

USTR Requests Input on Impact of Trade Agreements on Government Procurement

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On August 21, 2017, the Department of Commerce (Commerce) and the Office of the United States Trade Representative (USTR) issued a [request for public comment](#) on the impact of government procurement provisions of U.S. trade agreements on U.S. manufacturers and suppliers. Prompted by President Trump’s “[Buy American and Hire American](#)” Executive Order (E.O.), the request seeks to understand how domestic preference laws affect participation of U.S. manufacturers and suppliers in the Federal procurement process. Noting the significance of reciprocity in the global trading arena, the request also asks for industry input concerning the “costs and benefits” of trade agreements, and related laws, from those U.S. manufacturers and suppliers competing in foreign government procurement markets. Comments are due by September 18, 2017.

Background of the Request for Comment

The President’s Executive Order

Designed to further the Administration’s “America First” agenda, the “Buy American and Hire American” E.O., which we [previously analyzed](#), aims to maximize the Federal government’s use of goods, products, and materials produced in the United States by requiring agencies to increase monitoring, enforcement, and compliance with Buy American Laws¹ while minimizing the use of waivers.

The E.O. mandates that agencies assess Buy American Laws and provide specific recommendations regarding ways to strengthen those laws and develop policies to maximize the use of materials produced in the United States. It also directed the Secretary of Commerce and the USTR to conduct a review of the effects of U.S. Free Trade Agreements (U.S. FTAs) and the World Trade Organization’s Government Procurement Agreement (GPA) on the implementation of domestic procurement preferences.

¹ The E.O. defines “Buy American Laws” to mean “all statutes, regulations, rules, and Executive Orders relating to Federal procurement or Federal grants including those that refer to “Buy America” or “Buy American” that require, or provide a preference for, the purchase or acquisition of goods, products, or materials produced in the United States, including iron, steel, and manufactured goods.”

The Administration's Memorandum

As part of the E.O.'s initiatives and prior to the USTR's release of its request for comment, the Office of Management and Budget (OMB), issued a [memorandum](#) to Federal agencies entitled, "Assessment and Enforcement of Domestic Preferences in Accordance with Buy American Laws" on June 30, 2017. The memo directs agencies to address three primary areas bearing upon Federal procurement:

1. *Oversight of Buy American Laws:* Agencies must assess "the monitoring of, enforcement or, implementation of, and compliance with Buy American Laws." The memo requires agencies to provide a report addressing 1) any procedures and guidance that the agency has developed "to assist the workforce in meeting the requirements of Buy American Laws and the application of the Trade Agreement Act (TAA)"; 2) any internal reviews conducted in the last two fiscal years regarding compliance with such laws; 3) any marketing and outreach that the agency has taken to promote and enhance visibility for the acquisition workforce of products that are compliant with Buy American Laws; and 4) any training tools or resources that the agency uses to ensure the acquisition workforce understands the parameters and technical mechanics of Buy American Laws and the TAA.
2. *Enforcement of Buy American Laws and Waiver Usage:* Agencies are required to analyze the use of waivers within their agencies by type and impact on domestic jobs and manufacturing.
3. *Steps to strengthen implementation of Buy American Laws:* Agencies must "develop and propose policies to ensure that, to the extent permitted by law, Federal financial assistance awards and Federal procurement maximize the use of materials produced in the United States, including manufactured products; components of manufactured products; and materials such as steel, iron, aluminum, and cement." The memo also instructs agencies to address ways to improve current agency practices bearing upon oversight of Buy American Laws.

The Request for Public Comment on the Impact of Public Procurement Trade Agreements

The request for public comment by Commerce and the USTR addresses one of the E.O.'s mandates by seeking industry input "to better understand how the U.S. government procurement obligations under all U.S. free trade agreements and the GPA affect U.S. manufacturers' and suppliers' access to and participation in the domestic government procurement process." This is a somewhat curious way of formulating the topic, since in general neither Buy American Laws nor trade agreements restrict or regulate whether U.S. manufacturers have access to U.S. procurements. Rather, they govern which foreign-made products have access to the Federal market. Perhaps a better way of summarizing what the request is trying to get at would be, how do trade agreements affect the competition faced by U.S. manufacturers in Federal procurements? And, what are the costs and benefits to the U.S. economy and U.S. taxpayers of such trade provisions?

Acknowledging that "reciprocal access to trading partners' markets is an important motivation for including government procurement obligations in U.S. free trade agreements and for the United States' membership in the GPA," Commerce and the USTR are also seeking comment on how these

obligations affect manufacturers and suppliers competing in foreign government procurement markets. Any modifications to current trade agreements lessening foreign access to the Federal market could also lead to reduced procurement of U.S. goods by foreign governments. The request for comment poses a series of questions on access to U.S. Federal and to foreign government procurement markets for U.S.-manufactured goods. In responding to the questions, commentators are requested to consider the impact with respect to:

- Business opportunities that are made available;
- Economic incentives that trade agreements and Buy American Laws provide;
- How trade agreements impact business competitiveness, or increase or decrease competition, in government procurement opportunities;
- How trade agreements affect companies' (prime contractors') supply chain and sourcing decisions for goods;
- How Buy American or similar foreign requirements increase or decrease companies' (prime contractors') competitiveness in government procurement opportunities;
- Administrative compliance costs tied to Buy American and similar government procurement policies; and
- Additional costs relating to providing or otherwise proving the country of origin of goods provided.

Potential Impacts

It will be interesting to review the impact assessments that industry and other interested parties submit in response to the request. Perceived impacts are likely to vary by sector, due to varying coverage and restrictions of Buy American Laws and trade agreements, and due to differing market conditions and supply chains in those sectors.

Pharmaceuticals: The TAA is a major issue for pharmaceutical companies because over 80% of the world's active pharmaceutical ingredients come from India and China, non-FTA countries. However, recognizing that innovator drugs under patent are available from only one source, the Department of Veterans Affairs recently liberalized its procurement policy with respect to the Federal Supply Schedule (FSS) by requiring such drugs to be offered for FSS contracts even if they have non-FTA country origin. If instead drugs were subject to the Buy American Act (BAA), a price evaluation preference would be applied to non-domestic offers, but that would have no impact if there is no U.S. final manufacturer. In theory there could be some inducement for more U.S. final manufacture, but the Federal market is small relative to the commercial market and might not be enough to affect many product sourcing decisions. The cost of components test would not apply, since drugs are commercial off-the-shelf items.

Information technology (IT) equipment: Congress has removed commercial IT products from coverage of the BAA. Therefore, the effect of the TAA in this field is not to liberalize trade, but

to reduce the range of potential sources by making non-FTA countries ineligible. China is the country most affected, as most other major IT manufacturing countries are FTA signatories.

Other commercial items: While the BAA still requires U.S. manufacture for non-IT items, Congress has waived the cost of components test for commercial off the shelf (COTS) items. This is probably the area in which FTAs have had the greatest impact. The GPA and other FTAs open U.S. procurement on an equal basis to manufacturers located in the vast majority of significant U.S. trading partners. However, it is worth noting that the country that first comes to mind for low-cost manufacturing—China—is not one of them. Nevertheless, the economic impact is mitigated because government sales generally make up only a relatively small fraction of total commercial item sales. Therefore, sourcing and supply chain decisions by U.S. as well as non-U.S. companies tend to be driven far more by cost, quality, and reliability than by access to the Federal market. Therefore, it is doubtful whether application of the BAA standard rather than the TAA standard would result in relocation of much manufacturing to the United States. In some cases the BAA price preference would not be enough to enable a BAA product to win bids. Any benefit would have to be balanced against the increased cost to the taxpayer and the fact that the government would lose access to sophisticated technology manufactured in places such as Japan and Germany.

Military equipment: This is an extremely large U.S. export sector. It is little affected by FTAs, because there are national defense carve outs. Instead, this sector is governed by bilateral memoranda of understanding between the U.S. Department of Defense and the defense ministries of allied countries, including all NATO nations and Israel. These provide for reciprocal free trade. Historically the major systems manufacturers and integrators have opposed content restrictions, for multiple reasons. One is that the companies are major exporters and have more to gain than to lose by open government procurement. Another is that major systems are incredibly complex, having hundreds of thousands of components, and tracking component origin can be an administrative nightmare with little countervailing benefit. On the other hand, there may be some U.S. specialty component manufacturers who would prefer to be protected against foreign competition. There are carve-outs for congressionally-imposed preferences for U.S. textiles and clothing, food, specialty metals, and other niche goods. These restrictions are not affected by trade agreements.

Other non-commercial items: This is a relatively small category of goods. Since the cost of components test applies to it, the proportion of products that are eligible is smaller than for commercial items. Conversely, by waiving the BAA, FTAs have a correspondingly larger liberalizing impact for this category of goods. However, even companies that do some or all of their manufacturing in the United States do not necessarily favor Buy American because it limits their ability to source components elsewhere to meet competition.

Steel: A lot of steel goes into state and local highway and transit projects funded in part by Department of Transportation grants. Grant restrictions, including US-melted steel requirements, are carved out of FTAs. Interestingly, some U.S. as well as foreign steel producers are also excluded because raw materials may come from other countries. Thus, these restrictions benefit some U.S. producers and disadvantage others.

Construction material: The BAA regime for construction materials parallels that for supplies. Unmanufactured materials must be produced in the U.S. Manufactured materials must be manufactured in the U.S. Non-COTS manufactured materials are subject to the additional

requirement that U.S. components represent at least 50% of total component cost. Nearly all Federal projects are over the applicable FTA monetary thresholds, however, where the TAA makes construction materials from any FTA country acceptable. Application of the BAA could benefit some U.S. makers of building materials, but it could make business more complicated and expensive for general contractors and their customers.

Software: To date, software has been little affected by trade restrictions or trade liberalization. This is attributable in part to the fact that Buy American Laws generally pre-date the software industry and there are no general restrictions specifically targeting software. Customs and Border Protection decisions hold that recording of software onto media is a substantial transformation of the media. Consequently, it is a simple matter to establish compliant origin at the point of recording, regardless of the fact that development work many have occurred in multiple other countries.

Services: FTAs have had little impact with respect to services, for several reasons. First, Buy American Laws generally aim at manufactured goods, certain commodities (e.g., steel, textiles, specialty metals), and infrastructure (especially highways and transit), not services. Therefore, even though procurement FTAs apply to services, there are few potentially waivable limitations in the first place. Second, the rule of origin for services only requires that the service provider be established (have a permanent place of business) in the United States or an FTA country. This is easy to comply with for any company doing international business, so there is little impact on who can compete for service work among FTA countries. Third, many types of services must be provided at the customer site regardless of any trade requirements (e.g., construction, custodial work, landscaping, maintenance). Some others, such as call centers, cloud computing, and software development, lend themselves easily to remote sourcing.

Small businesses: Small business preferences are carved out from U.S. FTAs, so the FTAs have no impact on them. Small business preferences (which benefit only small businesses operating in the United States) are a sore point with U.S. trading partners, but it is uncertain how much impact they actually have on trade. It is questionable how many overseas small businesses have the resources to participate in U.S. government procurements, even if permitted to compete for U.S. small business set-asides. Canadian small businesses, many of which do sell in the U.S. market, are probably most affected.

Conclusion

The request for comment is a step in pursuit of the Administration's "Hire American-Buy American" agenda. The Administration may find that industry does not universally share the President's view that the GPA and other FTAs are "bad deals" for U.S. industry and the U.S. economy. Changes to the U.S. FTAs or the GPA may have varying impacts on the different industry sectors. Regardless of any policy preferences or prescriptions that may be offered by commenters, one can hope that responses will contribute to a more evidence-based discussion on the proper approach to future trade agreements or potential revision of current pacts.

For additional information about the request for comment and domestic preference issues, please contact the authors of this posting or the Hogan Lovells attorney with whom you work.

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