Office of the United States Trade Representative
Washington, D.C.

April 30, 2000

ANNUAL REPORT ON DISCRIMINATION IN FOREIGN GOVERNMENT PROCUREMENT

I. Executive Summary

Executive Order 13116, which the President signed on March 31, 1999, re-institutes the provisions of Title VII of the Omnibus Trade and Competitiveness Act of 1988 ("Title VII"), as amended. Title VII establishes procedures for identifying foreign countries engaging in discriminatory government procurement practices. The Executive Order mandates that the United States Trade Representative ("USTR") submit a report on the identified countries and practices to the Congressional committees of jurisdiction within 30 days of the submission of the National Trade Estimate Report (for the years 1999, 2000, and 2001), and publish these reports in the *Federal Register*. This is the second annual report required by the Executive Order.

In accordance with the provisions of the Executive Order and on the recommendation of the Trade Policy Staff Committee (TPSC), USTR has decided to terminate the 1996 Title VII identification of Germany for discrimination in the heavy electrical sector. This decision is based on Germany's implementation of new legislation that appears to effectively address the concerns raised by the United States through the original Title VII identification.

USTR's 1992 identification of the European Union ("EU") for discriminatory procurement practices of government-owned telecommunications entities in certain member states, as well as the resulting U.S. sanctions, remains outstanding. There are no other outstanding Title VII identifications. However, the Administration continues to work in a range of bilateral and multilateral fora to resolve U.S. concerns with procurement practices described in this and previous Title VII reports. Those concerns, discussed in detail below, relate to foreign procurement practices in the following areas:

- Japan: public works
- Taiwan: various aspects of the procurement regime
- Canada: provincial price preferences
- Mexico: implementation of new procurement laws and NAFTA tendering periods
- Korea: airport construction
- Germany: "sect filters"

In addition, this report describes the Administration's efforts to eliminate discriminatory foreign procurement practices by building and strengthening the international rule of law in a wide range of multilateral, regional and bilateral fora:

- The FTAA Business Facilitation initiative and Negotiating Group on Government Procurement
- The WTO Working Group on Transparency in Government Procurement
- The WTO Committee on Government Procurement
- The NAFTA Working Group on Government Procurement
- The OECD and OAS Conventions on Combating Bribery and Corruption
- Consultations on the Use of Offsets in Defense Trade

II. Provisions of the Executive Order

Pursuant to Executive Order 13116, USTR is required to submit to the Congress each year a report identifying foreign countries:

1) that have failed to comply with their obligations under the WTO Agreement on Government Procurement ("GPA"), Chapter 10 of the North American Free Trade Agreement, or other agreements relating to government procurement to which that country and the United States are parties; or

2) that maintain, in government procurement, a significant pattern or practice of discrimination against U.S. products or services which results in identifiable harm to U.S. businesses, when those countries' products or services are acquired in significant amounts by the U.S. Government.

Within 90 days of the submission of the report, USTR must initiate under section 301 of the Trade Act of 1974, as amended, an investigation with respect to any country identified in the report, unless USTR determines that a satisfactory resolution of the matter has been achieved. If the matter is not resolved during that period and USTR determines that the rights of the United States under an international procurement agreement are being violated, or that any discriminatory procurement practices exist, the Executive Order permits USTR, *inter alia*, to initiate formal dispute settlement proceedings under the international agreement in question or revoke any waivers for purchasing requirements granted to the discriminating foreign country.

Title VII has been a useful and effective tool in challenging foreign governments' procurement barriers. From 1991 to 1996, USTR conducted six annual reviews under Title VII. During that time, six identifications were formally made, while numerous potentially discriminatory government procurement practices were noted. USTR achieved satisfactory resolution with respect to eight discriminatory or potentially discriminatory practices. The re-institution of Title VII procedures through Executive Order 13116 sends a strong signal that the President is committed to protecting U.S. interests in international procurement markets.

III. Identification of Specific Discriminatory Foreign Procurement Practices

A. Practices Identified in Previous Reports

Germany -- Power Generation: In 1996, USTR identified Germany for its failure to comply with market access procurement requirements in the heavy electrical equipment sector. The identification was based on irregularities in the procurement process for two separate steam turbine generator projects in Germany. In particular, the 1996 Title VII Report noted a "pervasive institutional problem" with respect to Germany's implementation of a remedies system for challenging procurement decisions. The imposition of trade sanctions, however, was delayed until September 30, 1996, because consultations with Germany suggested a resolution might be possible given additional time.

On October 1, 1996, USTR announced that the German Government had agreed to take steps to ensure open competition in the German heavy electrical equipment market, including reform of the government procurement remedies system as well as outreach, monitoring, and consultation measures. The United States did not, however, terminate the Title VII action at that time because legislation implementing reform of the procurement remedies system needed to be enacted.

In May 1998, the German parliament passed legislation requiring significant reforms in the German procurement system, including with respect to bid challenge procedures. This legislation entered into effect on January 1, 1999. Although the law is still relatively new and not fully tested, a precedent-setting decision in an August 1999 case demonstrated that losing bidders can now challenge procurement decisions in a court of law and anticipate a fair ruling. The United States has not received further complaints from U.S. suppliers.

Accordingly, USTR has decided, on the recommendation of the TPSC, to terminate the outstanding Title VII determination against Germany for discrimination in the heavy electrical sector. The Administration will continue to monitor the implementation of Germany's procurement reform legislation.

EU -- Telecommunications: In 1992, USTR identified the European Union (EU) as engaging in discriminatory procurement via the practices of telecommunications entities with "special and exclusive rights" in certain member states. As a result of this identification, the United States imposed sanctions in 1993, which remain in place today. In 1999, the European Commission informed the Administration that telecommunications operators in most EU member states were exempted from the procurement requirements in the Utilities Directive. Consequently, the EU requested that the United States remove the sanctions imposed in 1993. The Administration has asked the EU for clarification of the amendments to its regulations and how those amendments apply to individual EU Member States. When that information is received, the Administration will review the issue, including the overall market access conditions in the EU telecommunications market.

B. Practices Identified in this Report

In developing this report, USTR has given careful consideration to a wide range of views and information, including the recommendations of other executive agencies and U.S. embassies and consulates overseas, private sector responses to USTR's request for comments on this year's Title VII report (published in the Federal Register on February 1, 2000), and information on foreign government procurement practices reported in the 2000 National Trade Estimate Report.

On the basis of this information, and after consultation with the TPSC, USTR has determined that no practices meet the criteria for Title VII identification this year. As in previous years, however, there remain a number of foreign government procurement practices of concern which the Administration is pursuing in bilateral and multilateral fora, including WTO dispute settlement when appropriate, or that require continued monitoring and study.

Japan -- Public Works:

American companies are world-renowned for their expertise and competitiveness in design/consulting and construction projects. However, in 1999, American design and construction firms won only $50 million (.02 percent) in contracts in Japan's $250 billion public works market. This is the same level of participation as 1998, only half of the $100 million in Japanese public works contracts awarded to U.S. firms in 1997, and well below U.S. participation in this market in the late 1980's. Proportionally, Japanese firms do 12 times as much public construction business in the United States as American firms do in Japan.

These disappointing results have occurred despite commitments made by Japan in our two U.S.-Japan public works agreements. In particular, the 1994 U.S.-Japan Public Works Agreement aims at "reforming bidding and contracting procedures for public works in Japan, to enhance transparency, objectivity and competition, as well as to strengthen the application of the principle of non-discrimination." In spite of this, Japan has engaged in a significant and persistent pattern of practices of discrimination that impedes American companies from participating in Japan's public works sector. These practices include rampant bid-rigging; unreasonable restrictions on the formation of joint ventures, including the three-company joint venture rule which limits to three the number of members in joint ventures for construction projects; the use of unreasonably vague and discriminatory qualification and evaluation criteria; and the structuring of procurements and calculation of procurement values so they fall below the agreements' thresholds.

The U.S. and Japanese Governments have met at least annually to discuss the U.S. Government's substantive concerns with these and other practices in this sector. These discussions have been helpful in making progress on some issues, but major impediments continue to deprive American firms from opportunities within Japan's vast public works sector. Although the 1994 Agreement has no expiration date, the consultation provision requiring annual meetings between the United States and Japan expired on March 31, 2000, and Japan rejected the U.S. Government's formal request to extend the consultation provision. The United States believes a continuation of the

government-to-government discussions on the implementation of the 1994 Agreement is needed given the continuing problems in this sector.

The United States expects that Japan will take steps to resolve concerns regarding this persistent pattern of practices. If these concerns are not resolved in a timely manner, the U.S. Government will initiate the steps necessary to identify Japan under Title VII.

Taiwan – General Procurement Procedures: Taiwan, which is in the process of acceding to both the WTO and the GPA, recently enacted a law and promulgated regulations intended to bring its procurement practices into conformity with the requirements of the GPA. Although the new procurement law is an improvement over the former procurement regime, particularly in the area of transparency, it will not be fully applicable to foreign bidders until Taiwan's accession and does not cover the full range of procurement activities of interest to U.S. suppliers. Moreover, the new regulations do not appear to have effectively addressed problems that U.S. suppliers continue to experience in the Taiwan procurement market, particularly in the following areas:

- The lack of timely and effective arbitration procedures, which prevent satisfactory resolution of contract disputes;
- high bid bond requirements and unacceptably high potential contract liabilities;
- frequent costly and unreasonable contract change orders;
- the use of tender specifications to exclude foreign bidders;
- qualification requirements that require experience in similar projects in Taiwan, which do not take into account relevant experience in other markets;
- qualification requirements that require foreign suppliers to establish local subsidiaries; and
- the use of offsets in certain key sectors.

The Administration continues to urge the Taiwan authorities to take concrete steps, in preparation for its WTO and GPA accession, to eliminate these and other procurement practices that appear inconsistent with WTO requirements or that constitute an unfair or unnecessary restriction on competition in Taiwan's government procurement market.

Canada – Provincial Price Preferences: Canada is the only Party to the GPA that has not assumed obligations to cover procurement by sub-central government entities. Some Canadian provinces maintain "Buy Canada" price preferences that favor Canadian suppliers over U.S. and other foreign competitors. The Administration is concerned that the application of those preferences may result in an imbalance of bilateral market access opportunities in government procurement. Therefore, it will continue to raise these concerns in bilateral discussions, with a view to bringing Canadian provincial governments and other government and government-owned entities within the scope of the GPA and NAFTA procurement rules.

Mexico – Implementation of New Procurement Laws and NAFTA Tendering Periods: On January 4, 2000, Mexico published new laws relating to the procurement of Public Works and Related Services. These laws require Mexican procurement agencies to implement a new system

of "Buy Mexico" purchasing preferences. While the laws appear to include a general exception for treaty obligations, there remains a potential risk that Mexico could implement the laws in a way that would be inconsistent with Mexico's NAFTA commitments. The Administration is following the situation closely to ensure Mexico's conformity with its obligations under the NAFTA.

The United States also remains concerned about complaints that some Mexican agencies are not adhering to NAFTA requirements relating to the time periods to be provided for tendering. The United States has joined Canada is seeking clarification of this issue in the NAFTA Negotiating Group on Government Procurement (NGGP), and continues to urge Mexico to ensure that its procurement authorities comply with the relevant NAFTA commitments.

Korea – Airport Construction: Practices applied by Korea in procurements for construction of the new Inchon International Airport project favor Korean firms over foreign firms. These practices, such as the use of domestic partnering, short deadlines and certain licensing requirements, appear inconsistent with the GPA, and restrict the ability of U.S. and other foreign firms to participate meaningfully in bidding opportunities and to win contracts. U.S. officials raised these concerns with Korea repeatedly in the WTO Government Procurement Committee and in informal bilateral consultations.

Because Korea's GPA schedule does not explicitly list the names of the entities procuring for the Inchon International Airport project, the United States and Korea disagreed about whether such procurements were even covered by the Agreement. The United States maintained that these entities, which were specifically created for the purpose of procuring for this particular project, are covered because they are in fact subordinate to Korea's Ministry of Construction and Transportation, a "central government" entity explicitly listed in Korea's GPA schedule. Korea, on the other hand, denied coverage of these entities under its GPA obligations.

The two governments could not come to an agreement after two years of discussions. Therefore, the United States asked a WTO panel to examine this issue. Formal consultations between the governments were held on March 17, 1999, and meetings of the panel were held in October and November of last year. On April 7, 2000, the panel issued its final report to the two governments. In its report, the panel concluded that this particular airport construction project is not covered by the GPA. The panel made this determination based on its findings, *inter alia*, that the project is not explicitly written into Korea's GPA schedule and that the entities procuring for the project are not "legally unified" with Korea's listed entities.

Germany -- "Sect Filters": Policy guidance issued by the German Federal Government has raised concerns about a potential for discrimination against U.S. firms in procurement decisions by German entities. In September 1998, the Federal Economics Ministry issued procurement guidelines to be put into effect by all Federal Government Ministries. These procurement guidelines warn that a firm should be deemed "unreliable" if it refuses to sign a so-called sect filter. The filter requires a firm's leadership to attest that Scientology principles will not be used

or spread in fulfillment of any contract; that the leadership of a firm will not recommend or approve participation in courses or seminars relating to Scientology principles during the course of business; and that firms reject Scientology principles in conjunction with any subsidiary. Procurement entities are permitted to reject bids and immediately terminate contracts if a firm does not sign the sect filter.

Although issued at the Federal level only for use on procurements related to consulting or training services, state-level entities and even private firms currently appear to be using sect filters beyond that narrow scope. While it still remains unclear how these measures will be implemented, at least one major U.S. supplier has had to undergo a qualification process that was significantly more extensive than that required by its competitors. Upon learning of the sect filter requirements, the Administration raised its concerns with the German Government and continues to press the Germans to repeal this discriminatory policy.

IV. Expanding and Strengthening the International Rule of Law With Respect to Government Procurement

A. Free Trade Area of the Americas ("FTAA")

In the March 1998 San José Declaration, the Trade Ministers of the 34 countries of the Western Hemisphere agreed that the specific objectives of the FTAA negotiations in the area of government procurement were to ensure: "openness and transparency of government procurement processes"; "non-discrimination ... within a scope to be negotiated"; and "impartial and fair review for the resolution of complaints and appeals by suppliers and the effective implementation of such resolutions." In the November 1999 Toronto Declaration, FTAA Ministers instructed their negotiators to submit draft negotiating texts for ministerial review by the end of 2000. The FTAA governments are committed to concluding the FTAA negotiations by 2005.

Currently, only 27 countries and territories are Parties to the WTO Government Procurement Agreement. The entry into force of the FTAA procurement chapter, therefore, is likely to more than double the number of countries that have agreed to open their government procurement markets and subject them to strong, binding, non-discriminatory international procurement rules. In order to achieve the Toronto mandate, the Administration has pressed for a focused and forward leaning work program in the Negotiating Group on Government Procurement ("NGGP"). During the first part of the year, the NGGP has agreed that delegations will submit drafting proposals on all the elements that have been identified for inclusion in the FTAA procurement chapter. The NGGP will consolidate those proposals and seek to narrow differences and, where possible, achieve consensus on specific provisions by the end of the year.

The resulting negotiating text will provide the framework for subsequent negotiations on the coverage (*i.e.*, specific market access commitments) of the eventual procurement chapter.

B. WTO Working Group on Transparency in Government Procurement

Continued, active support for early conclusion of a WTO Agreement on Transparency in Government Procurement is a key element of the Administration's ongoing efforts to promote the rule of law in public sector economic management throughout the world. Conclusion of this Agreement will serve a wide range of important U.S. interests. It will help to establish a more stable and predictable business environment for U.S. exporters, even in markets where governments maintain "buy national" or other purchasing restrictions. It will also build on the "good governance" reforms that a growing number of countries have adopted in response to the international financial crisis and the deeper structural impediments to efficient long-term growth and development.

In 1999, the WTO Working Group on Transparency in Government Procurement moved forward rapidly with the development of concrete provisions for potential international commitments in this area. On this basis, WTO Members are in a good position to conclude a multilateral agreement on transparency in government procurement. This work provides a strong foundation for continuing to pursue U.S. procurement objectives in bilateral and regional negotiations, as well as in the WTO. The Administration will, in the context of WTO Members' decisions on the overall WTO agenda, continue to actively support the efforts to conclude a strong multilateral Agreement on Transparency in Government Procurement at the earliest date possible.

C. The WTO Agreement on Government Procurement ("GPA")

The GPA, which entered into force on January 1, 1996, is a "plurilateral" agreement included in Annex 4 to the WTO Agreement. As such, it is not part of the WTO's single undertaking, and its membership is limited to the 27 WTO members that signed the Agreement in Marrakesh or that subsequently acceded to it. In its report to the 1996 Singapore Ministerial Conference, the Committee on Government Procurement, which monitors the GPA, stated its intention to undertake an "early review" of the GPA starting in 1997. The Administration considers the review of the Agreement to be an important opportunity to streamline the GPA and make it more understandable to current and potential new GPA Parties, their suppliers, and their procuring entities.

The United States and the other GPA Parties believe that the completion of this process will make the Agreement more accessible to a much broader range of WTO Members. Currently, five WTO Members are in the process of negotiating accession to the GPA, or preparing for those negotiations. A number of other countries, particularly eastern European countries seeking to accede to the European Union, have committed to pursue GPA accession in the future. In order to facilitate and expedite this process, the WTO Government Procurement Committee is developing standard accession procedures and time-tables. The Administration believes that the development of systematic accession procedures will complement the review process in making the GPA more accessible to a broad range of WTO Members and significantly expanding international participation in the open, rules-based international trading system for government

procurement.

The GPA provides a consultative procedure to assist the Parties in monitoring and enforcing their procurement commitments under the Agreement. The United States has used this procedure to comment on questionable procurement practices, such as the application of the EU "Utilities Directive," and to obtain detailed information relevant to potential dispute settlement cases.

D. Chapter 10 of the North American Free Trade Agreement ("NAFTA")

In NAFTA Chapter 10, the NAFTA signatories agreed to open the majority of non-defense related federal procurement opportunities to competition from all North American suppliers. Because Mexico is not a member of the GPA, its participation in the NAFTA marked the first time that Mexico had committed to eliminate discriminatory government procurement practices. While differences exist between NAFTA Chapter 10 and the GPA (*e.g.*, with respect to thresholds and sub-federal coverage), the principles of non-discrimination, fair and open competition, and transparency are established with equal force in both agreements.

As with the WTO Government Procurement Committee, the NAFTA Working Group on Government Procurement provides a useful forum for the Administration in monitoring and enforcing the NAFTA Parties' procurement commitments.

E. Combating International Bribery and Corruption

Among the most consistent complaints the Administration receives from U.S. industry and labor representatives is that bribery and corruption can seriously compromise commercial opportunities in many overseas government procurement markets. This is particularly true for big ticket infrastructure projects for which preparation of a bid package alone can cost millions of dollars. U.S. exporters often report that they bid on projects with little or no certainty as to whether the offered technology and price are going to be the primary criteria in the award of contracts. In many cases, they may be doubly disadvantaged if their international competitors are not subject to legal disciplines similar to the U.S. Foreign Corrupt Practices Act. Despite these concerns, U.S. firms are frequently hesitant about coming forward publicly with cases in which they have seen bribery and corruption influence contract awards, because of fears that they may experience a commercial backlash with respect to future contracts.

These circumstances call for government-to-government initiatives to root out bribery and corruption in international procurement markets. The Administration is aggressively pursuing this objective in a wide range of international fora. The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, for example, represents a major breakthrough in this area. The Convention obligates the parties to criminalize bribery of foreign public officials in the conduct of international business, which can include government procurement. It is aimed at proscribing the activities of those who offer, promise, or pay a bribe. For this reason the Convention is often characterized as a "supply side" agreement,

as it seeks to effect changes in the conduct of companies in exporting nations. The Convention entered into force in February 1999 for 12 of the 34 signatories. As of April 2000, 20 signatories, including the United States, had ratified it.

In March 1996, countries in the Western Hemisphere concluded negotiations on the Inter-American Convention Against Corruption. To date, 26 countries have signed it and 18 have ratified. This Convention, a direct result of the Summit of the Americas Plan of Action, requires that the signatories criminalize bribery, using language modeled in part on the U.S. Foreign Corrupt Practices Act, and adopt other various measures aimed at both national and international corruption. The Convention entered into force in March 1997 for those countries which have ratified it.

The Administration is pursuing a broad range of complementary initiatives in the WTO and other international and regional trade fora. For example, we continue to press WTO Members for early conclusion of a multilateral Agreement on Transparency in Government Procurement. We have also led initiatives to ensure full and timely implementation of the WTO Agreement on Customs Valuation and to strengthen the operation of the WTO Agreement on Pre-Shipment Inspection. As part of the Business Facilitation initiative for the Free Trade Agreement of the Americas, the Administration has already secured important commitments to ensure transparency and due process, particularly in relation to customs procedures, that will apply to all 34 countries of the Western Hemisphere. These initiatives strengthen the international rule of law and help to create a transparent, stable and predictable business environment that suppresses corrupt practices and allows U.S. firms and their workers to compete on a level playing field in overseas markets.

F. Offsets in Defense Trade

When purchasing defense systems from U.S. contractors, many foreign governments require compensation, in the form of offsets, as a condition of purchase in either government-to-government or commercial sales of defense articles and/or defense services. Offsets include mandatory co-production, licensed production, subcontractor production, technology transfer, countertrade, and foreign investment. Offsets may be directly related to the weapon system being exported, or they may take the form of compensation unrelated to the exported item, such as foreign investment or countertrade.

Originally designed to enhance allied national security, some key U.S. trading partners now use offsets to pursue economic and commercial objectives. Department of Commerce data indicates that, while over 90 percent of recent offset agreements were associated with exports of U.S. aerospace weapons systems, almost half the resulting offset transactions were fulfilled with non-aerospace products. Such mandatory offset requirements may negatively affect U.S. firms and their workers by enhancing foreign suppliers' competitive capabilities or opportunities, reducing U.S. exports, and potentially limiting domestic job opportunities in these industries. They may also have a negative impact on the foreign buyer, since contract award decisions that are determined by the willingness or ability of a supplier to provide offsets may result in procurement

that does not achieve the best possible value in terms of the price and quality of the equipment, installation, materials or services supplied.

An Interagency Offset Steering Committee, chaired by the Department of Defense and including representatives of the Departments of Commerce, State and Labor and the Office of the United States Trade Representative, was established in 1999. The Committee has been working to develop strategies that would reduce the adverse effects that defense related offsets may have on the industrial base and on U.S. trade interests. On this basis, the Committee has initiated bilateral discussions with U.S. allies in an effort to focus allied governments' attention on the adverse effects of offsets in defense trade and to explore ways for reducing or eliminating them.