Development Aid and Procurement: The Case for Reform

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INTRODUCTION*

If you are one of those government officials, finance experts, development professionals or NGO members whose eyes glaze over when you see an article on procurement, you are the audience I want to address. Procurement is the purchase of works, goods and services by individuals or firms, or government entities in the case of public procurement. We all make procurement decisions in our everyday lives. We pride ourselves on making good decisions and being able to apply discretion and judgment. Now imagine if you were improving your home and were constrained by pages and pages of legal and technical regulations that take away that discretion. You would soon question whether those regulations were relevant and whether they provide any value or simply delayed and jeopardized good decision-making. Worse yet, imagine if you had to follow rules that someone else outside your family, your community or your country set for you. While public procurement requires a higher standard of governance than personal procurement, developing countries and other stakeholders are raising these questions regarding the policies set by multilateral aid institutions.

In November 2013, the World Bank released the report of its first stage efforts in reforming its procurement policy as it relates to the projects it finances.¹ As the World Bank enters the second stage in designing the actual reforms, the “development community” faces a crucial moment and opportunity to refine and reform a fundamental instrument in the development toolbox—one that has been treated for too long as a “plumbing and wiring” issue that ignores the broader public policy implications and the growing burden of conflicting objectives, regulations, incentives and political polemics. The purpose of this paper is to examine concerns regarding reform of multilateral agencies’ public procurement policies, enhance awareness of what is at stake and lay the groundwork for the reform discussions at development institutions that will take place over the next year.

I should alert you, however, that I am neither a procurement specialist, nor am I a lawyer or an engineer. I would describe myself as a development practitioner. After decades of working on infrastructure projects and on multilateral operational policy, I have maintained a deep respect for my procurement colleagues who have protected my proverbial “backside.” One quickly learns in this business that a mistake in procurement can result in serious consequences as one sits in the middle of the converging, and often conflicting, interests of governments, donors, private sector and, of course, affected communities. The procurement policies applied by the multilateral finance institutions have been responsible for enhancing competition, deepening transparency and raising the integrity of investment in developing countries, as well as opening markets for developed and developing countries’ businesses. As the world of public procurement has evolved, however, one also learns that procurement is becoming more than just getting the “plumbing and wiring” right. Indeed, the role and application of public procurement policies and practices is an essential element of design and implementation with crucial consequences for the quality of outcomes. The case set forth in this paper lays out the factors driving the need for major reform of multilateral banks’ procurement policies—rather than simply adapting existing policies. This paper also presents the major challenges to be addressed in designing the reforms and the tensions to be resolved or balanced as the World Bank enters the more detailed design stage of its reform effort.²

*The author thanks Christine Zhang for her analytical support in preparing this paper.
WHAT IS DRIVING REFORM?

The complexity of the debate around reform at the multilateral banks (especially the World Bank and the Regional Development Banks) is exacerbated by the often conflicting trends and concerns in development finance and public procurement more generally. Among these are five key trends that I would emphasize:

1. Growing recognition of the importance of public procurement in the governance agenda and in the management of public expenditures. A look at the relative volume of public procurement underscores what is at stake in setting procurement policies and procedures. The 2002 paper by Denis Audet of the Organization for Economic Cooperation and Development (OECD), based on 1998 gross domestic product (GDP) data, provides a starting point. Audet estimates that the ratio of government procurement is about 20 percent of GDP for OECD member countries and about 14.5 percent for non-member states.3 As these estimates exclude all defense-related expenditures, there is some underestimation. There is a wide variation among countries that depends more on the economic structure of the country and not its classification as developed or developing, and these ratios can change dramatically from year to year in smaller economies due to the timing of major investments. Most interesting is Audet’s finding that subnational public procurement in OECD countries, or procurement at the state and city level, is greater than national procurement by a factor of up to 3.4 While there are no parallel statistics for developing countries, the consistent trend in fiscal decentralization and rapid urbanization suggests an equivalent move in this direction.

The implications of these statistics are clear in terms of the importance of public procurement in the governance of public expenditures, and increasingly in the dialogue over international trade and market access. This has led to the increased focus of the World Trade Organization (WTO) on the Government Procurement Agreement (GPA). As stated by Sue Arrowsmith and Robert Anderson, “…the WTO regime on government procurement…is undergoing far-reaching transition from constituting an important but relatively obscure element of the WTO to becoming a cornerstone of the international trading system.”5 First signed in 1994, the GPA has been seen mainly as an agreement among developed countries. Recent revisions, however, are directed at encouraging broader country signatories, especially developing countries, and are starting to have some effect. These revisions, together with reforms of the European Union public procurement directives and the United National Commission on International Trade Law (UNCITRAL) Model Law on Public Procurement, represent the growing worldwide interest in public procurement.6 It is important for multilateral institutions to influence these reforms as well as to take these reforms into account in their own policy reform efforts.

2. Changing nature of development finance. A key factor in the case for procurement reform for multilateral institutions like the World Bank is the changing role and nature of development aid. One of the more striking trends is in the composition of the types of investments funded. As shown in Figure 1, since 1980 the share of World Bank financing for infrastructure projects declined from 76 percent of annual lending to 41 percent in 2012, while the share of education and health financing, typically comprising a large number of lower-value contracts, rose from 5 percent to 18 percent.7 Even within the realm of infrastructure, the nature of the contracts has tended toward lower-value investments in maintenance, rural roads and community works. The share of non-investment lending has also increased, as Development Policy Lending (originally called Ad-
justment Lending) rose from 4 percent to 34 percent. These loans provide general budget support and are not associated with the financing of any specific investment contracts.

Figure 1. Composition of World Bank Lending in Fiscal Years 1980 and 2012

![Fiscal Year 1980 Lending vs Fiscal Year 2012 Lending](image)

Note: Infrastructure Projects defined as Agriculture, Energy, Urbanization, Transportation, Water Supply and Sewage sectors. Education and Health Financing defined as Education and Health Sectors.


The implications of this shift in the types of projects financed are substantial. Current multilateral procurement policies are mainly directed at the larger projects and encourage the application of International Competitive Bidding (ICB). The purpose of ICB is to ensure an open, competitive, fair and transparent process with extensive rules, model bidding documents and review processes. Smaller contracts, which normally would not attract foreign competition, are mostly tendered under National Competitive Bidding procedures (NCB). NCB procedures are local procedures that are reviewed to ensure “economy, efficiency, transparency and broad consistency” with the World Bank’s guidelines but are less regimented than ICB. Of the 100,000 contracts financed annually by the World Bank, over 90,000 are tendered under NCB procedures. A new lending instrument being piloted at the World Bank, Program for Results, further recognizes this shift and the need to “rethink” procurement policies and the mode of disbursements. In Program for Results, investments are treated on a “program” basis rather than as individual contract transactions—applying the guidelines of localized or national procurement systems rather than ICB. The bottom line is that if the multilaterals want to ensure the appropriate use of an increasing share of their funds, the key will be to influence the nature of national or local systems, well beyond the traditional “ring-fencing” of (or singular focus on) the individual transactions being financed.

A second factor that affects multilateral procurement policy and underscores the need for increased focus on country policies and practices is the reduced weight of multilateral and bilateral aid in developing country budgets. Historically, multilaterals have had a significant role in opening up developing country markets to foreign
competition, as multilateral financing and the application of multilateral procurement policies provided some degree of comfort to enter these markets. In the 1980s, firms from developed countries represented the main suppliers under World Bank financing using ICB. As shown in Table 1, developed countries (those not eligible for borrowing from the World Bank) represented nine out of the top 10 suppliers. Over time, the benefit of opening markets extended to firms from developing countries, increasing South-South transactions. By 2012, developed countries represented only six out of the top 10 suppliers by 2012. Further, if one takes into account the growing share of ICB contracts won domestically, this number drops to four.10

As multilateral aid as a percentage of national GDP in developing countries declines, however, the role of multilaterals in opening markets is reduced. World Bank non-concessional lending has declined from a high of 0.67 percent of borrowing countries’ GDP in the 1980s to less than 0.20 percent in 2012. Similarly for countries qualifying for concessional lending, the decline was from 1.6 percent at its peak in the 1990s to a little over 0.60 percent in 2012.11 While other sources of multilateral funding have grown, the overall trend is the same. As a result, public procurement is increasingly happening without multilateral funding. Statistics are not available, but it is evident that international firms are entering the markets—at least in a number of developing countries—using local systems instead of depending on multilateral procedures and oversight. If one listens carefully to industry calls for procurement reform for developing country markets, the focus is on targeting the policies of the emerging market countries directly rather than that of the multilaterals.12 To the extent that multilaterals can help pursue this agenda, such firms should be supportive.

Table 1. Top 10 Ranked Suppliers for ICB Procurement under World Bank Financing (by value of contracts in fiscal year)

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Note: Total goods, civil works and services where supplier is from country other than borrower country. Countries shaded in blue represent “developed countries,” which are defined as countries not eligible for borrowing from the World Bank in the fiscal year indicated.

The combination of these shifts underscores the need to rethink and reformulate the procurement policies and practices of the multilaterals. While there is still a need for policies and procedures to ensure that complex and high-risk investments are subject to substantive review and oversight, the increased need to focus on and improve national policies requires a change in the balance and emphasis of multilateral policy and practice.

3. **Adapting to new procurement approaches.** The traditional focus on a set of rules to ensure transparency, open markets and award criteria was heavily directed at setting clear expectations and minimizing discretion in the process. Over time, questions have been raised about the implications for the quality of the investment outcomes of such an approach. The policy and procedures, especially for works and goods, sharpened the focus on the price of the bid, with some limited ability to reject a bid under the concept of “lowest evaluated bidder.” Yet investment decisions have arisen that require a broader perspective and a greater focus on how to better integrate other factors affecting the quality of the investment outcome. Procedures for tendering for information technology goods and software opened up this line of questioning. Now, the relatively singular focus on price is also being questioned with regard to more traditional sectors such as road infrastructure, in which broader concerns about quality and durability were not sufficiently reflected in standard tenders. Today, this focus is better known as “value for money” with concern for: overall costs, or “life-cycle costing”; opportunities for innovation, or “design/build” approaches; adaptation to new financing partnerships, or “private public investments”; speed, or “framework agreements”; and dynamic negotiations, or “electronic auctions.”

These approaches raise new challenges for multilateral aid institutions as well as bilateral donors. Efforts to standardize rules and procedures become overwhelming as the number of variables to be applied and measured is expanded. The most significant change is in the amount of discretion permitted by procurement professionals and related technical experts. How does one design “objective” measures to incorporate such concerns into bidding and award procedures? Under what market circumstances and governance conditions is it appropriate to apply such practices? Indeed, the implications on the development and training of procurement staff are substantial as they move from a more standardized set of rules.

4. **Serving objectives beyond economy and efficiency.** As if the situation was not becoming complex enough, the relatively straightforward principles that guided multilateral and worldwide policies on public procurement are now being revisited as a range of other objectives enter the public procurement equation. Governments, unlike the private sector, have tended to use procurement policy to pursue a range of public policy objectives. In recent discussions on reform, these have been referred to as “horizontal” policies or as Sustainable Public Procurement (SPP). SPP, as defined by the United Kingdom Sustainable Procurement Task Force, is “…a process whereby organizations meet their needs for goods, services, works and utilities in a way that achieves value for money on a whole life basis in terms of generating benefits not only to the organization, but also to society and the economy whilst minimizing damage to the environment.” Social policies have been incorporated in procurement by developed and developing countries for many years. From policies to promote women and minority owned businesses in the United States, to the protection of small and medium-sized enterprises in Europe, to the preference given to support historically disadvantaged individuals in South Africa, using procurement to further social objectives has been an accepted practice. More recently, environmental concerns are being incorporated in bidding procedures in what is termed as “green procurement.” There are
substantial measures being incorporated in legislation in developing countries. While it is relatively straightforward to incorporate environmental concerns into specifications when one is purchasing a good (assuming there are internationally accepted standards by which to judge), the incorporation of such considerations in comparing the performance of goods or civil works over the course of the life of the asset (for example, in terms of carbon footprint) involves a more complex analysis for which objective criteria are still being developed.

Multilateral institutions’ policies are relatively silent on incorporating “horizontal” objectives. Such institutions have applied their own approaches to protecting or fostering the development of local enterprises in developing countries through the incorporation of a domestic preference through a pricing margin. For instance, the World Bank, since 1966, has allowed for a margin of preference in pricing of 15 percent for locally manufactured goods and 7.5 percent for works (eligibility for works, however, is limited to countries below a certain income level). Recent analyses have concluded that such margins are rarely applied; even when applied, they have only affected awards in a very limited number of cases. Simply dropping this preference, however, ignores the fact that most countries allow for some form of preference in bidding. The more important question should not be whether or not a policy has been applied, but rather which policies have been successful or not in terms of achieving “horizontal” objectives. If effective, then, are there guidelines to ensure objective criteria in bidding and evaluation? The multilaterals should play an important role in ensuring that developing country interests are represented in related industrial forums to discuss such criteria and standards.

5. Working under the cloud of fraud and corruption. Addressing fraud and corruption is clearly the most sensitive hot-button issue in the reform debate. As other factors are pushing the envelope toward greater discretion and the use of multiple approaches in procurement policies and practices surrounding development aid, the overwhelming counter-pressure over the last decade has been concern for fraud and corruption. After decades of a relatively benign perspective on the treatment of fraud and corruption by multilaterals, the pendulum has swung aggressively to address an issue that has haunted public procurement throughout the world. While client countries and even bilateral donors press for faster and more flexible procurement on the one hand, they are quick to come down hard when either fraud or corruption is identified, because they face reputational risks at home. Multilaterals find themselves caught in the middle, needing to protect their status as strong fiduciary trustees for donor money. But if there is any one factor that slows down the procurement process from the multilateral side, it is the processes that have been put in place to manage such risks and the risk-averse environment that has evolved. Part of this is a natural learning process, as task teams and management work through the logistics of applying such practices. But another part is due to a great amount of uncertainty and a reluctance to make decisions. One possible indication of this is that despite raising contract value thresholds to lessen the number of contracts requiring prior review by the World Bank, the median value for contracts actually reviewed remains relatively low. From fiscal year 2010 to fiscal year 2012, the median value for prior review of civil works contracts was less than $700,000, and for goods contracts, the median contract value subject to prior review across the regions was less than $200,000. The more contracts that require prior review and get pushed up the bureaucratic ladder, the longer the bidding process.

There is no doubt that the anti-corruption efforts of the multilateral banks have been a welcome initiative and that they have raised awareness and introduced new approaches to the design and implementation of projects.
It is not the purpose of this paper to discuss the overall governance and anti-corruption work of these institutions, but to focus on the application of such work to procurement. The history of similar efforts in developed countries offers lessons to multilaterals, and it is important to step back and assess whether the procedures put in place are cost-effective in terms of reducing corruption and whether the relative transaction costs are appropriate. Frank Anechiarico and James B. Jacobs wrote, in their 1996 work on public contracting, “After pursuing the vision of corruption-free government for almost a century, we have the worst of both worlds—too much corruption and too much corruption control.”

The change in culture within the multilaterals is evident in the open way in which corruption is being discussed as well as in the adoption of cross-debarments so that the multilaterals recognize and mutually enforce each other’s sanctions. World Bank reports reveal high profile cases of corruption that have been investigated and sanctions that have been applied. Still, out of the almost 100,000 contracts awarded for financing by the World Bank in fiscal year 2011 (of which about 9,000 were subject to prior review by the Bank due to the amount involved or the relative risk), there were only 52 contracts in which misprocurement was declared.

In the case of the Integrity Unit of the World Bank (INT), of the 157 cases in which sanctions were issued between 2006 and early 2012, about 70 percent involved only fraud while 30 percent involved corruption or a combination of both. According to the World Bank’s procurement guidelines, fraud entails deriving a benefit through misrepresentation, whereas corruption entails the act of providing “anything of value to influence improperly the actions of another party.” Most of the respondents committing these acts of “misprocurement” were from the country in which the bidding took place, and the incidence of fraud and corruption was mainly in lower income countries. Despite a number of high profile cases, it is difficult to accept that lower-income countries face that much more corruption and that most of it is for fraud. This is not to fault multilaterals, but rather to recognize their limitations in discovering and prosecuting corruption. It raises the question of whether the Bank’s policies and efforts are merely effective at exposing “incompetent” fraud as opposed to more sophisticated cases of fraud and corruption.

Empirical studies evaluating the impact of anti-corruption efforts in procurement are almost non-existent. One source of work has been the efforts of Charles Kenny focusing on the construction industry. His findings question the ability of multilaterals to uncover the larger cases (“grand corruption”) and the relative impact of different anti-corruption approaches on development outcomes. More importantly, he raises the question of whether the resources put toward anti-corruption could be better spent overseeing contract execution, where substantial corruption may occur even after a supposedly clean bidding process. The question arises as to whether multilaterals have focused too much attention on the bidding process and not enough on other elements of the project cycle—elements that can be more damaging to the quality of the outcome. Procurement professionals in the multilaterals generally consider their job done once the contract is awarded. In the case of infrastructure, shorting of materials and bribing of supervisory officials can have more serious impacts that may not be evident until years after project completion. Thus, while some may consider issues regarding fraud and corruption outside the ambit of procurement reform, it is apparent that it should be very much front and center in the discussion.
RESPONDING TO THE CHANGING ENVIRONMENT

The response of the World Bank and other multilateral lending institutions to these trends has been to periodically edit and adapt existing policies and guidelines, raising thresholds for review and incorporating new procurement options. Any reading of the guidelines issued by multilaterals will illustrate the patchwork nature of their adaptation. With the changes in development aid and in the realm of procurement worldwide, there is clearly a need for a reformulation of the policy: one that encompasses the broader objectives of procurement as well as the growing range of options; that sets forth clear principles but allows room for discretion and application of professional judgment; and that upholds the demand for integrity while recognizing the risks and trade-offs of alternative approaches, with a focus on the quality of development outcomes. Overall, the new policy should place procurement in a more strategic and integrated role within sustainable development, rather than treating it as simply the “plumbing and wiring” of the system. This is the approach that is presented in the Phase I report of the World Bank. As we enter the phase for the detailed design, however, there are a series of complex and contentious issues that needed to be discussed. Among the key issues are those outlined below:

Moving Beyond the Use of Country Systems (UCS) Debate. The pressure for reform in development aid procurement policy originally focused on the use of country systems versus the use of multilateral or donor systems. This was underpinned in international agreements including the Paris Declaration (2005), the Accra Agenda for Action (2008) and the Busan Partnership for Effective Development Cooperation (2011). While the donor community showed strong support for the concept, there was a lack of a shared understanding as to what the use of country systems meant. As a result, attempts to pursue UCS have led to protracted debates and limited impact. The World Bank scrapped its pilot initiative on the use of country procurement systems when it became clear that the assessment bar was being set so high that very few if any countries would qualify (or would be interested to qualify at that level).25 The case for reform described above, however, implies that the debate over UCS is not as relevant today. It is no longer a situation of whether to use “their” systems or “our” systems. It is more about agreeing on the basic principles and options and adapting them to the circumstances on the ground. The UCS emphasis on the need for greater attention to developing country laws and procedures as well as technical capability and performance remains valid, but the broader range of instruments and the breadth of objectives being placed on procurement policy require a different kind of dialogue and approach that is not amenable to simple “green” versus “red” lights.

Shifting the Focus from Compliance to Outcomes. While it may seem obvious that one should focus on the impact on outcomes of procurement policies and procedures, the fact is that the current emphasis has been on compliance with procedures and the bidding process. Procurement practice has always been well-served by combining the efforts of technical people with knowledge of sectoral or industry issues with procurement professionals who understand the contracting and compliance concerns. In the effort to enhance competition, ensure fairness and guard against fraud and corruption, discretion by governments and donor institutions has been increasingly restricted. The question arises as to whether the pendulum has swung too far so that professional judgment is not only overly constrained, but that there are few incentives to apply such judgment. This is happening at the level of the client countries as well as the donor institutions. The new procurement instruments, however, require greater use of professional judgment and the challenge is how far to open the door to such discretion and regain the joint input of the sectoral and procurement professionals.26
Integrating Cost-Effective Approaches to Fraud and Corruption. Related to the issue of limiting “discretion” in procurement is the influence of efforts to guard against fraud and corruption. There is a need to step back and ask tough questions about what works and what does not: whether a procedure is about anti-corruption or reputational risk; which processes are cost-effective and which are not; and whether we have the focus right by emphasizing the bidding procedures. Procurement policies and procedures should be seen in a broader context, and anti-corruption measures should be viewed across the project cycle. What good is a clean bidding process, if there was corruption in the selection of the project itself or in the execution of the contract? Although most assessments have mentioned the need for greater attention on contract management and execution, very little is said about what is required, what are the potential trade-offs with bidding procedures and what are the roles of multilateral procurement staff versus technical experts and the government.

Measuring the Effectiveness of “Horizontal” Objectives. There is a worldwide trend to use public procurement to address objectives beyond the economy and efficiency of investments. Social objectives to promote small businesses, support minority-owned enterprises and redress historically disadvantaged groups have been accepted as part of procurement policy in developed and developing nations. There is surprisingly little empirical work, though, on the effectiveness of these initiatives. Similarly, the relatively new approach of “green” procurement to support environmental goals is gaining ground and presenting new challenges for the procurement community. Here again, the empirical basis for policy is ill-defined as of yet. Determining to what extent multilateral policies should incorporate such objectives needs to be considered with a keen eye on the evidence of impact; and clear guidance is needed on how to set objective criteria to ensure a fair bidding process.

Reinventing the Procurement Profession. What is left unsaid in most discussions of procurement reform are the implications for the profession itself. It is clear that at least within multilateral institutions, these changes require a major shift in focus and expertise. Can procurement staff, who have been trained mainly to handle specific transactions and details of bidding documents, be easily reformulated into experts on the application of the range of instruments and related policies? What will it take to retrain, recruit and properly “incentivize” staff in this new role? How can multilaterals ensure that sectoral technical staff feel responsible and are integrated into the procurement function?

CONCLUSION

The dialogue that needs to occur over the course of the coming year among a range of stakeholders represents a significant opportunity to undertake major reform with substantial implications for development outcomes. It is clear from the issues described above that this dialogue requires a level of trust and mutual understanding across stakeholders to address politically, economically and socially sensitive perspectives. As Herbert Kaufman once wrote, “One person’s ‘red tape’ may be another’s treasured safeguard.” The result, however, should represent a significant step in recognizing and incorporating the types of changes that need to occur in the provision of development aid. Multilaterals traditionally have been at the forefront of efforts to set the standard and practices for procurement in developing countries. As the world moves to a more globalized and integrated system of finance and trade, will multilaterals take a key role in leading that agenda or remain singularly focused on the integrity of individual transactions?
REFERENCES


ENDNOTES

1. A number of background reports are referred to in this paper. The full list of reports can be accessed through the World Bank Procurement website: http://web.worldbank.org/WBSITE/EXTERNAL/PROJECTS/PROCUREMENT/0,,pagePK:84271~theSitePK:84266,00.html.

2. The main focus of this paper is on procurement of goods and civil works. Procurement of services, mainly consultancies, raises a different set of issues.


4. Ibid., p. 151.


7. World Bank Annual Reports.

8. Ibid.


10. World Bank Annual Procurement Reports. Contracts won domestically are defined as those in which the supplier firm is located in the borrowing country.


12. Letter to the President of the United States from Jim McNerney of the President’s Export Council, September 19, 2013.


20. The World Bank requires prior review of the various stages of the bidding process including prior to award (see Appendix 1, par. 2-4 of “Guidelines Procurement Under IBRD Loans and IDA Credits”) depending on the size, scope and relative risk of the contract. A threshold, based mainly on the size of contract, is set for the level of prior review within the Bank.


