. In Italy, the share of high value contracts to small businesses is 65% when the contract value does not exceed €300k, whereas it markedly decreases when the value is above this threshold. Therefore, the dividing of contracts into lots should further assist small businesses report greater levels of success in bidding for high value contracts. The difference between the share of Italian SMEs in public procurement above threshold contracts and their role in the economy is approximately minus 47%, whereas the EU-27 average is minus 29%.<sup>116</sup>

### 5.3.3 Policy Initiatives

Italy has adopted a substantial number of SMEs policy measures in line with the SBA priorities but the progress is moderate and, in some cases, limited. The regulatory framework for insolvency and related enforcement needs to be further improved as procedures remain lengthy and costly and are not supportive enough of restructuring. The administrative burden is still an issue despite the measures taken in the recent years.

The Public Procurement Code adopted in April 2016 generally aims to bring simplification, increase transparency, reduce the administrative burden and rationalize the sector. The Code seeks to offset the difficulties inherent in the

<sup>116</sup> *Ibid.*

participation of SMEs in public tenders (difficult access to information, insufficient knowledge of tender procedures, demanding requirements for participation, delayed payment terms, bureaucratic burdens, and inadequate segmentation of procurements). However, the full implementation of the new Code depends on the adoption of a number of regulatory instruments and guidance. During the reference period, the National Anti-Corruption Agency issued several guidelines to clarify some aspects of the new rules.

The e-Marketplace (MEPA) was launched in 2003 and currently operates with an e-catalogue of more than one million items. MePA is one of the leading e-marketplaces currently operating in Europe. Managed by Consip, MePA provides a paperless environment for awarding (mainly) low value public contracts for goods and services. MePA aims to become part of the solution to encourage the participation of SMEs in the public procurement market.

The reputational rating (i.e. the business qualification system) introduced by the New Public Contracts Code - released by the National Anti-Corruption Authority (“Anac”) on the basis of qualitative and quantitative criteria capable of demonstrating the structural capacity and reliability of the companies – is no more a mandatory requirement to take part in public tenders. The possession of such rating will be optional and will constitute at most a valorization element during the procedure. The requirements to obtain ‘SOA’ certification, which is essential for performing works, have been made more flexible, enabling companies to prove their requirements by choosing the five best years of activity over the last 10 years. While the deadline for the issuance of the payment certificates by the Contracting Authority has been shortened to within 45 days from the work progress status certification.

## 5.4 Portugal

### *5.4.1 Key Procurement Legislation in Portugal*

In Portugal, Legislative Decree no. 111-B/2017 published 31st of August, modified the Public Contracts Code and introduced in Portuguese legislation the revised European directives. The contract system between public entities increased its cooperation between public entities and promoted the awarding of contracts in lots to stimulate the participation of small businesses

Other relevant legislation:

- the Administrative Procedural Code (approved by Decree-Law no. 4/2015, of 7 January), which contains the general rules on administrative procedures;
- the Procedural Code of the Administrative Courts (approved by Law no. 15/2002, of 22 February, amended by Decree-Law 214-G/2015, of 2 October), which contains the rules on litigation regarding pre-contractual procedures and public contracts; and
- Ordinance no. 701-A/2008, of 29 July, to Ordinance 701-J/2008, of 29 July, which regulate several aspects referred to in the PCC.

Portugal has a decentralized approach to public procurement, with the central government, two autonomous administrative regions, the islands of Madeira and Azores and the municipalities, each adapting the national public procurement rules to local particularities. The main three categories of contracting authorities are:

1. The traditional public sector (central, regional and local authorities). This group includes the Portuguese state, the autonomous regions of Madeira and Azores, municipalities, public institutes, public foundations and public associations.
2. Bodies governed by public law, namely, entities with legal personality, independently of their public or private nature, provided they were established for the specific purpose of meeting needs in the general interest; do not have an industrial or commercial character; and are financed, for the most part, by any entity of the traditional public sector or by other bodies governed by public law.
3. Entities operating in the utilities sector – water supply, energy supply, transport and postal services sector.

### 5.4.2 Small and medium sized businesses (SMEs) in Portugal

The share of SMEs in Portugal's 'non-financial business economy' is higher than in the rest of the EU. Small businesses account for more than two thirds of total value added (compared to an EU average of 57 %) and nearly four out of five jobs (compared to an EU average of about two out of three jobs). In 2015, however, SME productivity, as calculated by the ratio of value added to employment, was approximately €21 000 per person, which is less than half the EU average of around €43 000. The manufacturing and wholesale and retail trade sectors each contribute about a quarter of total SME value added and a similar share of employment. Their shares are slightly higher than the average shares of the same sectors in other EU countries.

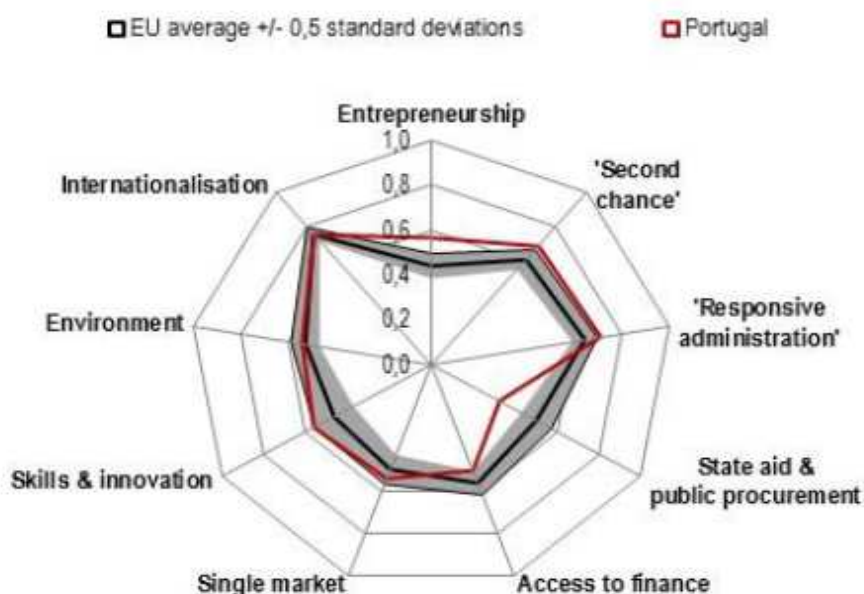
Figure 5.11 Snapshot of firms in Portugal and EU28

Class size	Number of enterprises			Number of persons employed			Value added		
	Portugal		EU28	Portugal		EU28	Portugal		EU28
	Number	Share	Share	Number	Share	Share	Billion €	Share	Share
Micro	746 474	95.2 %	92.8 %	1 218 660	41.3 %	29.5 %	16.9	23.8 %	21.2 %
Small	31 921	4.1 %	6.0 %	607 090	20.6 %	20.2 %	16.1	22.8 %	18.0 %
Medium-sized	4 912	0.6 %	1.0 %	478 852	16.2 %	17.0 %	15.9	22.5 %	18.2 %
<b>SMEs</b>	<b>783 307</b>	<b>99.9 %</b>	<b>99.8 %</b>	<b>2 304 602</b>	<b>78.1 %</b>	<b>66.8 %</b>	<b>48.9</b>	<b>69.0 %</b>	<b>57.4 %</b>
Large	757	0.1 %	0.2 %	646 090	21.9 %	33.2 %	22.0	31.0 %	42.6 %
Total	<b>784 064</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>2 950 692</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>71.0</b>	<b>100.0 %</b>	<b>100.0 %</b>

*These are estimates for 2015 produced by DIW Econ, based on 2008-2013 figures from the Structural Business Statistics Database (Eurostat). The data cover the 'non-financial business economy', which includes industry, construction, trade, and services (NACE Rev. 2 sections B to J, L, M and N), but not enterprises in agriculture, forestry and fisheries and the largely non-market service sectors such as education and health. The advantage of using Eurostat data is that the statistics are harmonised and comparable across countries. The disadvantage is that for some countries the data may be different from those published by national authorities.*

Data on Implementing the Small Business Act for Europe (SBA) suggest that Portugal's SBA profile is generally in line with the EU average, although on State aid & public procurement and Access to finance Portugal continues to trail the EU average. Alternative sources of funding, such as private equity, venture capital, crowdfunding and funding by business angels, remain marginal and quite underdeveloped.

Figure 5.12 SBA profile in Portugal



On e-procurement, Portugal is among the top 10 performers in the EU, partly due to the BASE portal, which provides information on available opportunities. One of the most important steps taken since 2008 by the Portuguese government to support the participation of SMEs in public procurement was the launch, in 2009, of the centralized public procurement platform. E-procurement in Portugal diverges from EU peers in that the system rests exclusively on privately run platforms, which compete against each other to offer e-procurement services to contracting authorities. There are seven private portals that are connected to the BASE platform,<sup>117</sup> which acts as single point of contact for economic operators. The central BASE portal centralizes and records information about the procurement procedures carried out via different e-platforms and performance of contracts. The information that is collected and provided to candidates and bidders by BASE consists of the calls for tenders, application, receipt and evaluation of tenders, as well as performance of contracts. Documentation is published on the entire tendering procedure, which aims to make this information available to all interested parties. Indeed, the percentage of businesses submitting proposals in a public electronic tender system in 2013 was 18.56 in Portugal, relatively higher than the EU average of 12.85%.

<sup>117</sup> Vortal processed 28% of the electronic contracts, Construlink 27%, Saphety Level-Trusted Services 21%, ANO Informatics System & Services 16% Acin icloud solutions 6%, Infosistema sistemas de informação 1%, and central E-informação e comércio Electronico S.A. 1%.

However, contracting authorities in Portugal reportedly often use the direct award procedure. Further, when SMEs do win contracts they are still not adequately protected against late payment, despite policy efforts to minimize the impact on SMEs through, for example, minimum interest rates for late payment. In 2015, the average delay in payments from public authorities stood at 39 days in Portugal, as compared with the EU average of 12.6 days. The percentage of SMEs participating in public tenders in 2015 was 31% compared with the EU average of 37%. SMEs accounted for 19% of the total value of public contracts awarded in 2015, while the EU average was 29%. Transparency and efficiency in public procurement need to be increased as regards public-private partnerships and concessions, particularly at local and regional level.

In the area of access to finance, Portugal scores below the EU average. This is largely due to poor indicators for late payment. Despite improvements in recent years, the time it takes to be paid in Portugal is still over a month longer than the EU average. In addition, Portugal scores second-lowest in the EU on the strength of legal rights, a measure of the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending.

In terms of cross border procurement markets, Portugal's performance in both the Single Market and Internationalization is broadly in line with the EU average and has markedly improved in both. Since 2008, Portugal has been among the seven EU Member States that improved most in the overall score on this latter principle and has gradually increased its exports of goods outside of the EU.

### *5.4.3 Policy Initiatives*

Portugal has taken steps to help Portuguese SMEs benefit from the single market — including through the establishment of the SOLVIT center and the creation of an online portal to help take advantage of business opportunities in the EU.

Since 2008, Portugal has made significant efforts to facilitate SME access to finance. Public support schemes such as guarantees for bank loans, credit lines and funds have been introduced. The Development Finance Institution (Instituição Financeira de Desenvolvimento) was set up to serve as a 'wholesaler' of the different public financial instruments available. Various other measures have been taken to facilitate the cash flow of small businesses. These measures include setting minimum interest rates for late payment, adopting low tax rates for small businesses, and granting VAT exemptions for small businesses with an annual turnover of up to €500 000. To address the lack of venture capital, a new legal framework was approved for venture capital investment activities (Regime da atividade de investimento em capital de risco), transposing relevant EU directives in the process. However, while significant public funds have been made



available for small businesses and start-ups, the lack of private investment has remained an issue to be addressed. Accordingly, to attract more private investors, a new line of financing (Nova linha de Business Angels) was put in place to provide public funding of up to 65 % of the total amount invested.

Other recent policy measures have focused on reorganizing public administration services and reviewing legal systems, processes and procedures to reduce complexity and response times. Adding to the existing public funding available, several new funds were established to enhance creation, growth and internationalization of small businesses. Transparency and efficiency on public private partnerships and concessions need to be increased, particularly at local and regional level.

Portugal has put in place various additional policy measures to support SME internationalization. These include the provision of specialised consulting and training to SMEs, and the Portugal brand (Marca Portugal) initiative established in 2014 to strengthen the global image and raise awareness of Portuguese exports. A financial credit line was created of €500 million to support Portuguese companies with operations in Angola (Linha para Empresas Portuguesas com Processo de Internacionalização em Angola) to improve their cash-flow situation.

‘SME Leader’ (PME Líder) status aims to enhance the reputation of financially sound small businesses. It is awarded to companies by the Public Agency for Competitiveness and Innovation (IAPMEI), and by ‘Turismo de Portugal’ for tourism enterprises, under the FINCRESCCE programme. The scheme works in partnership with 11 banks operating in Portugal.<sup>118</sup> SME Leader status can be obtained if the company meets the following requirements:

- it is a small business according to Portuguese legislation defining micro-, small and medium-sized enterprises which, itself, follows the EC recommendation of 6 May, 2003 (2003/361/EC), as proven by online certification, which must be renewed annually;
- it has no debts to the Tax Office, Social Security, IAPMEI or Turismo de Portugal;
- it has a specific focus on pursuing growth and competitiveness strategies;
- it has a risk profile that meets the standards of the different banks’ internal systems for credit ratings;

In addition to the credit rating profile, the company must meet at least three of the following conditions:

- (i) positive financial outcome in period under review

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<sup>118</sup> Banco BIC, Banco BPI, Banco Popular, Barclays, Caixa Geral de Depósitos, Crédito Agrícola, Millennium BCP, Montepio, Novo Banco, Novo Banco Azores and Santander Totta.

- (ii) earnings before interest, taxes, depreciation, and amortization positive in the two years under review;
- (iii) at least 30 % of equity in assets in period under review
- (iv) at least €1 000 000 turnover in period under review
- (v) at least 8 employees, as an autonomous company, in period under review

Companies that meet the above criteria are sought by the partner banks, which with their agreement recommend them to IAPMEI or to Turismo de Portugal. SME Leader status is granted to the company, acknowledging the bank that recommended it. As a visible statement of financial health, the small businesses can use the SME Leader logo in their corporate communications, which boosts their competitiveness. By January 2016, 7 270 companies were SME Leaders.

Although the SBA 'small business test' has been adopted, it lacks methodology to make it effective and consistent across the administration.

## 5.5 Spain

### 5.5.1 Key Procurement Laws in Spain

The key legislation for Spain's public procurement regime consists of three main laws which implement the Public Sector Directive, the Utilities Directive and the Defence Directive, respectively:

- the Law on Public Procurement, Compilation Text approved by Royal Decree 3/2011, of 14 November (PPL);
- the Law on Public Procurement in the water, energy, transport and postal services sectors, 31/2007, of 30 October;
- the Law on Public Procurement in the defense and security sectors, 24/2011, of 1 August.

In addition, the PPL is implemented through Royal Decrees:

- Royal Decree 1098/2001, of 12 October, approving the General Regulation of the Law on Public Administrative Contracts;
- Royal Decree 817/2009, of 8 May, which partially implements Law 30/2007, of 30 October. Although these Laws on public procurement have been repealed by the current PPL, their implementing regulations are still in force.
- Royal Decree 94/2018, of 2 March, which sets up the Inter-ministerial Commission for the inclusion of social clauses in public procurement. The Inter-ministerial Commission's primary role will be to analyze and monitor the application of social clauses in public procurement procedures; however, it will also be responsible for preparing and making proposals, recommendations, reports, studies or guidelines to the Spanish Cabinet.

The legislation rests on the guarantee of the principles of free access to tenders, the publicity and transparency of the procedures, and the non-discrimination and equal treatment of candidates. The PPL also ensures the effective use of public funds through a definition of the specific requirements to be met, and that the contract must be awarded to the most economically advantageous tender. The enhancement of competition is established as a general principle and as a target to be fulfilled through the public procurement procedure. Guarantors of these principles are the administrative tribunals of contractual appeals. These were created under Law 34/2010, of 5 August, which implemented the Remedies Directives and amended the PPL, and, ultimately, the administrative courts of justice.

According to Article 3 PPL, three levels of bodies are subject to it, classified on the grounds of their nature and characteristics. These levels are not absolutely closed; rather interconnected and sometimes overlap. This is 'the concentric circles theory', which operates on principle that the closer the contracting entity

is to the center of the circles, the greater the applicability of the PPL to it. According to this theory, all public administrations are contracting authorities and belong to the public sector, while not all of the bodies included within the public sector are public administrations or contracting authorities. This distinction is highly important since, depending on the level the contracting entity is classified under, the contract shall be of an administrative or private nature, with all the consequences of the applicable legislation that this implies.

‘Minor contracts’ exist for public works contracts whose value is below €50,000 (or €18,000 for other types of contracts). They only require the approval of the corresponding expenditure and their incorporation in the invoice to be awarded to anyone with full capacity and holding the required professional license. However, publicity is a general requirement in Spain’s public procurement regime, and it is mandatory except when justified reasons allow for the use of the negotiated procedure without publication of the contracts notice.

Foreign suppliers can participate in bids in the same way as national suppliers under equal conditions and as long as they meet the contracting entities’ requirements regarding capacity or soundness. Foreign individuals or legal persons from countries outside the EU must prove their capacity through a report from the Spanish permanent diplomatic mission or the Spanish consular section of the country where the contractor has his or her legal domicile. This must be accompanied by a certificate of reciprocity on public procurement from the corresponding Spanish permanent diplomatic mission, unless the contractor is from a country that is party to the WTO GPA and the contract is subject to harmonized regulation.

As a special rule for public works, the contractor is required to have a branch in Spain and to be registered with the business registry, as well as to mandate proxies or representatives in Spain. However, if the contractor is from a Member State, they will only require a registration indicating capability in the relevant registry under the state of establishment’s legislation, or an affidavit or certificate in the forms established in the PPL regulations.

### *5.5.2 Small and medium-sized businesses (SMEs) in Spain*

The Spanish non-financial business economy relies on SMEs to a greater extent than the EU average. SMEs account for 61.8 % of value added and nearly three quarters of employment, which is around 5 percentage points above the EU average for both. Micro firms are particularly important, accounting for more than 40 % of all new jobs in the non-financial business economy. Spanish SMEs employ an average of 3.3 persons, compared to 3.9 in the EU. Calculated as value added per person employed, Spanish SMEs suffer from low productivity and are roughly one fifth less productive than the EU average.

Spanish SMEs in the non-financial business economy underperform in entrepreneurship, state aid & public procurement, single market and environment. Despite significant progress since 2008, access to finance is still limited and is below the EU average. Over the last few years, Spain has focused policy efforts on improving access to finance for SMEs and entrepreneurs, supporting internationalization and giving honest bankrupt entrepreneurs a second chance.

Spain performs well below the EU average in the area of State aid and public procurement. The average delay in payment from public authorities was the second highest in the EU, at 33 days. Payment delays discourage companies from participating in public tenders, with the proportion of businesses participating substantially lower than the EU average.

Figure 5.13 Snapshot of firms in Spain and EU28

Class size	Number of enterprises			Number of persons employed			Value added		
	Spain		EU-28	Spain		EU-28	Spain		EU-28
	Number	Share	Share	Number	Share	Share	Billion €	Share	Share
Micro	2 375 079	94.9 %	93.0 %	4 619 433	41.2 %	29.8 %	121.2	25.9 %	20.9 %
Small	108 993	4.4 %	5.8 %	2 051 482	18.3 %	20.0 %	84.9	18.1 %	17.8 %
Medium-sized	14 798	0.6 %	0.9 %	1 467 047	13.1 %	16.7 %	83.2	17.8 %	18.2 %
<b>SMEs</b>	<b>2 498 870</b>	<b>99.9 %</b>	<b>99.8 %</b>	<b>8 137 962</b>	<b>72.6 %</b>	<b>66.6 %</b>	<b>289.3</b>	<b>61.8 %</b>	<b>56.8 %</b>
Large	2 935	0.1 %	0.2 %	3 078 531	27.4 %	33.4 %	178.6	38.2 %	43.2 %
Total	<b>2 501 805</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>11 216 493</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>467.9</b>	<b>100.0 %</b>	<b>100.0 %</b>

*These are estimates for 2016 produced by DIW Econ, based on 2008-2014 figures from the Structural Business Statistics Database (Eurostat). The data cover the non-financial business economy, which includes industry, construction, trade, and services (NACE Rev. 2 sections B to J, L, M and N), but not enterprises in agriculture, forestry and fisheries and the largely non-market service sectors such as education and health. The following size-class definitions are applied: micro firms (0-9 persons employed), small firms (10-49 persons employed), medium-sized firms (50-249 persons employed), and large firms (250+ persons employed). The advantage of using Eurostat data is that the statistics are harmonised and comparable across countries. The disadvantage is that for some countries the data may be different from those published by national authorities.*

Figure 5.14 Small Business Act Profile in Spain

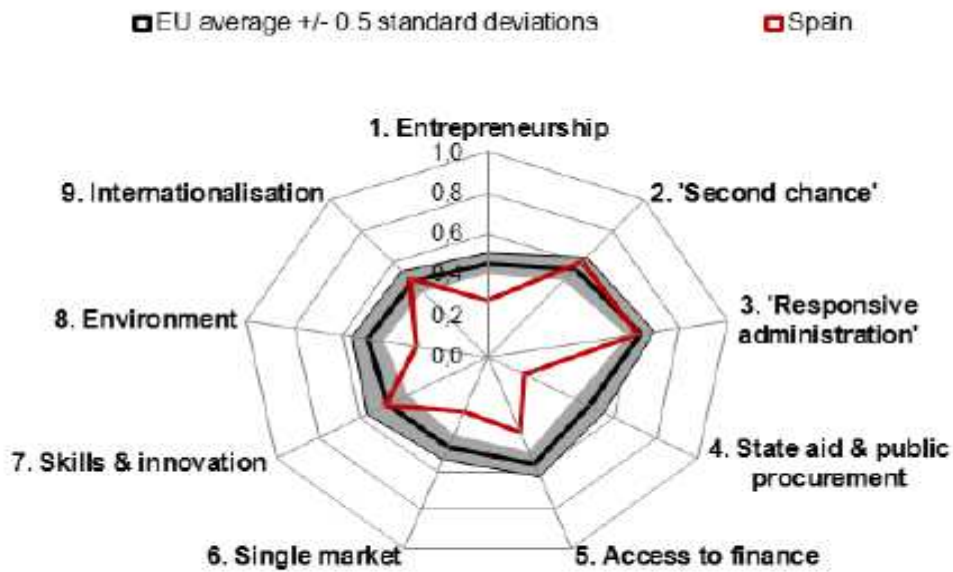
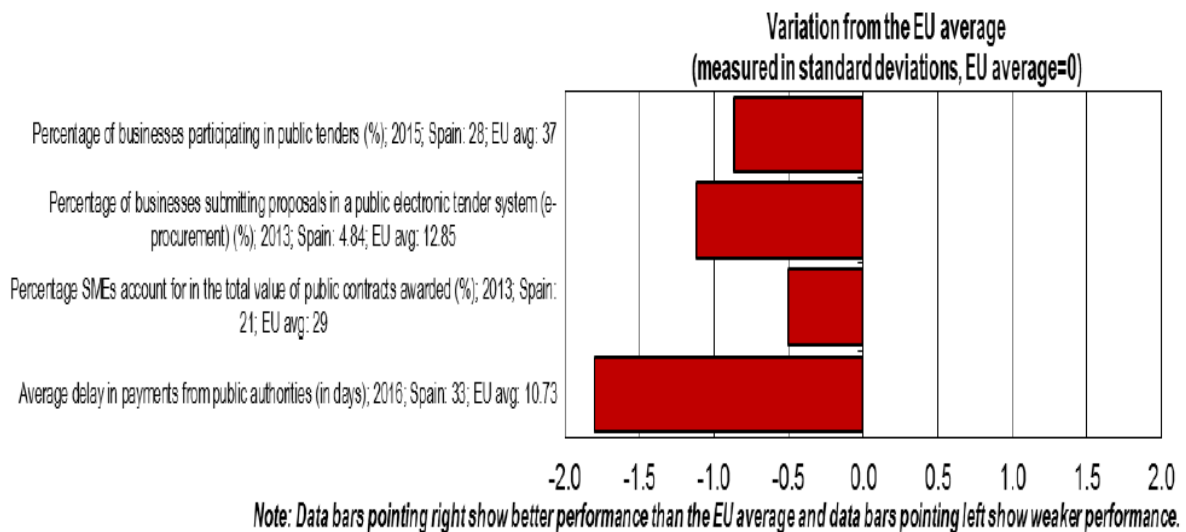


Figure 5.15 State aid and Public Procurement in Spain



Spain also performs below the EU average on access to finance. Although the percentage of rejected loan applications and offers unacceptable to SMEs has decreased substantially since 2012, from 20% to about 8%. Business funding for new and fast-growing firms has also accelerated. By contrast, equity funding remains critical, with Spain having the second worst score in the EU on this indicator. The venture capital market remains weak and unattractive to investors. Late payment also remains a key concern.

In the area of the Single Market, Spain continues to perform below the EU average, with the second lowest score among EU countries. On the other hand, in terms of Internationalization, the percentage of public contracts secured abroad by SMEs is 4.4%, above the EU average of 2.6%. New, fast-growing firms are also less likely to be unfairly blocked by established firms than elsewhere in the EU.

### 5.5.3 Policy Initiatives

The government has implemented most of the SBA measures in this area, including a single point of contact to support small businesses, a SOLVIT center and an internal market information system. In addition, the CEVIPYME<sup>119</sup> platform and the programme for the promotion of patent applications abroad have helped SMEs access intellectual property protection for their products and services.

Spain has also introduced some measures to improve the situation with delayed payments from public authorities — including ‘e-invoicing’ for public procurement and a ‘late payment prevention plan’ to tackle the issue. But there are still major gaps that need further attention. The requirements for tendering are disproportionate for SMEs, and larger contracts are typically not divided into smaller lots.

Spain has established a number of measures to improve conditions of access to finance for SMEs and entrepreneurs. To increase the availability of venture capital, the state-owned bank ICO set up the FOND ICO Global, a venture capital and private equity fund of funds. To increase alternative sources of funding, Law 5/2015 also laid down rules on crowdfunding. By the end of the reference period, agreements worth €352 million had been concluded with financial intermediaries under the European Fund for Strategic Investments. These are expected to lead to €6 billion worth of investment, benefiting an estimated 36 000 small businesses. In the current reference period, a number of significant measures were introduced:

- The ENISA credit line for the digital agenda (*Línea de crédito ENISA para la agenda digital*) was introduced to provide equity loans for launching and developing business projects in the ICT and digital sector.
- The Connected Industry 4.0 programme (*Industria Conectada 4.0*) launched a call for R&D&I projects with favourable financing conditions for innovative small businesses.

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<sup>119</sup> Centro de apoyo a la PYME en materia de gestión de Propiedad Industrial, Intelectual e innovación.

- The ENISA entrepreneurs and ENISA young entrepreneurs' scheme (*ENISA emprendedores y ENISA jóvenes emprendedores*) was established set up to provide equity loans to small businesses that are not in the financial or real estate sectors.
- The ICO commercial credit line (*Línea ICO crédito comercial*) was introduced to address the issue of late payment by providing a mechanism through which Spanish companies can apply for loans equal to clients' unpaid invoices.
- The ICO exporters line for 2017 (*Línea ICO export adores 2017*) addresses the liquidity/cash needs of small businesses for the production of goods export.
- The ICO businesses and entrepreneurs' line for 2017 (*Línea ICO Empresas y Emprendedores 2017*) provides financial aid to small businesses and the self-employed to address cash needs and productive investment.

The small business test for new legislation has been adopted but needs to be implemented. Several measures have been introduced on access to finance (e.g. on late payment) but more time is needed to measure their impact. In late 2016, the Council of Ministers announced its decision to lower the threshold for awarding contracts by negotiated procedure without prior publicity via a resolution of the Directorate-General for State Assets.



## 6. Conclusions

### 6.1 Identifying Good Practice in the EU Approach Supporting Small Businesses

Increasing the participation of small businesses in public procurement markets is a priority for all governments. This report has indicated that while small businesses account for a large proportion of businesses, this is not reflected in the levels of participation in undertaking public tenders. Within the EU, the Procurement Directives are designed to further encourage small and medium-sized business participation. Alongside ensuring non-discrimination, transparency and due process, which is to the benefit of all businesses, the Directives require simplified tender procedures, and a limitation of the turnover required to participate in a tender procedure. Other provisions encourage lot-splitting and e-procurement to increase access and transparency. The Small Business Act (SBA) has directly targeted many of the obstacles that prevent small businesses from bidding in public procurement tenders as well as winning contracts. It seeks to promote their access to finance, endorsements and fast payments.

The country reporting from the Small Business Act highlights:

In **France**, the Industry for Future Programme has been designed to encourage small companies with investment and tax incentives. However, the single market indicators for France remain below the EU average and the volume of public contracts secured in the rest of the EU is less than have the average.

**Greece's** performance is generally below the EU average in most of the Small Business Act indicators. Its performance in access to finance is the lowest in the EU, while the second weakest area is small businesses' internationalization. Nevertheless, measures such as lot splitting has increased small businesses' share in the total value and volume of public contracts, and is the highest in the EU.

**Italy** currently performs below the EU average in all SBA areas and is among the three EU lowest-performing countries in the area of public procurement and state aid. Despite some improvements in the latest years, late payments still constitute a major obstacle for Italian small business's cash-flow and are one of the biggest problems in general. Nevertheless, Italy has made progress in the area of

internationalization, and now scores above the EU average in this indicator, securing almost double the share of the EU average.

**Portugal's** SBA profile is broadly in line with the EU average. Although on State aid & public procurement and Access to Finance Portugal continues to trail the EU average, along with the time it takes for small businesses to be paid. Portugal's performance in the Single Market and Internationalization is broadly in line with the EU average and has improved significantly over the past decade. Various additional policy measures have been implemented to support small business internationalization, including training, marketing, access to finance and an effective e-procurement platform.

**Spanish** SMEs also underperform in many areas. Spain performs well below the EU average in the area of State aid and public procurement. Access to finance is still limited and the average delay in payment from public authorities was the second highest in the EU. In terms of internationalization, Spain performs well in its involvement with the trade community, its formality procedures and its small businesses with extra-EU exports of goods. Spain has focused policy efforts successfully on improving access to finance for small businesses and entrepreneurs, Public contracts secured abroad by small businesses is significantly above the EU average and new and fast-growing.

These case studies demonstrate the mixed results of assessments of SME performance among the five EU Member States, despite being a long-standing policy priority at both the EU and national level. A summary of the obstacles includes:

- i) difficulties related to the size of the contracts;
- ii) access to relevant information;
- iii) financial requirements;
- iv) administrative burden;
- vii) emphasis on price, rather than quality-price relationship
- vii) time given to prepare quotations
- viii) payment terms

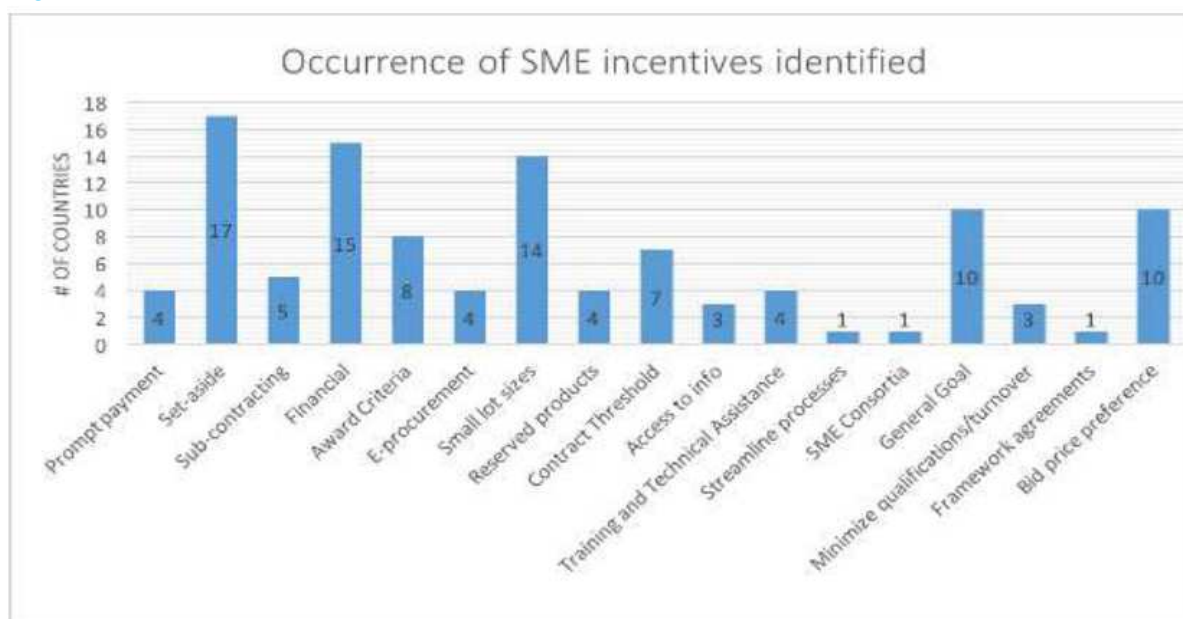
The existing research suggests that the following policies do have demonstrated benefits:

- Lot splitting and aggregation - access
- Contracting agency efficiency and professionalism – late payments, fairness
- Transparency & standardization – e-procurement procedures
- Insurance against late payment - finance

- SME Leaders programme – financial endorsement

Figure 6.1 indicates that less attention has been placed on those policies with demonstrated benefits than blunter economic measures, which have less evidence to support them.

Figure 6.1 Occurrence of Small Business Incentives<sup>120</sup>



Although micro and small businesses in Brazil are currently supported by measures such as lot splitting and offsets, these businesses seeking to enter procurement markets could further benefit from greater legal certainty and a more simplified procedure to monitor the lawfulness of the tendering procedure and the achievement of each contract obligation when:

1. It is a low-price contract (for instance, following the values for direct contract as specified in the federal law 8666/93);
2. It is a tendering procedure for small businesses;
3. It is a tendering procedure for a recurring purchase.

<sup>120</sup> World Bank Group Technical Report: Policies that Promote small business Participation in Public Procurement. The Business Environment Working Group (BEWG) of the Donor Committee for Enterprise Development (DCED). 2017.

## 6.2 Promoting Small Businesses through Competition Law

While it is commonplace for competition law to address cartels or bid rigging, EU Competition Law is also applicable to public procurement bodies when they are undertaking an economic rather than social activity. This means, for example, that excluding potential bidders or delaying payments on contracts can be considered an economic activity and subject to prohibitions on abuse of dominance or subsidy control. Brazil could choose to reinforce a competition approach to public procurement by providing the competition authority CADE with further resources and guidance on how to apply and enforce competition law to public bodies that are behaving anti-competitively, corruptly or abusing their dominance. Enforcing CADE's authority in public procurement could increase small business participation in public procurement contracts, due to increased enforcement and legal certainty about what is acceptable or not in public procurement. This would also utilize CADE's expertise in anticompetitive behaviour and institutional reputation.

Promoting a more integrated institutional and legal approach to implementing competition and public procurement law and policy could involve greater monitoring of the use and effect of horizontal policies implemented through procurement awards across the different regions of Brazil. This would allow for more coherent evidence-based impact assessments of these regulatory measures. Given the relative lack of resources and market power that smaller businesses typically possess, a more transparent, coherent and competitive framework for potential bidders would particularly benefit smaller companies wishing to enter the lucrative internal Brazilian procurement market.

## 6.3 Promoting Small Businesses through RTAs and the WTO GPA.

Promoting small businesses through trade agreements has become common in the more recent RTAs and under the working programme of the WTO GPA committee. While the WTO GPA does not include any specific provision to promote small businesses, some parties have protected their small businesses through negotiated offsets and price preferences, or excluding certain markets from the scope and coverage of the agreement. If Brazil were to accede to the WTO GPA, it would be able to protect its small businesses *ex ante* through its negotiations. However, without other complementary policies, it is unlikely that small businesses would have any more de facto capacity or competitiveness to

enter into GPA parties' markets, than it currently has. The evidence suggests that cross-border procurement is low generally, but particularly for small businesses seeking to win procurement contracts in foreign markets.

Some RTAs include provisions aimed at promoting small businesses. The EU-Japan RTA and the CPTPP, for example, include a chapter dedicated to facilitating the entrance of small businesses into markets both public and private. The EU-Canada CETA agreement also includes specific provisions to promote small businesses in the public procurement, investment and trade and labour chapters. The CETA prohibits offsets or price preferences in those markets covered by the agreement. The parties focus on cooperation and non-binding best endeavor measures such as improving transparency and reducing administrative burden to facilitate small businesses entering public procurement markets.

## **6.4 Promoting Small Businesses in Cross-border Procurement Markets**

The most notable finding of this report is the lack of internationalization and small business involvement in cross border procurement markets. While EU small businesses are improving their presence in cross border procurement contracts, it is more generally held that more could be achieved to help small businesses participate more in foreign contracts, including those opened up under the WTO GPA, or RTAs with comprehensive procurement commitments on market access.

Some of the obstacles to cross-border participation are:

- Lack of competitiveness to win
- Lack of access to finance to support bid
- Lack of information
- Lack of capacity
- Cultural linguistic obstacles

In Brazil, there are very few exporting firms – less than .5% of all formal businesses. The top 1% of exporting firms accounts for 59% of total exports, while the top 25% of firms generate 98% of exports.<sup>121</sup> There is very little market dynamism and very few firms become new exporters. Brazil is also largely absent from global production networks and value chains. This can be caused partly by geography but is also the result of on-going national policy decisions on trade

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<sup>121</sup> Otaviano Canuto, Cornelius Fleischhaker VoxEU. Exporter dynamics database. 2015.

and local content.<sup>122</sup> Yet Brazil's experience with trade liberalization in the 1980s and the results of policy simulations both point to potentially large gains from trade liberalization in Brazil. Trade reforms within Mercosur are projected to yield the largest economy wide gains, followed by a reciprocal preferential trade agreement between Mercosur and the EU.<sup>123</sup>

In order to compete on the international arena and reap the gains from international trade, Brazilian micro and small-businesses need to build up their competitiveness, starting from within the large internal Brazilian procurement market. Existing evidence from Brazil suggests that winning government contracts through auctions increases firm growth and competitiveness, not only because firms are more likely to get more contracts in the future, but also because they enter more valuable auctions, penetrate more markets, and also increase the variety of products they sell. Flanking labour policies are important to ensure small businesses acquire the necessary skills and access to finance to meet the needs of public contracts.

The complementary policy measures to build such capacity and competitiveness domestically are:

- Transparency
- Standardization
- Due process
- Training / ITC skills
- Prompt payment
- Access to finance

## 6.5 Summing up

Small businesses are not participating sufficiently in public procurement markets domestically, regionally or internationally. While focusing on cross-border contracts is attractive, most small businesses are not yet sufficiently competitive even within domestic markets. From this perspective, *de facto* reforms such as increasing transparency, finance and professionalism are perhaps more important than *de jure* reforms for promoting the participation of small businesses in public procurement markets through offsets and price preferences. These preferences can operate to undermine the competitiveness of public procurement markets and produce a distortive effect on the behaviour of businesses. More impact assessments should be undertaken both *ex ante* and through monitoring

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<sup>122</sup> *Ibid.*

<sup>123</sup> Jose Guilherme Reis et al. 2018. *op cit.*

the effect of these measures, to ensure they are well targeted and demonstrably effective in meeting their objectives.

The option of negotiating RTAs or acceding to the WTO GPA with *de jure* market access commitments could, if well-prepared, be a strategy to complement the primary challenge of supporting domestic reforms to promote growth and economic development. Using RTAs or the WTO GPA to help implement necessary domestic procurement law reforms can serve this objective through exposure to international know-how and technology,<sup>124</sup> as well as legislative push, promoting good governance and policy lock-in.<sup>125</sup> Nevertheless, effective internal regulations and flanking labour and social policies are a necessary precondition for harnessing the benefits of trade liberalization successfully.

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<sup>124</sup> Jose Guilherme Reis et al. 2018. *op cit.*

<sup>125</sup> Tas, Bedri Kamil Onur; Dawar, Kamala; Holmes, Peter; and Togan, Sübidey. *Does the WTO government procurement agreement deliver what it promises?* World Trade Review. October 2018.

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