

Background Paper:

Review of the World Bank's Procurement Policies and Procedures

THE USE AND IMPACT OF THE BANK'S POLICY OF DOMESTIC PREFERENCES

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WORLD BANK

REVIEW OF THE WORLD BANK'S PROCUREMENT POLICIES

THE USE AND IMPACT OF THE BANK'S POLICY ON DOMESTIC PREFERENCES

Introduction

One of the topics of interest in analyzing the World Bank's experience under its current procurement policies is the impact of the Bank's policy on domestic preference. The Bank's Procurement Guidelines for Works, Goods and Non-consulting Services allow qualified bidders of the country of the contracting agency a margin of preference in the evaluation of the CIF value of their bids let under International Competitive Bidding (ICB). In the case of locally manufactured goods, the margin is 15 percent. In the case of works, the margin is 7.5 percent. Appendix 2 of the Bank's Guidelines provides detail on how the price comparison is to be done.

For domestic preference to apply, the borrower must request the preference and reflect this in the procurement plan and in the bidding documents. For goods, the determining criterion is not the nationality of the manufacturer but where the manufacturing takes place. In granting the preference, priority is first given to goods that have at least 30 percent local content and next to goods that are produced locally as compared to imported goods. For works, bidders must show that they are locally owned to qualify. The preference for works only applies in countries with low per capita incomes, roughly the cut-off for eligibility to IDA credits.

Background

Allowing domestic preference under ICB has been a long standing position taken by the Bank, reflecting its interest in encouraging the development of local contractors and manufacturing in borrowing countries. It was adopted in 1966 and has remained part of the Bank's Guidelines since then. At the time, over 60 percent of the Bank's lending was disbursed against goods and works from Western European countries, Japan and North America.

Importantly, such preferences may not be as relevant as they were when they were first introduced. By the early 1990s, the relative position between suppliers from Part I (non-borrowers) and Part II (borrowers) had reversed, with borrowing countries accounting for 60 percent of the suppliers of those contracts reviewed by the Bank. For the past decade, the share of borrowing countries as suppliers has continued to increase, reaching about 80 percent.

More generally, the granting of preferences is increasingly at odds with the direction taken under various international agreements and instruments on public procurement that have emerged in the past twenty years. These new instruments attempt to level the playing field for all bidders and to reduce discrimination among bidders on the basis of nationality. This is a view shared by the Bank with the principle of open competitive otherwise pervading the Bank's procurement policies.

As a result, as part of the review of the Bank's procurement policies, we undertook a review of the Bank's experience, analyzing available data on those contracts let under the domestic preference provision.

Results of the Data Analysis

The results of the analysis of ICB contracts from FY99 to FY09 show that domestic preference (DB) is in fact infrequently used. There were only 153 identified contracts, valued at US\$280 million and averaging US\$1.83 million, that allowed domestic preference. This compares to almost 57,000 total contracts for goods and for IDA-funded works awarded during the same period, valued at US\$63.7 billion. The DP contracts, thus, account for 0.3 percent of the total number of contracts and 0.4 percent of the total value.

Moreover, the analysis further estimates that DP rarely would have had a substantial effect on outcomes (see Annex 1 for the methodology used). Out of the 153 contracts in which DP was allowed, it is estimated to have potentially affected the outcome of the contract award in only 12 contracts with a value of US\$4.3 million. This represents 8 percent of those cases in which DP was allowed and an extremely small percentage of the total contracts awarded.

Use of Domestic Preferences

We further examined in more detail when DP was allowed.

- **Procurement Category.** The reviewed DP contracts were only for goods and civil works let under ICB. **Goods** was the largest category in terms of number of contracts with 115 contracts or 75 percent of the number of DP contracts. **Works**, however, has the largest value with US\$191 million, at 68 percent, of the total value.
- **Regional Usage.** Looking at the number of contracts by region, **Europe and Central Asia (ECA)** had the highest concentration of the number of contract with 51, or 33 percent of the DP contracts reviewed. **South Asia (SAR)** had the highest concentration of the value of contracts with US\$81.5 million, at 29 percent.
- **Major Sector.** The largest sector in terms of number of contracts is **Health** with 68 contracts, or 44 percent of the DP contracts reviewed. The sector with the highest value of contracts, however, is **Transport** with US\$171 million, or 61 percent, of the total value of DP contracts.
- **Cross-Tab Sector and Region.** The largest concentration in terms of numbers is in the **Health sector in ECA** with 37 contracts, or 24 percent of the number of DP contracts reviewed. The next largest is Health in the Africa Region with 16 contracts, or 11 percent. The largest concentration in terms of value is in the **Transport sector in SAR** with US\$73.7 million, or 26 percent. The next largest groupings for value are Transport in LCR (US\$73.5 million, 26%), Health in MNA (US\$29 million, 10%), and Health in ECA (US\$18.9 million, 7%).

Looking only at the twelve cases where DP made a difference in the contract award, all of the cases were involved goods, none works. The average contract size was US\$356,000. Two of the twelve were in the Africa region; five in ECA; one in MNA, three on EAP; and one in SAR. No case involved a country in LAC. Seven of the twelve were in the social sectors (health, nutrition, and education), one in public sector management, and four in energy. In ten out of the twelve cases, the losing bidder came from a neighboring Part II country and in only two cases did the losing bidder come from a Part I country.

The results of this analysis show that the use of DP is isolated, with no particular pattern emerging other than: (i) the relatively high concentration in the health sector in the ECA region, most likely the effect of transition on industrial structures in that region; and (ii) the relatively large average size of contracts in the transport sector, especially in SAR and LAC. In terms of actually affecting the tender outcome, the impact was even much less, involving relatively small goods contracts and driven by regional competition.

Conclusions and Recommendations

Based on this analysis, the impact of the Bank's policy towards domestic preference has been minimal. Over the past decade, it has been rarely used and only in isolated instances. Even when applied, it did not likely have any material effect on changing the outcomes of the bidding. It is very doubtful, therefore, that the policy continues to generate much benefit for local industries: either they would have won in the first place or the preference did not change the outcome. It may be that the use of domestic preferences has outlived its usefulness and, as corroborated in other studies, that other policy instruments are more useful in developing local industries. One of the areas that remains to be clarified, not addressed in this analysis, is the interface between local tariff protection and the Bank's policy on domestic preference based on CIF prices. Thus, it may be worthwhile to explore further additional research on this topic and how the evolution of trade and tariff policy has affected the usefulness of the Bank's domestic preference policy.

Use of Domestic Preferences

Data Analysis Methodology

Since the available data on contract award do not explicitly indicate whether or not DP affected the outcome of the award process, we devised a way to approximate when DP would have come into play, based on the available data on the top bidder (the winning supplier) and the nationality of the next three highest bidders.¹ The main assumption is that DP would likely only have an impact among the top four bidders, not any more than that.

Based on analysis of these four top bidder nationalities, the contracts were divided into four categories:

	Contract Category	#	%	Amount (USD)	%
1	Top 4 Bidders all Local	74	48%	189,137,675	68%
2	Top 4 Bidders all International	58	38%	51,844,485	19%
3	Local in Top 4; won over International	12	8%	4,275,473	2%
4	Local in Top 4; <u>did not win</u> over International	9	6%	34,305,349	12%
	TOTAL	153		279,562,981	

	Contract Category	Local in Top 4	International in Top 4	Local Won	International Won
1	Top 4 Bidders all Local	√		√	
2	Top 4 Bidders all International		√		√
3	Local in Top 4; won over International	√	√	√	
4	Local in Top 4; <u>did not win</u> over International	√	√		√

Category 1: Top 4 Bidders all Local

Since the four top bidders were all local, DP would have been applied equally to all bidders. For that reason, DP would not likely have affected the award of contract unless a fifth international bidder was pushed out of the Top 4 by having DP applied equally to the four local bidders. That is not thought to be very likely.

Category 2: Top 4 Bidders all International

DP would not have affected this category since no local bidder was in the Top four. Even if DP had been applied and affected the ranking by pushing a local bidder higher, the highest position could only have been 5th and was not likely to have affected the outcome.

¹ Nationality is determined by place of registration for a supplier, which may not necessarily be the country of origin.

Category 3: Local Bidder(s) in Top 4; Local Won Contract

DP may have affected this category to give the winning local bidder a higher ranking and therefore be awarded the contract over the international bidders.

Category 4: Local Bidder(s) in Top 4; International Won Contract

DP may have affected this category to give a local bidder a higher ranking, but the effect of the preference was still not enough to win the contract over an international bidder.

Based on this information, it is possible that DP may have had an effect for contracts in Category 1 although that does not seem like a very high probability as all four top local firms would have to have beaten out an international firm. Contracts under Category 2 are also clear: since a foreign company won, the preference was not sufficient to change the outcome. Next, DP would have most effect on Category 3 and Category 4 where local and international bidders are both among the Top four bidders. However, in the case of Category 4 contracts, the effect of DP was not enough to change the outcomes. Only in the case of contracts falling into Category 3 is it likely that DP shifted the winner from an international supplier to a local one. That category consists of only 12 contracts, or 8 percent of the total number of DP contracts and 1 percent of their value.

OVERALL STATISTICS

	Contract Category	Number	%	Amount (USD)	%	Local in Top 4	International in Top 4	Local Won	International Won
1	Top 4 Bidders all Local	74	48%	189,137,675	68%	√		√	
2	Top 4 Bidders all International	58	38%	51,844,485	19%		√		√
3	Local in Top 4; won over International	12	8%	4,275,473	2%	√	√	√	
4	Local in Top 4; <u>did not win</u> over International	9	6%	34,305,349	12%	√	√		√
TOTAL		153		279,562,981					

Further Breakdown

Top 4 Bidders all Local	74	Top 4 Bidders all International	58
4 suppliers listed	18	4 suppliers listed	20
3 suppliers listed	25	3 suppliers listed	11
2 suppliers listed	6	2 suppliers listed	10
1 suppliers listed	25	1 suppliers listed	17

PROCUREMENT CATEGORY STATISTICS

Procurement Category	Number	%	Amount (USD)	%
Goods	115	75%	88,342,033	32%
Civil Works	38	25%	191,220,948	68%

MAJOR SECTOR STATISTICS

Major Sectors	Number	%	Amount (USD)	%
Agriculture & Water	13	8%	3,982,838	1%
Education	19	12%	15,098,873	5%
Energy and Mining	16	10%	16,460,356	6%
Health	68	44%	57,447,849	21%
Information Technology	7	5%	5,087,032	2%
Public Administration & Finance	19	12%	10,193,420	4%
Transport	11	7%	171,292,614	61%

REGION STATISTICS

Regions	Number	%	Amount (USD)	%
AFR	32	21%	32,770,688	12%
EAP	19	12%	15,537,345	6%
ECA	51	33%	38,043,149	14%
LCR	13	8%	78,372,584	28%
MNA	19	12%	33,292,931	12%
SAR	19	12%	81,546,284	29%

REGION-SECTOR CROSS STATISTICS

Major Sector / Region	AFR	EAP	ECA	LCR	MNA	SAR	TOTAL (USD)
Agriculture & Water	828,151	660,275	111,020	0	2,383,391	0	3,982,838
Education	3,014,247	74,887	7,715,111	592,371	1,308,020	2,394,238	15,098,873
Energy and Mining	2,105,739	13,714,392	0	0	0	640,225	16,460,356
Finance	0	15,661	0	353,612	0	0	369,273
Health	6,978,971	0	18,877,879	2,299,024	29,144,080	147,894	57,447,849
Information Technology	0	406,920	0	0	0	4,680,112	5,087,032
Public Administration	3,870,559	665,211	3,627,353	1,661,024	0	0	9,824,147
Transport	15,973,021	0	7,711,785	73,466,553	457,440	73,683,815	171,292,614
TOTAL (USD)	32,770,688	15,537,345	38,043,149	78,372,584	33,292,931	81,546,284	279,562,981

Major Sector / Region	AFR	EAP	ECA	LCR	MNA	SAR	TOTAL (Number)
Agriculture & Water	3	2	1	0	7	0	13
Education	4	1	3	2	2	7	19
Energy and Mining	3	11	0	0	0	2	16
Finance	0	1	0	1	0	0	2
Health	16	0	37	5	9	1	68
Information Technology	0	1	0	0	0	6	7
Public Administration	5	3	7	2	0	0	17
Transport	1	0	3	3	1	3	11
TOTAL (Number)	32	19	51	13	19	19	153