

Chapter 14

GOVERNMENT PROCUREMENT

1. OVERVIEW OF RULES

Economic Aspects and Significance

Government or public procurement is the purchase, lease or rental of products and services by government entities. The size of the government procurement market and its share of the economy differs from country-to-country, but estimates generally place it between 10 percent and 15 percent of GDP. Therefore, procurement laws that discriminate against foreign suppliers distort the international flow of products and services, which worsens as the economic importance of services and soft industries increases.

National security is one reason offered for policies that favor domestic products in government procurement. However, these policies are also commonly enacted to promote industrial policy, *i.e.*, to protect specific industries. Discrimination between domestic and foreign suppliers in government procurement will, in the short run, help countries achieve their industrial policy objectives, but ultimately creates an arbitrary barrier to fostering a fully competitive environment. For entities procuring goods, restrictive policies will prevent them from buying the best possible goods and services at the lowest possible price and will, therefore, prevent the government budget from achieving maximum utility. For suppliers, procurement restrictions mean that domestic industries are given excessive protection, creating disincentives for the protected industries to improve the ways in which they conduct business or develop new products. Such policies, therefore, weaken suppliers.

Given that the size of the government procurement market is quite large, when procurement protection is linked to policies that protect domestic industry, disciplines on subsidies become meaningless; such protection ultimately causes palpable distortions to the free-trading system. Policies that accord preference to domestic products in government procurement are without question detrimental to one's own economy, as well as to world trade.

Background of Rules

Establishment process of agreements related to government procurement

Governments tend to favor procurement of their own country's goods and services for reasons ranging from national security to the promotion of domestic industry. The negotiators of the GATT were aware of this reality and through Article III:8(a) exempted government procurement from the requirement of national treatment.

However, as discussed in this chapter, discrimination against foreign products in procurement procedures can exist in a variety of ways, including: (1) expressly prohibiting foreign companies from tendering bids for government procurement contracts; (2) giving preferential treatment to companies that agree to use substantial amounts of domestic merchandise in the execution of government contracts; and (3) imposing conditions and requirements on bidders for the purpose of shutting out foreign companies and promoting domestic industry.

The Kennedy Round of GATT negotiations first recognized that the use of procurement procedures to protect domestic industries constituted a major non-tariff barrier. As the growing volume of government procurement transactions became increasingly important to the world economy, the major contracting parties to the GATT realized a need to establish rules and disciplines. As a result, in 1979, under the Tokyo Round, the Agreement on Government Procurement (hereinafter “the 1979 Agreement”) was concluded and required national treatment and most-favored-nation status, as well as fair and transparent procurement procedures. The 1979 Agreement subsequently was partially amended in 1987.

Additional negotiations to revise the 1979 Agreement were initiated with a view toward improving the text of the Agreement and to expand its coverage. These negotiations and the WTO Agreement were concluded simultaneously in December 1993. The new Government Procurement Agreement (hereinafter “the 1994 Agreement”) was signed in April 1994 at Marrakech and took effect January 1, 1996. In this new agreement, the procurement of services became included, as well as other “soft” parts of the economy, that is, regional governments and government-related entities. Furthermore, it became mandatory for contracting countries to implement systems in which suppliers who believed there was a breach of the Agreement in the procurement procedure of a government entity could file a complaint.

The Agreement on Government Procurement (GPA) is one of plurilateral trade agreements made under the WTO agreements. The Agreement is only applicable with respect to Member countries that become parties to the Agreement (hereinafter referred to as “contracting countries”). Countries that wish to join the Agreement need to negotiate accession with the existing contracting countries and be approved by the Committee on Government Procurement. Currently, 43 countries and regions, mostly developed countries (Armenia, Canada, the EU, 28 EU Member States, Hong Kong, Iceland, Israel, Japan, Republic of Korea, Lichtenstein, Netherlands Antilles, Norway, Singapore, Switzerland, Taiwan and the US), are contracting parties. In addition, international organizations and some WTO member countries participate as observers. In addition to Armenia and Croatia, which became new contracting countries in September 2011 and July 2013, respectively, currently ten countries and regions are negotiating for accession, including China, which submitted an accession application in December 2007 (see Chapter 1, Part I for the status of China’s accession negotiations). In the future, extensive participation, including by developing countries, as well as active participation of other developed countries, is anticipated.

Legal Framework

As was the case with the 1979 Agreement, the 1994 Agreement includes the principles of national treatment and non-discrimination and requires fair and transparent procurement procedures. The 1994 Agreement reinforces and improves the 1979 Agreement in the following respects:

(a) Expansion of Coverage

In the Appendix to the Agreement, each member specifies services and entities subject to the Agreement.

(b) Challenge Procedures

Under the Agreement, parties must hear the complaints of suppliers that suspect government procurement procedures are violating the Agreement; a court or an impartial and independent institution must review complaints submitted. If a violation is found, correction of the breach of the Agreement, compensation for damages and other remedial measures shall be provided. Japan has created an Office of Government Procurement Review within the Prime Minister's Office to handle complaints concerning government procurement. The Chief Cabinet Secretary chairs the new agency. After establishing detailed procedures for the handling of complaints, Japan formed a Government Procurement Review Board consisting of experts in the field to serve as the complaint resolution body. Since 1996, 12 complaints have been processed. In December 2008, the Board accepted a claim for the first time, certifying a violation by a procurement agency and proposing that the procurement agency reexamine the bidding or rebid the procurement. Thus, Japan is trying to further increase transparency, fairness and competitiveness of government procurement systems under the principle of equal treatment of domestic and foreign companies.

(c) Dispute Settlement Procedures

The Agreement requires that disputes be settled in accordance with the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). There are, however, several departures from normal DSU procedures. First, given the time-sensitive nature of government procurement tenders, the Agreement requires that an effort be made to shorten the panel review period as much as possible. Second, the Agreement does not allow cross retaliation under any circumstances. (Normal DSU procedures allow for cross retaliation if the requesting party can show that retaliation in the same area would not be effective.)

(d) Reduced Obligations for Sub-Central and Government-Related Entities

The Agreement allows sub-central and government-related entities to use

simplified procedures in requests for tenders and to maintain lower statistical reporting obligations than central-government entities. This has the effect of reducing the burden on sub-central and government-related entities to which coverage has been newly extended.

Figure II-14

Outline of Concessions by the “Quad” Countries and Republic of Korea under the 1994 Government Procurement Agreement

[Entities]

	Central government entities	Sub-central government entities	Government-related entities
Japan	All central government entities (including legislative and judiciary entities)	47 prefectures and 17 designated cities	About 130 special corporations and independent administrative institutions
US	Federal government entities	37 states	TVA, 5 power marketing administrations of the Department of Energy and the St. Lawrence Seaway Development Corporation (11 entities total)
EU	The Council of the European Union, the European Commission and central government entities of 27 EU member countries	Sub-central government entities of 28 EU member countries (including municipal-level entities)	Entities in the water, electricity, transport, port and airport sectors
Canada	Central government entities (including some judiciary entities but excluding legislative entities)	10 provinces and 3 territories	10 Crown Corporations
Rep. of Korea	Almost all central government entities	16 cities including Seoul Metropolitan Government and local governments of 3 Metropolitan cities	25 entities including Republic of Korea Development Bank

[Threshold values]

(Unit: SDR 10,000)

		Japan	US	EU	Canada	Rep. of Korea
Products	Central government entities	10	13	13	13	13
	Sub-central government entities	20	35.5	20	35.5	20(40)
	Government-related entities	13	18.2 (40)	40	35.5	40
Services (excluding construction services and architectural, engineering and other technical services)	Central government entities	10	13	13	13	13
	Sub-central government entities	20	35.5	20	35.5	20(40)
	Government-related entities	13	18.2 (40)	40	35.5	40
Construction services	Central government entities	450	500	500	500	500
	Sub-central government entities	1500	500	500	500	1500
	Government-related entities	1500 (450)	500	500	500	1500
Architectural, engineering and other technical services	Central government entities	45	13	13	13	13
	Sub-central government entities	150	35.5	20	35.5	20(40)
	Government-related entities	45	18.2 (40)	40	35.5	40

(4) Outlines of GPA revision negotiations and revised Agreement

1) Review of the GPA

The GPA that came into effect in 1996 provided for the conduct a new negotiation within three years after the agreement came into effect. Therefore in 1997, the Committee on Government Procurement started negotiating for revisions of the GPA, with the following three points as the major areas to be reviewed: i) Improvement of the Agreement and the simplification of procedures; ii) Abolition of discriminatory measures and procedures that inhibit open procurement; and iii) Expansion of the scope of procurement entities covered by the Agreement.

Concerning i), a proposed work program was agreed upon in June 1998 and successive negotiations were conducted by the Committee on Government Procurement. In December 2006, a provisional agreement on proposed revision of the Agreement's articles was reached.

Concerning ii) and iii), an integrated deliberation taken place, with bilateral negotiations conducted based on requests for the expansion of coverage and offers regarding expansion submitted between contracting countries based on the modality (negotiation framework) agreed in July 2004. Since it was not easy to bridge the differences in perceptions between the contracting countries, agreement was not reached for many years. However, because of vigorous negotiations between the contracting countries in preparation for the eighth regular WTO Ministerial Conference, negotiations were substantially concluded on December 15, 2011, during the WTO Ministerial Meeting on GPA, which was held prior to the eighth regular WTO Ministerial Conference. (With regard to the improvement of the Agreement and the simplification of procedures, the revisions provisionally agreed on in 2006 were substantially agreed to without change). Later, the revised Agreement on government procurement (hereinafter referred to as "revised GPA") was adopted formally in March 2012, and it will come into effect in 30 days after two-thirds of the contracting countries of the Agreement on Government Procurement have accepted it. The revised GPA expands the scope of covered procurement – such as by expanding the entities that each country includes as subject to the Agreement – creating more government procurement markets. Furthermore, the Agreement articles were revised, introducing clauses to promote the accession of developing countries, as well as implementing provisions for conducting more effective procurements, such as promoting the use of electronic procedures.

2) Outline of the revised GPA

As of February 2014, domestic procedures for acceptance of the revised GPA were in progress in the contracting countries. Eight countries and regions, namely Liechtenstein, Norway, Canada, Chinese Taipei, the US, Hong Kong, the EU, and Israel, accepted the revised Agreement and deposited their acceptance, but the requirement of acceptance by two-thirds of contracting countries has not yet been met. Although it has still not come into effect, this document will provide a brief outline of the revised Agreement. In particular, the enhancement and the strengthening of the content detailed below have been carried out.

(a) Expansion of coverage

According to the WTO General Council, it is estimated that an expanded government procurement market ranging in size from 80 billion to 100 billion dollars is to be created. Specific entities, services, organizations and thresholds subject to the Agreement, which forms the coverage of the Agreement, are stipulated in the Agreement's annexes. The outlines of the new commitments that major countries made for this Agreement revision are the following.

Japan: decrease of thresholds of procurement of goods and services to be opened internationally -- 130,000 SDR (16 million yen) → 100,000 SDR (12 million yen). Procurements in seven cities (e.g., Shizuoka) were added as subjects of coverage under

the revised Agreement.

US: coverage of ten federal government entities was added.

EU: coverage of approximately 160 central government entities was added.

Canada: all provinces will become covered under the revised Agreement.

Republic of Korea: decrease of thresholds of the procurement of goods and services to be opened internationally. Districts within three metropolitan cities (*e.g.*, Seoul) were added as covered by the revised Agreement.

b) Utilization of electronic tools

With the increase in electronic transactions, utilization of electronic tools during the bidding procedure of government procurement was conducted to some extent. However, there were situations in which electronic tools were difficult for countries to use since provisions for such bidding procedures did not exist. Therefore, provisions related to electronic bidding were newly included in the revised GPA. Specifically, obligations of procurement agencies when using electronic tools were newly included in the general principles (revised GPA Article 4 Clause 3). Furthermore, provisions were made for the promotion of electronic tools in the official notice of procurement plans, short bidding periods when using an electronic tool in respect of the bidding period, as well as procedures when using electronic auction systems (revised GPA Article 7 Clause 1, Article 11 Clause 5 and Article 14). It is anticipated that participation by foreign suppliers in government procurement will be easier because of such revisions.

(c) Promotion of accession of developing countries

Currently, most of the contracting countries of the GPA are developed countries. Therefore, promoting the accession of developing countries, which possess potentially large government procurement markets, is one of the major tasks for the future. Due to this, provisions to promote the accession of developing countries were included in the revised Agreement -- specifically:, (1) the provision of S&D (special and differential treatment) of developing countries during the process of accession negotiations and implementation of the revised Agreement; (2) the provision of the most favorable coverage of the Agreement by the existing contracting countries when developing countries accede and special treatment after accession during the transition period for applying the Agreement (*i.e.*, a price preference for developing country products, offsets, the gradual addition of organizations and areas to which the Agreement applies, and a threshold higher than the permanent threshold); and (3) the provision of technical cooperation and capacity-building related to accession and implementation (revised Agreement Article 5). The promotion of accession to the GPA by developing countries, including countries that are currently negotiating accession, is anticipated from these measures.

(d) Filing objections against the modification of application coverage

Concerning the procurement organizations that are subject to the Agreement by a contracting country, when it wishes to revise the content of its annexes to change the

name change (or something else) or to withdraw an organization from the annexes due to reasons such as privatization, it must submit a notification to the Committee on Government Procurement. It is possible for other contracting countries to the Agreement to file an objection against this notification. If no objection has been filed by any other parties or when a resolution has been reached with respect to an objection, the modifications will be approved. In the current GPA, as long as other countries do not retract their objection, organizations that become privatized cannot be excluded from the list of subject organizations. (For example, three Japanese companies -- Higashi-Nihon Ryokaku Tetsudo (JR Higashi-Nihon), Tokai Ryokaku Tetsudo (JR Tokai) and Nishi-Nihon Ryokaku Tetsudo (JR Nishi-Nihon) -- had all of their state-owned shares sold, and thus the companies' capital became owned by the private sector. However, since the EU had not retracted its objection concerning the withdrawal of these companies from the annex of the Agreement, the three companies continued to be covered by the Agreement). Specific dispute settlement procedures (*i.e.*, consultation by involved countries and the arbitration procedure adopted by the Committee on Government Procurement) were established in order to secure a measure for a third party to objectively judge and resolve such conflicts between contracting countries. Furthermore, the adoption of indicative criteria (for removing a privatized organization from the annex) became a mandatory responsibility of the Committee on Government Procurement. Discussions on the specifics continue in the Committee on Government Procurement. As mentioned above, even for Japan, inconvenient situations in which privatized corporations cannot be removed from the coverage of the Agreement due to various countries' objections have occurred. Therefore, a prompt resolution is necessary.

(e) Future tasks

After the revised Agreement came into effect, conducting further negotiations were planned with the objective of further improvements to the Agreement and reducing and abolishing discriminatory measures. As part of this, a specific work plan was formulated concerning the five areas -- SMEs, statistical data, sustainable procurement, removal and restriction of contracting countries in the annexes and safety criteria of international procurement.

(5) Responses in Japan concerning the GPA

Regulations in Japan concerning government procurement relating to central government entities include the Public Accounting Act, the Cabinet Order concerning the Budget, Auditing and Accounting, and the Special Ad Hoc Cabinet Order concerning the Budget, Auditing and Accounting. These regulations include the principles of fairness, equal opportunity and economy. They share the same basic principles of non-discrimination and transparency contained in the GPA. Additionally, the procurement procedures of the Agreement are ensured by domestic regulations such as the Cabinet Order Providing for the Special Cases of Procurement Procedure of Domestic Products or Specified Services and the Ministerial Ordinance Specifying the Special Cases of Procurement Procedure of Domestic Products or Specified Services.

In addition, regional government entities and government-related entities each put in place ordinances based on the Local Autonomy Act and bylaws conforming to the Agreements, ensuring the implementation of procurement procedures of the GPA within Japan. In addition, voluntary measures that exceed the standards in the Agreement designated, such as having the bidding period stipulated to be forty days or more, while it is fifty days or more in the Agreement.

2. RECENT DEVELOPMENTS

(1) Toward the entry into force of the revised Agreement

The revision negotiation of the GPA, which had been going on for fourteen years since 1997, was substantively concluded in December 2011. However, in order for it to entry into force, two-thirds of the Agreement's contracting countries need to assent. Currently, the domestic procedures for acceptance of the revised Agreement are underway in each contracting country. As of February 2014, eight countries and regions have accepted the revised Agreement and deposited their acceptance. In Japan, acceptance of the revised Agreement was approved at the extraordinary Diet session in 2013, and the government is working to revise relevant domestic laws/regulations and accounting regulations of government-affiliated agencies, etc.

(2) Promotion of Negotiations toward New Accessions

After the substantive conclusion of revised Agreement, negotiations for accessions of developing countries will become the focus. Ten countries are currently involved in accession negotiations -- Albania, China, the Republic of Georgia, Jordan Kyrgyzstan, Moldova, Montenegro, New Zealand, Oman, and Ukraine. China, in particular, has a large government procurement market, and its accession will have a large impact on promoting the accession of non-contracting countries. Therefore, early accession of China at a high commitment level is desired. The accession negotiations with China commenced in December 2007, with China's initial offers being submitted at the same time.

Afterward, a revised offer, a second revised offer, a third revised offer, and a fourth revised offer were submitted in July 2010, November 2011, November 2012, and December 2013, respectively. However, it has been pointed out that the contents of the offers are still insufficient. Therefore, further improvements are needed.

3. MAJOR CASES

Procurements which fall outside the scope of covered entities, as set forth in each country's Agreement on Government Procurement, can obviously not be considered to violate the Agreement. The United States and other countries, for example, engage in practices, which, while not in violation of the GPA, generally contravene the spirit and intent of the Agreement. These practices are examined below.

THE UNITED STATES

1) Myanmar Sanctions Law (The Massachusetts Act of June 25, 1996 Regulating State Contracts with Companies Doing Business with or in Burma (Myanmar)(DS88, 95)

In June 1996, the Commonwealth of Massachusetts passed a law prohibiting the ability to contract with companies doing business in Burma (Myanmar). The law excludes from state agency procurement: (1) companies that have a principal place of business in Myanmar or who otherwise conduct business in Myanmar, including any majority-owned subsidiaries of such companies; (2) companies providing financial services to the Government of Myanmar; (3) companies promoting the importation or sale of gems, timber, oil, gas or other related products from Myanmar (trading in all is largely controlled by the Government of Myanmar); and (4) companies providing any goods or services to the Government of Myanmar. Under the law, the state government created a “restricted purchase list” of companies that meet these criteria. Companies on the list are, in principle, barred from bidding on state contracts, or when allowed to bid, less favorable terms are imposed on them than companies not on the list. There were 350 companies on the list, 50 of which were Japanese.

The Commonwealth of Massachusetts is included among the 37 state governments listed by the United States under the 1994 Agreement on Government Procurement. The law is likely in violation of Article VIII, which mandates the qualification of suppliers, and Article XIII:4, which contain bidding standards. In addition, the state government discriminates between companies depending on whether they are on the list, which may also be inconsistent with Article III:1 of the 1994 Agreement, which mandates both national treatment and non-discrimination.

Japan repeatedly expressed its concerns about the apparent inconsistency of this state law with the GPA, and in March 1997 requested further information under the terms of the Agreement. Japan repeatedly asked the United States to expedite its answers on Agreement-consistency and its provision of further information, but the government of the United States failed to respond in good faith on this matter. The EU shared many similar concerns with Japan on this issue. The EU and Japan requested consultations with the United States in June and July 1997, and during 1997 three consultations were jointly conducted.

Subsequently, Japan decided — in light of the situation in the United States, the schedule of the Massachusetts state legislature, and the apparently positive attitude of the country — to observe the US actions. No progress was made, however, leading Japan and the EU to jointly request the establishment of a WTO panel in September 1998. This panel was established in October, but subsequent litigation within the United States (described below) declared the law unconstitutional and void, so Japan and the EU took procedures to suspend the panel in February 1999. On February 11, 2000, the authority of the panel lapsed because Article 12.12 of the Dispute Settlement Understanding (DSU) voids panels that have been suspended for more than twelve months.

Apart from the WTO panel, in the United States a private US organization, the National Foreign Trade Committee (NFTC), filed a suit in federal court on April 1, 1998, claiming that the state law conflicted with the US Constitution. In November 1998, the federal district court decided that the law was indeed unconstitutional and declared it null and void. The Commonwealth of Massachusetts appealed the decision and filed a motion for stay pending appeal, but in June 1999 the federal appeals court upheld the decision of the district court. Massachusetts appealed to the US Supreme Court, but the Supreme Court in June 2000 affirmed the lower courts' findings that the Massachusetts law was unconstitutional.

One problem is that many US states and local governments have imposed or are considering sanctions similar to those enacted by Massachusetts. Most of these sanctions take the form of restricting government procurement from companies that have business dealings with the sanctioned countries. We are pleased that the US Supreme Court found the law unconstitutional because the ruling will eliminate the barriers for private companies from trade-related legislation passed by individual states. The Supreme Court bases its ruling on the principle that foreign relations is an area specifically reserved to the federal authority and state laws that impinge upon this authority are unconstitutional. The ruling will act as a restraint on future state-level legislation.

In some cases, however, the state or local government will not be bound by the obligations of the GPA because it was not included in the "offered" institutions, although many of the measures themselves are likely to constitute violations. We should pay close attention to whether these measures will be eliminated or amended in the United States.

In the meantime, the US Federal Government established a law in July 2003 that bans imports from Myanmar and freezes their assets in the United States until Myanmar's military regime improves human rights policies and adapts democratic policies. This calls for close observation in the future.

2) National Security Exceptions

Article XXIII of the 1994 Agreement states that any party may take such measures as warranted by national security concerns. This Article permits any party to use national security as a reason to refuse foreign tenders. The 1994 Agreement does not contain any clear standards as to the kind of cases in which national security exceptions may apply. (Although this is stipulated under Article 3 in the revised Agreement, there has been no change to the content).

It is common for the United States to use national security as a reason for excluding contracts from open, competitive tendering procedures. Domestic law states that US security may not be compromised by disclosing an agency's needs to persons who do not have access to classified information. It also states that products must be procured from domestic enterprises so as to preserve the US industrial mobilization base and to ensure that the United States does not have to rely on foreign products in times of emergency.

(a) Federal Acquisition Regulations (FAR)

FAR provides general rules on US government procurement. It provides for full and open competition in the acquisition process. (The Buy American Act is still applicable, though.) FAR, however, allows exceptions from those procedures for contracts: (1) when it is necessary to award the contract to a particular source or sources and keep a facility, producer, manufacturer or other supplier available for furnishing certain supplies or services in case of a national emergency or to achieve industrial mobilization; or (2) when the disclosure of the agency's needs would compromise national security (unless the agency is permitted to limit the number of sources from which it solicits bids or proposals).

(b) Department of Defense FAR Supplement (DFARS)

DFARS is a supplement to FAR that may exclude foreign companies from defense contracting. Under DFARS, no Department of Defense contract under a national security program may be awarded to a company owned by an entity controlled by a foreign government if access to proscribed information is required for that company to perform the contract.

(c) Clinger-Cohen Act (The Information Technology Management Reform Act of 1996)

This law took effect February 2, 1996, and abolished the Brooks Automatic Data Processing Act. The aim of this law is to promote the efficient federal procurement of goods and services in the area of computer and telecommunications equipment and support. Authority for all procurement in this sector is granted to the Office of Management and Budget and other federal agencies; the Act does not apply to national security-related procurement by the Department of Defense or Central Intelligence Agency. The contracting officer of each agency makes the decision on whether security exceptions apply. It is difficult to ascertain whether those decisions are consistent with the Agreement.

The possibility remains that security exceptions could be employed arbitrarily to unfairly limit foreign companies' access to the US government procurement market. It would be appropriate to clarify the principles under which national security exceptions are granted and to ensure their uniform application.

In addition, management and operation of research and development facilities under the Department of Energy, NASA and the Department of Defense are often entrusted to private companies and universities under "Management and Operating Contracts" (M&O Contracts). Because many of these facilities began as nuclear weapons development centers, they are considered security exceptions. Their M&O contracts, thus, do not follow the full and open competition procedures required under Federal Acquisition Regulations (FAR).

The main fields of technology addressed by these facilities are now being converted to commercial technology or dual-use (military and commercial) technology. Even though there are some examples of agencies using competitive procedures, the

United States shows no signs of uniformly placing their M&O Contracts under competitive procedures except in a few limited cases. The United States has excluded M&O Contracts from the list of covered services in the 1994 Agreement. We consider this to be an attempt to use national security as an excuse to limit competition and thereby improve the competitiveness of the US industry. The expansion of “national security” to include “national economic security” goes against the spirit of the 1994 Agreement and its basic principle of non-discrimination.

EUROPEAN UNION

EU Utilities Directive

In January 1993, as part of its market integration, the European Union issued an EU-wide directive on the procurement procedures of entities operating in the water, energy, transportation and telecommunications sectors. The directive contains two discriminatory provisions designed to ensure that third parties would not enjoy a “free-ride” after EU integration. The two discriminatory provisions are:

- A local content provision that permits the rejection of bids for supply contracts where the proportion of foreign products to be used exceeds 50 percent of the total value of products; and
- A provision that grants preferential treatment to domestic suppliers by stipulating that prices of tenders shall be considered equivalent if the price of domestic products is not more than three percent higher than that of imported products.

These provisions are intended to apply to countries that do not offer the same openness in government procurement procedures as the European Union provides in the same sector. With regard to procurement by entities in utility sectors, a new directive to replace the above-mentioned directive was issued in 1993 and another new directive – the “Directive coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors” (2004/17/EC) -- was issued in 2004. However, the 2004 directive contains similar provisions (Articles 58 and 59).

In response, the United States designated the European Union under Title VII of the Trade Act of 1974, as amended by the Omnibus Trade and Competitiveness Act of 1988, as “a country which maintains procurement practices discriminatory toward the United States.” This provision of US law provides for sanctions against countries that discriminate against US firms in their public procurement practices. Subsequent consultations between the two parties failed to resolve the issue. January 1, 1993 was the member countries’ deadline for implementing the EU directive (for developing related domestic laws). On February 1, the United States announced its intent to invoke sanctions beginning on March 22, 1993. The United States delayed imposing sanctions to allow for further bilateral negotiations. On April 21, following limited progress in

the consultations, an agreement was reached under which the United States removed heavy electrical equipment from the scope of the sanctions.

Because the agreement was limited, on May 23, 1993, the United States imposed sanctions against the European Union worth approximately \$20 million a year. The European Union retaliated on June 8, when it approved sanctions against the United States worth approximately \$15 million. Despite an additional agreement reached on April 13, 1994, the United States maintained the sanctions because of the absence of an agreement on telecommunications procurement. Under the Title VII review conducted in April 1995, the United States decided to continue the sanctions and to extend them to the three new EU member states: Austria, Finland, and Sweden. The European Union also decided to continue counter sanctions against the United States in June 1995. Subsequently, the EU made a proposal to the United States to mutually abolish existing sanctions by excluding the telecommunications sector from the application of a new directive on government procurement. In January 2002, the European Commission adopted rules to abolish sanctions against the United States Title VII provision. Upon the US elimination of the Title VII provision, the EU formally adopted the rules in February 2006 and the rules came into effect in March 2006.

Since the four sectors in question were not subject to the provisions of the 1979 Agreement, the existence of discriminatory provisions in this directive does not mean that it failed to comply with the 1979 Agreement. It did, however, include three of the sectors in question as part of the 1994 Agreement (the telecommunications sector was still excluded). Therefore, the European Union determined that the Directive in question no longer applies to tenders comprising certain products originating in Korea, Japan, Switzerland and the United States. For each of these countries, the European Union excluded certain products in certain sectors from the Directive, pursuant to its Annex to the 1994 Agreement. The European Union, however, still applies the Directive to Japanese suppliers with respect to the procurement by entities in electricity and urban transport sectors, which are not within the scope of the 1994 Agreement. The system is discriminatory in nature and Japan urges the European Union to dismantle it voluntarily.

In March 2012, the European Commission proposed a new regulation providing, in addition to these provisions, more detailed procedures for restricting the access to the public procurement market in the EU of products/services of trade partner countries providing insufficient access for EU companies to their public procurement market. At present, a proposed new regulation is under deliberation in the European Parliament and European Council (see Chapter 4 “European Union”, Part I).