

## **The economic impact of eliminating domestic preference margins in GPA countries: a ‘phantom’ tax modelling assessment**

Public procurement is gaining importance on the trade negotiation agenda, both under the aegis of the WTO and at bilateral level in various preferential trade agreements. These trends reflect the economic importance of public procurement markets in terms of GDP and trade flows, as well as the fact that to date a relatively small part of these markets has been committed internationally, both at bilateral and at multilateral level. In GDP terms worldwide, the size of government procurement expenditures as measured in the most recent GTAP database 9 amounts to 10-25% of GDP.

In terms of impetus from trade policy measures, the potential of committing public procurement markets is deemed important in an environment where tariffs are globally already at very low level. In this context, in April 2014, liberalisation efforts at the multilateral level led to the signature of the revised Government Procurement Agreement (GPA). The revised agreement includes additional commitments in terms of government entities as well as new services and public procurement activities. Currently, there are 45 WTO members parties of the GPA.

In spite of the size and importance of international public procurement markets there is a lack of economic analysis of the impact stemming from public procurement markets liberalisation. From an empirical point of view the economic literature by Shingal (2015), Kutlina-Dimitrova and Lakatos (2014), Rickard and Kono (2014), Brühlhart and Trionfetti (2004) and (2001) Trionfetti (2000) etc. provide factual evidence for the presence of ‘home bias’ in government procurement or focus on the identification of possible determinants of cross-border public procurement expenditures. However a quantitative economic assessment of public procurement liberalisation in a multilateral context is not available. Also in terms of CGE modelling apart from the CEPR TTIP report there is no inclusion of public procurement liberalisation efforts in the framework of a free trade agreement assessment.

This paper aims at filling-in this gap. For this purpose the paper uses the public procurement database developed by the GTAP centre for a project commissioned by DG TRADE and the public procurement modelling extension of the standard GTAP model. The former is a MRIO database developed for the assessment of public procurement liberalisation efforts. It accounts for the first time for the fact that traditional IO tables do not feature a split of investment uses in public and private investment. Moreover, this database extension allows for identification of the sourcing of imports per agent i.e. the government, private households and firms hence enabling an assessment of bilateral elimination of domestic preference. The modelling extension follows the database extension and introduces a phantom tax modelling approach whose main notion is that ‘home-biased’ government procurement policies can be modelled through a subsidy accruing to domestic producers and a concurrent tax levied on imports. The exact match in terms of revenue flows ensures that there are no tax revenues gains/losses from a change in domestic preference margins. This is a novel trade cost modelling approach deviating from the AMS/TMS traditional chocks as these are not appropriate for simulating the impact stemming from a reduction in domestic preferences in public procurement markets.

The scenario design in the current paper includes an elimination of domestic preference margin for all GPA parties. The precise shock to the margin is computed by taking the difference between the import penetrations of the government sector versus the private one. In other words, the shock is based on the assumption that GPA parties’ governments will import

the same share of goods and services from abroad as the private sector. This is in line with the above mentioned literature which measures the presence of 'home-bias' in government procurement by looking at a persistent difference between the government and private sector import penetration.