CHAPTER 13 GOVERNMENT PROCUREMENT

1. OVERVIEW OF RULES

(1) Government Procurement

Government or public procurement is the purchase, lease or rental of products and services by government entities. Governments tend to favour 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.

Thus, as discussed in this chapter, discrimination against foreign products in procurement procedures exist in a variety of ways, such as: (i) expressly prohibiting foreign companies from tendering bids for government procurement contracts; (ii) giving preferential treatment to companies that agree to use substantial amounts of domestic merchandise in the execution of government contracts; and (iii) 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 recognised that the use of procurement procedures to protect domestic industries is 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 realised that there was a need to address this issue. The result was the Agreement on Government Procurement, (hereinafter “the 1979 Agreement”) which was concluded in 1979 as part of the Tokyo Round Codes, and subsequently partially amended in 1987.

Negotiations to revise the 1979 Agreement were initiated with a view towards 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 became effective 1, January 1996.

(2) Legal Framework

The 1979 Government Procurement Agreement

The 1979 Agreement provided for the principles of national treatment and non-discriminatory treatment in the area of government procurement and fair and transparent procurement procedures in order to realise these principles.

Under the 1979 Agreement, each party provided immediately and unconditionally to products and suppliers of other parties, treatment no less favourable than that accorded to domestic products and suppliers, or products and suppliers of any other parties, with respect to all laws, regulations, procedures, and practices regarding procurement of products worth SDR 130,000 (according to a notice by the Ministry of Finance, the equivalent of ¥21 million from April, 2000 to the end of March, 2002) or more. And, the scope of the 1979 Agreement was limited to the entities each party designated in the Annex to the 1979 Agreement. In addition, the 1979 Agreement provided that parties to the Agreement should, in principle, use
open or selective tendering procedures. In closely defined circumstances, however, they could use single tendering procedures. For both open and selective tendering procedures, entities were obligated to publish a notice of proposed procurement 40 days before the close of bidding. The entities also had to provide information about government procurement including relevant laws and regulations, information on the contracts awarded, statistics, and so on.

Accession to the 1979 Agreement, however, was optional, and bound only a handful of countries and territories. Only 12 countries, most of which were developed countries, acceded to the 1979 Agreement (Austria, Canada, the European Union, Finland, Hong Kong, Israel, Japan, Norway, Singapore, Sweden, Switzerland and the United States). Hence it was difficult to say that the philosophy of free trade in government procurement was widely accepted in the world community.

In addition, the 1979 Agreement applied only to a narrow category -- government procurement of products having a value of SDR 130,000 or more. Neither the procurement of products below SDR 130,000 nor the procurement of services *per se* was covered by the 1979 Agreement. Moreover, the 1979 Agreement applied mainly to the central government and only to those entities designated by each party. The designated entities were listed in the Annex to the 1979 Agreement.

**The 1994 Government Procurement Agreement**

Because of these restrictions, that the 1979 Agreement did not cover a large percentage of government procurement contracts, Parties to the 1979 Agreement became especially anxious to have the scope expanded to cover service transactions. Because, service transactions have become so important to the world economy that their exclusion has led to numerous problems. Parties to the 1979 Agreement also became interested in expanding the range of entities subject to the 1979 Agreement. In order to resolve these and other related issues, negotiations on government procurement were held in conjunction with the Uruguay Round to address these and other related issues. On December 15, 1993, negotiators reached a new Agreement that covers the procurement of services and the procurement by sub-central government entities and government-related entities.

As was the case with the 1979 Agreement, participation in the 1994 Agreement on Government Procurement is voluntary. Since the 1994 Agreement seeks a fairly high level of regulation, there are currently (as of 1, February 1998) only eleven countries and regions participating: Canada; Hong Kong, China; EU; Korea; Israel; Japan; Liechtenstein; Norway; Singapore; Switzerland; and United States. Austria, Finland and Sweden joined the EU on 1, January 1995 and became subject to the Annex to the Agreement that governs the EU. The Agreement became effective with respect to Korea on 1, January 1997 under transitional measures negotiated as part of the Agreement.

We look forward to the broad participation of developed countries in the future. Furthermore, we anticipate that many countries including developing countries will participate in the 1996 Agreement alike.
**Elimination of Non-application**

The extent to which the Agreement applies to procurement by entities of each party to the Agreement is specified in Appendix I, which is divided into five Annexes. Figure 13-1 contains a summary of the concessions offered by the “Quad” countries and Korea. A complete agreement, however, has not been reached on procurement by sub-central government entities and government-related entities. For example, at first the United States stated in its Annex that the 1994 Agreement would not apply to its sub-central and government-related entities unless it receives commensurate offers from Japan, the European Union, and Canada. The European Union also expressed similar reciprocal reservations. The United States and European Union decided to continue negotiations, reaching an agreement to expand their offers on 13, April 1994. This agreement eliminated mutual non-application between them to some extent, and called for the necessary amendments to be made to their Appendices. Between Japan and the United States, it was initially decided that the 1994 Agreement would not apply to sub-central government entities or government-related entities. However, the two countries reached an agreement to eliminate most of the mutual non-application between them, and their Appendices were revised accordingly in February 1996. The United States and Norway also agreed to eliminate mutual non-application in specific areas in July 1996. The United States and Switzerland also agreed to eliminate mutual non-application in specific areas in May 1997. But while negotiations are reducing the partial non-applicability provisions among the major countries, partial non-application of the Agreement still remains. This partial non-application remains an exception to the principle of non-discrimination prescribed in the Agreement. We hope to see a full agreement on procurement by sub-central and government-related entities reached soon.

*Figure 13-1* Outline of Offers Made by the “Quad” Countries and Korea under the 1994 Government Procurement Agreement

<table>
<thead>
<tr>
<th>Entities</th>
<th>Central government entities</th>
<th>Sub-central government entities</th>
<th>Government-related entities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>All central government entities (including legislative and judiciary entities)</td>
<td>47 prefectures and 12 designated cities</td>
<td>70 special corporations</td>
</tr>
<tr>
<td>United States</td>
<td>All central government entities</td>
<td>37 states</td>
<td>TVA, 5 power marketing administrations of the Department of Energy and the St. Lawrence Seaway Development Corporation (total 11 entities)</td>
</tr>
<tr>
<td>EU</td>
<td>All central government entities (including the Council of the European Union and the European Commission)</td>
<td>All sub-central government entities (including municipal level entities)</td>
<td>Entities in the water, electricity, urban transport, port and airport sectors</td>
</tr>
<tr>
<td>Country</td>
<td>Description</td>
<td>Central Government Entities</td>
<td>Sub-central Government Entities</td>
</tr>
<tr>
<td>---------</td>
<td>-------------</td>
<td>----------------------------</td>
<td>--------------------------------</td>
</tr>
<tr>
<td>Canada</td>
<td>All central government entities (including some judiciary entities but excluding legislative entities)</td>
<td>No offer</td>
<td>9 Crown Corporations</td>
</tr>
<tr>
<td>Korea</td>
<td>Almost all central government entities</td>
<td>15 entities</td>
<td>23 entities</td>
</tr>
</tbody>
</table>

* According to the agreement between the United States and Japan, each country eliminated most of the partial non-application provisions pertaining to sub-central and government-related entities in February, 1996.

* Canada did not offer its sub-central government entities and sub-central government-related entities. Therefore, partial non-application between Canada and three countries (the European Union, the United States, and Japan) continues to exist.

<table>
<thead>
<tr>
<th>[Threshold values] (Unit: SDR 10,000)</th>
<th>Japan</th>
<th>U.S.</th>
<th>EU</th>
<th>Canada</th>
<th>Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Products</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Central government entities</td>
<td>13</td>
<td>13</td>
<td>13</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>Sub-central government entities</td>
<td>20</td>
<td>35.5</td>
<td>20</td>
<td>35.5</td>
<td>20</td>
</tr>
<tr>
<td>Government-related entities</td>
<td>13</td>
<td>18.2</td>
<td>40</td>
<td>35.5</td>
<td>45</td>
</tr>
<tr>
<td><strong>Services (excluding construction services and architectural, engineering and other technical services)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Central government entities</td>
<td>13</td>
<td>13</td>
<td>13</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>Sub-central government entities</td>
<td>20</td>
<td>35.5</td>
<td>20</td>
<td>35.5</td>
<td>20</td>
</tr>
<tr>
<td>Government-related entities</td>
<td>13</td>
<td>18.2</td>
<td>40</td>
<td>35.5</td>
<td>45</td>
</tr>
<tr>
<td><strong>Construction services</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Central government entities</td>
<td>450</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Sub-central government entities</td>
<td>1500</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>1500</td>
</tr>
<tr>
<td>Government-related entities</td>
<td>1500</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>1500</td>
</tr>
<tr>
<td><strong>Architectural, engineering and other technical services</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Central government entities</td>
<td>45</td>
<td>13</td>
<td>13</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>Sub-central government entities</td>
<td>150</td>
<td>35.5</td>
<td>20</td>
<td>35.5</td>
<td>20</td>
</tr>
<tr>
<td>Government-related entities</td>
<td>45</td>
<td>18.2</td>
<td>40</td>
<td>35.5</td>
<td>45</td>
</tr>
</tbody>
</table>

* According to the agreement between the United States and the EU in April 1994, the United States decreased the threshold for government-related entities except in the area of construction services from 400,000 SDR to 182,000 SDR (However, the threshold for the Port Authority of New York and New Jersey, the Port of Baltimore and the New York Power Authority is still 400,000 SDR).

* Concerning procurement below the threshold values specified in the 1994 Agreement, Japan voluntarily requires non discrimination and transparency for procurement of goods and services worth 100,000 SDRs or more by central government entities and government-related entities.
Reinforcement by the 1994 Agreement

The negotiations on government procurement have provided a good starting point from which further progress can be made. The negotiations have expanded the coverage of the 1979 Agreement. In addition, the negotiations produced a much-improved 1994 Agreement, most notably by breaking it down into twenty-four articles instead of the nine in the 1979 Agreement and by adopting stronger disciplines. As is the case with the 1979 Agreement, the 1994 Agreement defines the principles of national treatment and non-discrimination, and provides for fair and transparent procurement procedures. In addition, the 1994 Agreement reinforces and improves the 1979 Agreement in the following respects:

(a) Expansion of Coverage

The Agreement expands coverage to include procurement of services and procurement by sub-central government entities and government-related entities. As coverage of the Agreement expanded, necessary changes were also made to the text. In the Appendix of 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 of being in violation of 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 according to the Agreement. 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 set up a Government Procurement Review Board made up of experts in the field to serve as the actual complaint resolution body. Sub-central entities also have there own procurement review procedures.

(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 speed required in government procurement, 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 the possibility of cross retaliation if one 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 the invitation to participate for tender and to have lower statistical reporting obligations than central-government entities. This has the effect of reducing the burdens on sub-central and government-related entities to which coverage has been newly extended.
(e) **Privatisation of Entities**

Procedures have been established for withdrawing privatised entities from the Appendix of the Agreement. The entity is automatically withdrawn from the Appendix if the Committee on Government Procurement is notified of the withdrawal and no objection has been made. Should there be an objection, it is settled under the procedures described in section (c) above. We note that a *quid pro quo* is not necessarily required for a modification to the Appendix. In other words, the party is not obligated to offer a new entity of similar size in exchange for the one withdrawn.

(f) **Offsets**

The practice of offsets in government procurement (requiring local content, technology transfers, investments or counter trades in exchange for award of contracts) is, in principle, prohibited under the 1994 Agreement. The 1979 Agreement did not necessarily prohibit these practices.

**Expansion of the Coverage of the Agreement**

Article III: 8(a) of the GATT (national treatment) exempts government procurement in principle. The 1994 Agreement, despite its expanded coverage, still does not cover all government procurement practices and there are some reciprocal exemptions. Therefore, there are some areas in which neither the GATT nor the 1994 Agreement will apply. Specifically, these areas are procurement below the thresholds set out in the Agreement and procurement by sub-central and government-related entities not bound by the Agreement.

**Recent Trend**

Article XXIV: 7(b) of the 1994 Agreement mandates new negotiations to begin within three years from the date of entry into force of the Agreement and, in accordance with these provisions, the Committee on Government Procurement began work during 1997. The revisions will seek: 1) to improve and simplify the Agreement (introducing information technology where appropriate), 2) to eliminate discriminatory measures and practices which distort open procurement, and 3) to expand the coverage of the Agreement. Work is proceeding on these three issues simultaneously. For the first goal, improvement and

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1 Article XVII:2 of the GATT provides, however, that “with respect to the imports of products for immediate or ultimate consumption in governmental use,” which are not subject to the Government Procurement Agreement, each Member shall accord to the trade of the other Members “fair and equitable treatment,” even though it may not accord non-discrimination treatment. This Article can be interpreted to obligate each contracting party to accord “fair and equitable treatment” with respect to government procurement.

This GATT provision was established based on US suggestions. The phrase “fair and equitable treatment” was adopted because it is not possible to apply non-discrimination treatment to government procurement with the same precision that is possible in the case of other regulatory measures. Nevertheless, in the future, we would like to see more areas covered by the Government Procurement Agreement.
simplification, a draft work plan was created in June 1998 that aimed for completion by the third WTO Ministerial Meeting that was held in Seattle in December 1999. The Committee considered this plan, but was unable to agree on the details.

The Working Group on Transparency in Government Procurement which was established at the WTO Ministerial Meeting of December 1996 is now investigating factors that go into the transparency of government procurement. Given the importance of greater transparency and the limited current participation in the Agreement, we look forward to a new agreement in which all WTO Members will be able to participate.

**<Box-1> Laying the Groundwork for an Agreement on Transparency in Government Procurement**

The 1994 Agreement on Government Procurement requires high levels of discipline and imposes some procedural burdens on participating governments, tending to make developing countries hesitant about joining. Though participants see expanding their numbers as an important goal, they are also aware that a significant expansion is not realistic over the short term. Nonetheless, it is still desirable, in light of the importance of government procurement to the world economy, that as broad a number of WTO participants as possible adopt appropriate disciplines for government procurement. Among these disciplines, ensuring the transparency of government procurement procedures is of vital importance since it is instrumental in assuring procurement opportunities and a fundamental prerequisite to such disciplines as national treatment. Furthermore, an agreement, which is limited to assuring transparency of procurement procedures and which does not containing detailed provisions similar to those of the Government Procurement Agreement, may enjoy wide participation from developing countries.

Therefore, while positioning an expansion of participation in the 1994 Agreement as a long-term goal, it was also proposed that a new agreement on transparency be drafted that would be acceptable to all WTO Members, including developing countries. During the Singapore meeting, it was decided to establish a working group to consider how such an agreement might be drafted.

In 1997, the working group began to discuss the elements that go into transparency in the context of government procurement. Discussions have continued on towards the goal of formulating a new agreement. One target for this discussion was the third Ministerial Meeting that was held in Seattle in December, 1999. Developing countries have usually been very cautious about establishing new disciplines, but during the working group discussions some have come to see the need for an agreement of this type. We look forward to further understanding and cooperation between the developed and developing countries as they work towards an agreement.
<Box-2> US Panel on Korean Airport Construction Procurement

In February 1999, the United States requested consultations with Korea regarding its procurement for airport construction. In May, it requested the establishment of a panel. The US alleges several violations of the Agreement on Government Procurement stemming from the Korean Airport Construction Authority's (KOACA) refusal to allow a US elevator construction company to take part in the bidding for construction of the Inchon International Airport. Specifically, the US argues that Korea violated the Agreement by: 1) requiring that foreign companies have manufacturing facilities within Korea in order to be eligible to bid, 2) requiring that foreign companies have joint ventures with Korean companies in order to be eligible to bid, 3) not providing any procedures for filing complaints regarding violations of the Agreement on Government Procurement, and 4) setting bidding deadlines that are shorter than mandated in the Agreement on Government Procurement.

Korea responds that KOACA was not offered in the list of government-related institutions covered by the Agreement and are therefore not subject to the Agreement. Japan and the EU are participating in the panel as third parties.

(3) Economic Implications

The size of the government procurement market and its share of the economy will differ from country to country, but estimates put it generally between 10 and 15 percent of GDP. Procurement laws that discriminate against foreign suppliers distort the international flow of products and services, and this distortion will only expand as the economic importance of services and soft industries grows. National security is one reason given for policies that favour domestic products in government procurement, but these policies are also commonly enacted for industrial policy reasons, i.e., for the purpose of protecting specific industries. Discrimination between domestic and foreign suppliers in government procurement will, in the short run, help countries to achieve their industrial policy objectives, but it will also serve as an arbitrary barrier to the creation of fully competitive environments in which foreign bidders also have a place. For those procuring goods, such 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, restrictions on the opportunities for foreign companies to enter the market will mean that domestic industries are given excessive protection, which will rob the protected industries of their motivation to make improvements in their ways of doing business or to develop new products. Such policies therefore weaken even the suppliers. Given that the size of the government procurement market is quite large, when procurement protection is linked to other protection and fostering policies for domestic industry, disciplines on subsidies become meaningless and such protection ultimately causes palpable distortions to the free-trading system.

Policies to give preference to domestic products in government procurement are without question detrimental to one’s own economy as well as world trade.

As reference information, we would note that the total value of procurement covered by the government procurement agreement for the United States and Japan in 1993 was SDR 14.3 billion (about $20 billion) and SDR 3.6 billion (about 400.3 billion). Although, the new Government Procurement Agreement has widened the range of institutions covered, and

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2 These figures are from the 1979 Government Procurement Agreement.
during the review process there will be negotiations on widening the range of applicable institutions even further.

2. PROBLEMS OF TRADE POLICIES AND MEASURES IN INDIVIDUAL COUNTRIES

Only four of the twelve countries covered by this report are parties to the 1994 Agreement (the United States, the European Union, Canada, and Korea), although Australia is reportedly considering becoming a party to the Agreement. Countries covered in this report who have not acceded to the Agreement can obviously not be termed in violation of it. Nonetheless, liberalising their government procurement markets will benefit the long-term development of their economies. We would like to urge them to accede to the Agreement.

(I) Measures Likely to Be Inconsistent with the Government Procurement Agreement

- The Massachusetts Act of June 25, 1996 Regulating State Contracts with Companies Doing Business with or in Burma (Myanmar) -

The sanctions imposed on Myanmar by a Massachusetts state law are one example of a measure that is highly likely to be in violation of the Agreement on Government Procurement. The issue has been given priority because of its implications for the area of government procurement, and so we discuss it in some detail in this report.

Outline of the Myanmar Sanctions Law

In June 1996, the Commonwealth of Massachusetts passed a law barring from state contracts all companies that do business with 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 has 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 favourable terms are imposed on them than companies not on the list. Currently, there are 350 companies on the list, 50 of that are Japanese.

Relationship with the WTO Agreement on Government Procurement

The Commonwealth of Massachusetts is included among the 37 state governments committed to by the United States and is therefore subject to 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 its list, which may also be inconsistent with Article III: 1 of the 1994 Agreement, which mandates both national treatment and non-discrimination.

3 Strictly speaking, it is not a state but a commonwealth. (I'm a Massachusetts native.)
Consultations in the WTO

Japan has repeatedly expressed its concerns about the apparent inconsistency of this state law with the Agreement on Government Procurement, 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 United States's actions. No essential progress was made, however, and this led to Japan and the EU to jointly request the establishment of a 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 11 February 2000, the panel expired because Article 12:12 of the Disputes Settlement Understanding (DSU) voids panels that have been suspended for more than twelve months. Japan should monitor legal developments within the United States, however, and make appropriate responses, including the initiation of new disputes settlement procedures, should the law be restored to force. Even though there is no longer rationale for the panel process, we still urge the United States to quickly eliminate this law or bring it into conformity with the Agreement.

Constitutionality questions within the United States

Apart from the WTO panel, a private US organization, the National Foreign Trade Committee (NFTC), filed a suit in federal court on 1 April 1998 claiming 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. In July, Massachusetts appealed to the federal the Supreme Court, and a verdict is currently awaited.

As of this writing in December 1998, the federal district court had declined the motion of a stay pending appeal.

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. In some cases, the state or local government will not be bound by the obligations of the Agreement on Government Procurement because it was not included in the "offered" institutions, although many of the measures themselves are likely to constitute violations. We are concerned about the spill-over effects on other states and, from the perspective of promoting free trade, would like to see these measures quickly eliminated, defeated, or brought into conformance with the Agreement.
(2) Policies and Measures Which Should Be Rectified

(i) United States

(a) “Buy American” Federal Legislation

- Buy American Act of 1933 at the federal level

The Buy American Act of 1933 provides the legal basis for discrimination against foreign products at the federal level of the US Government. It directs federal agencies to purchase, for public use, only “unmanufactured articles, materials and supplies ... produced in the United States,” and “manufactured articles, materials and supplies ... manufactured in the United States substantially from ... materials ... produced or manufactured ... in the United States” (41 U.S.C. 10(a)-(d)). For products or materials to be considered “produced” or “manufactured” in the United States, at least 50 percent of their content must be of domestic origin. (This provision pertains to the place of manufacture or production and not to the nationality or ownership of the contractor. Therefore, products manufactured in the United States by foreign affiliates, for example, are eligible under the Buy American Act.) The Act permits the purchase of foreign products only under certain circumstances. For example, foreign products may be purchased when purchasing a US product is not in the public interest. The statute also permits purchasing foreign products when the price of a US product is at least six percent higher than that of a comparable foreign product, making its procurement “unreasonable.” The purchase of foreign products is also allowed when the required product is not produced in the United States.

The guarantee of procedural transparency does not alter the fact that the Buy American Act contains provisions that expressly discriminate against foreign products. Thus, preferential treatment for domestic products is a basic policy of federal government procurement.

The Trade Agreements Act of 1979 as amended by the Uruguay Round Agreements Act to some extent mitigated the discriminatory treatment mandated by the Buy American Act. As a result, federal procurement procedures were rendered transparent and national treatment was accorded to countries that have acceded to the Agreement. US law allows the President to refrain from applying “Buy American” restriction to countries that i) have acceded to the 1994 Agreement and ii) provide appropriate reciprocal procurement opportunities for US products and US suppliers.

With respect to other countries, however, and to fields not covered by the Agreement, “Buy American” legislation remains essentially unchanged.

There are some Acts other than the Buy American Act as follows, which provide preferential treatment for domestic products.

- The US Federal Departments Specific Annual Budget Appropriation Acts

US federal department budgets are provided under annual appropriations acts passed by the Congress. These appropriations sometimes include specific preferential treatment language concerning the use of budget outlays for the purchase of domestic goods.
The Surface Transportation Assistance Act of 1982, as amended by the Intermodal Surface Transportation Efficiency Act of 1991

There are two types of Buy American provisions in this Act as follows.

**Buy American Provisions Governing the Federal Transit Administration**

In order for states to receive federal funds from the Federal Transit Administration for mass transit projects, including the purchase of mass transit “rolling stock,” Buy America provisions require that procurement is restricted to steel, iron, and other manufactured products that are made in the United States. In addition, the cost of the domestic components of any vehicles or rolling stock purchased must comprise more than 60 percent of the cost of all of the components of the rolling stock and the final assembly of the rolling stock must occur in the United States.

**Buy American Provisions Governing the Federal Highway Administration**

In order for states to receive federal funds from the Federal Highway Administration for federal-aid highway projects, all steel and iron used in a project must be manufactured in the United States.

- **The Rail Passenger Service Act**

  The national passenger rail service provider, Amtrak, which is funded by the US Government, is obligated to purchase domestic goods for procurement of goods worth a million dollars or more.

  Although these Buy American laws are not in technical violation of the 1994 Agreement, we think that they are discriminatory and should be rectified. As visible proponents of free trade, the United States, the European Union, and Canada should abolish all laws and regulations that discriminate against foreign suppliers in government procurement markets, even if these laws and regulations are not currently inconsistent with the 1994 Agreement because they are applied to areas which the 1994 Agreement does not cover.

(b) **Problems at the State Level (Buy American legislation etc.)**

There are also procurement laws at the state and local level that contain “Buy American” and “Buy Local” provisions similar to those imposed under the Buy American Act. These provisions give preferential treatment to government procurement of goods produced domestically and locally. Since 1995, some state-level governments, such as California’s, have amended their laws to prevent preferential treatment. Nonetheless, many local and state governments continue to maintain laws, which provide preferential treatment.

Los Angeles County's decision in January 1992 to rescind a contract it had concluded with a Japanese corporation for the purchase of rail cars illustrates the problems inherent in other local and state procurement systems. The Japanese company had won the contract, but new conditions were later added requiring California-made products to be used. There were

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3 This law has expired in May 1997. The Surface Transportation Extension Act of 1997 replaced it until May 1998. The Transportation Equity Act for the 21st Century was passed by Congress on 22, May 1998.
no new bidders in a subsequent round of bidding, so a portion of the contract was ultimately awarded to the original Japanese firm.

In August, 1999, the California state legislature passed a bill requiring the state government to sign contracts with businesses providing US or California-made products for public works undertaken with state funds and valued at $50,000 or more. The bill was vetoed by the state governor that September and so never became a law. But in as much as California is among the sub-central government institutions "offered" as part of the Agreement on Government Procurement, this legislation serves as an example of a potential violation of the Agreement's national treatment provisions.

At present, the United States has only offered to include 37 States in the 1994 Agreement. Government procurement by the other 13 states is not covered by the 1994 Agreement. Yet, with state governments accounting for 50 percent of all government purchases in the United States, their impact on international trade is at least as important as that of the federal government.

To a large extent, the liberalisation of government procurement will hinge on how well state and local systems can be incorporated into the free-trade framework. Sub-central entities covered by the 1994 Agreement should amend any law or regulation that provides for preferential treatment to local products and local industry so as to be consistent with the Agreement and should conduct all of their procurement in accordance with the Agreement.

(c) 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 same provision was contained in Article VIII of the 1979 Agreement. The 1994 Agreement does not contain any clear standards as to the kind of cases in which national security exceptions may apply.

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 mobilisation base, and to ensure that the United States does not have to rely on foreign products in times of emergency.

- 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.). FAR, however, allows exceptions from those procedures for contracts: (1) when it is necessary to award the contract to a particular source or sources to maintain a facility, producer, manufacturer, or other supplier available for furnishing certain supplies or services in case of a national emergency or to achieve industrial mobilisation; 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).
- **Department of Defence FAR Supplement (DFARS)**

DFARS is a supplement to FAR that may exclude foreign companies from defence contracting. Under DFARS, no Department of Defence 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.

- **The Information Technology Management Reform Act of 1996**

This law came into effect in February 1996, abolishing 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. However, the Act is not applicable to national security related procurement by the Department of Defence or Central Intelligence Agency.

The contracting officer in each agency makes the decision on whether security exceptions apply. It is difficult to ascertain whether those decisions are consistent with the Agreement.

There is a possibility 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 ensure their uniform application.

In addition, management and operation of research and development facilities under the Department of Energy, NASA, and the Department of Defence are often entrusted to private companies and universities under “Management and Operating Contracts” (M&O Contracts). Because many of these facilities had their start in nuclear weapons development, 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 for a few certain 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 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.

(ii) **European Union**

(a) **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,
transport and telecommunications sectors. The directive contains two discriminatory provisions, inserted to ensure that third parties would not enjoy a “free-ride” after the European 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 are 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.

The reaction of the United States to these provisions was to designate the European Union in February 1992 as “a country which maintains procurement practices discriminatory toward the United States” under Title VII of the Trade Act of 1974, as amended by the Omnibus Trade and Competitiveness Act of 1988. 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. The EU directive went into effect as planned on 1 January 1993. On 1 February, the United States announced its intention to invoke sanctions beginning on 22 March 1993. The United States delayed the invocation of sanctions to allow bilateral negotiations to continue. On 21 April, the United States decided to remove heavy electrical equipment from the scope of the sanctions as a result of an agreement reached between the two parties in this area.

The agreement was only partial, however, and on 23 May 1993, the United States invoked sanctions against the European Union worth approximately $20 million a year. The European Union retaliated on 8 June, when the EU approved sanctions against the United States worth approximately $15 million. Despite an agreement reached on 13 April 1994, the United States announced its intention to keep the sanctions in place, because of the absence of an agreement on telecommunications procurement. In the Title VII review conducted in April 1995, the United States decided to continue the sanctions and to extend these sanctions 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.

Since the four sectors in question were not subject to the provisions of the 1979 Agreement, the fact that the European Union issued 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, in accordance with 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 is not within the scope of the 1994 Agreement. The system is discriminatory in nature and Japan urges the European Union to dismantle it voluntarily.
(b) German Procurement Issues

Germany was singled out under a Title VII action initiative by the United States in April 1996. The United States identified Germany as a country that habitually discriminates in heavy industry government procurement under the provision of Title VII. The United States pointed out that the German review mechanism that examines whether each procurement was in accordance with domestic and international law was insufficient for the protection of foreign companies which had been injured as a result of mistakes or negligence in procurement procedures. Germany has decided to revise its public-procurement laws and on 1, January 1999 and pass amendments to the Law Against Anti-competitive Behaviour in the Market. These amendments appear to have brought domestic procurement procedures generally into line with the government procurement standards of the EU.

(iii) Australia

Offset Programmes

Australia is not a party to the 1994 Agreement, and thus is not bound by the obligations under the agreement.

Since 1991, Australia has enforced a “Partnerships for Development Programme” (PfD) and a “Fixed Term Arrangements Programme” (FTA) for promoting high-technology industries and improving their international competitiveness. The PfD applies to companies selling over A$40 million worth of information equipment to the government annually. Such companies are requested to achieve a target of exports and R&D investments in seven to ten years as a condition of designation as an endorsed supplier.

The FTA was introduced as a supplementary programme to the PfD and covers companies with annual sales under A$40 million. Such companies are requested to achieve a target of exports and R&D investments in four years as a condition of designation as an endorsed supplier.

The Government of Australia announced that these PfD and FTA programmes are not obligatory, but are offered on a voluntary basis. Nonetheless, participation under the programme is a necessary step toward designation as an endorsed supplier in the government procurement market, and is, in essence, a de facto obligation. We believe that the PfD and FTA programmes are offset programmes that would be in violation of the 1994 Agreement.

As such, they should be dismantled when Australia accedes to the 1994 Agreement. Australia is still considering becoming a party to the Agreement, and discussions have been prolonged. Only Australia and New Zealand have not yet acceded to the Agreement among major developed countries. We hope that Australia improves the country’s entire government procurement system to be in conformity with the Agreement, for instance eliminating promptly the measure which is inconsistent with the Agreement, and gives high priority to accession to the Agreement.
(iv) Canada

Provincial “Buy Canadian” Legislation

Canada’s provincial governments have “Buy Canadian” and “Buy Local” policies, similar to those of the United States. Preferential treatment is accorded to Canadian products in a variety of ways, requiring *inter alia* the purchase of Canadian or provincial products that are three to fifteen percent more expensive than comparable foreign products.

On 1 June 1995, the federal government arranged an “Agreement on Internal Trade” between all ten of the country’s provinces under which provincial governments were prohibited from discriminating against goods and providers from other provinces in their procurement. While this prevents provincial governments from enacting preferential pricing policies or discriminatory technical specifications for goods and suppliers from other provinces, it does not apply to goods and suppliers from other countries. This allows provinces to maintain their discriminatory treatment if they wish. Provinces are also allowed to exempt specific services and procuring institutions from the agreement. Improvements were seen in July 1999 with a new agreement obligating institutions that were formerly exempt from the agreement—local government institutions, education committees, and other organizations using public funds to procure academic research, insurance, or services—to adhere to non-discriminatory, transparent, and fair procedures in their procurement processes. However, Canada still maintains some exceptions. Institutions can give preferential treatment to domestic suppliers if the price difference is less than 10%, and can limit bidding to Canadian suppliers if Canadian markets are found to be sufficiently competitive and Canadian products are found to be sufficiently high in quality.

Canada initially expressed its intention to make domestic adjustments that would cover all provincial governments and to present a final offer covering sub-central government entities and sub-central government-related entities within eighteen months of the signing of the 1994 Agreement in Marrakesh. However, Canada was unable to obtain a commitment from provincial governments, and the Agreement took effect without an offer from Canada on its sub-central government entities and sub-central government-related entities. From the perspective of further liberalization of government procurement, we would like to see a broad offer on sub-central government entities and sub-central government-related entities in the near future, and would also like to see the system discussed above remedied as soon as possible.