CHAPTER 6
Government Procurement

This chapter considers the economic effects of domestic preference restrictions imposed on certain types of government procurement. Domestic preference restrictions include “Buy America”[1] provisions in transportation projects and food assistance programs, restrictions on Federal defense spending, set-aside programs for U.S. small and minority-owned businesses, and restrictions on State government purchases. Previous updates of this study have not considered domestic preference restrictions on government procurement as significant import restraints. Because procurement restrictions discriminate against imported goods and services, they are included in this update.

These restrictions are considered in a qualitative discussion and are neither formally quantified nor modeled. Existing policies are highly complex and in some cases overlap. This, in turn, creates significant difficulties in specifying the product coverage and value of government purchases which are covered by these policies, in estimating the potential increase in imports which might result from removing these policies on imports, or indeed even in documenting the total value of government-purchased imports subject to these restrictions. The following discussion may serve as an aid in understanding these complex issues for those who wish to pursue further research on this topic.

Import restraints can raise the cost of government purchases in two different ways: by mandating preferences for domestic goods and services as discussed in this chapter, and by increasing the cost of goods and services for which there are direct import restraints as discussed elsewhere in the report. The import restraints discussed elsewhere in this report may have significant effects on the cost of government procurement at both the Federal and

[1] A somewhat confusing aspect of the government procurement programs is the similarity of two distinct bodies of law: Buy America<u>n</u> and Buy America. In most cases, Buy American legislation regulates Federal spending on activities like defense. The main Buy American requirements are listed in 41 U.S.C. 10(a)–10(c). “Buy Americ<u>a</u>” programs include a series of Federal restrictions on spending by Federal grantees (typically, State and local governments). This legislation is usually contained in overall government procurement guidelines for a specific activity like highway construction.

sub-Federal levels. For example, uniforms and other work clothing are purchased in significant quantities by the U.S. military, by police and fire departments, and by public-sector hospitals. A large share of coastal shipping services are consumed either by the military or by haulers of solid waste which are either owned by or under contract to State and local governments. Categories of food subject to direct import restraints are served in school, the military, hospitals, and elsewhere in government. Removing product-specific import restraints could significantly reduce the costs of procurement even if other procurement provisions limiting imports stayed in place, by reducing the price of competing domestic merchandise. This, in turn, could enable either tax cuts, reduced government borrowing, or increased government purchases of these or other goods. This study does not attempt to model the effects on government budgets of product-specific import restraints mentioned in other chapters.

The United States has made significant commitments to apply the non-discrimination principle to many areas of Federal Government procurement. Chapter 10 of the North American Free Trade Agreement (NAFTA) commits signatories to accord goods and suppliers of other NAFTA countries "treatment no less favorable than the most favorable treatment that the Party accords to its own goods and suppliers."[2] Annex 4(b) of the Uruguay Round Agreements contains very similar language.[3] The restrictions discussed below are generally consistent with negotiated exceptions to the principle of non-discriminatory treatment of foreign suppliers.[4]

Government procurement restrictions in the United States fall into three main categories: Federal restrictions on procurement by the Federal Government, State restrictions on State and local government procurement, and Federal restrictions on the use of Federal grant money by State and local governments. Many of the Federal restrictions on Federal Government procurement have been removed as a result of commitments under the Uruguay Round Agreements and NAFTA. Remaining Federal restrictions on Federal spending include defense spending and preferences for small and minority-owned businesses. States impose a variety of restrictions on State and

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[2] North American Free Trade Agreement, Chapter 10, Article 1003.

[3] Uruguay Round Agreements, Annex 4(b), Article III. The WTO provides a non-technical summary of the government procurement provisions at *http://www.wto.org/english/tratop_e/gproc_e/over_e.htm*, retrieved on January 16, 2004.

[4] Both agreements include language that outlines general exceptions to the principle, as well as specific exceptions included in each country's annex.

local government spending.[5] The most significant Federal restrictions on State and local government procurement are "Buy America" restrictions imposed on the use of Federal grant money in transportation projects and food assistance programs.

The Buy American Act of 1933, which governs Federal procurement, applies in general to procurements between $2,500 and approximately $175,000 in value, and in some cases to larger procurements. It generally provides cost preferences for products grown or mined in the United States and products manufactured in the United States with at least 50 percent U.S. content by value.[6] These are administered by having the contracting officer add a 50-percent penalty to the bid of a foreign firm in the case of defense contracts, a 6-percent penalty for civilian contracts, and a 12-percent penalty for civilian contracts when the competing domestic vendor is a small business or operates in a labor surplus area. For large procurements, the Trade Agreements Act of 1979 supersedes the Buy American Act. This Act implements the GATT Government Procurement Code negotiated under the Tokyo Round and provides for national treatment for procurements from countries which are signatories to that code.[7] Procurements below $2,500 are designated as "micro procurements" under the Federal Acquisitions Streamlining Act of 1994 and are exempted from the Buy American Act. Additional Buy American provisions may apply to specific goods, particularly in defense.[8]

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[5] The Canadian Department of Foreign Affairs and International Trade maintains a web site that documents restrictions imposed on procurement by State governments in the United States. See *http://www.dfait-maeci.gc.ca/sell2USgov/procurement-en.asp*, retrieved on January 15, 2004.

[6] As characterized by the Canadian Department of Foreign Affairs and International Trade on its website at http://www.dfait-maeci.gc.ca/sell2usgov/buyact-en.asp, retrieved on February 27, 2004.

[7] The Office of the United States Trade Representative issues an annual *Federal Register* notice specifying the minimum thresholds for which the procurement obligations of the WTO Government Procurement Agreement and Chapter 10 of the NAFTA apply. For the calendar years 2004-2005, the WTO Government Procuremnt Agreement applies to central government procurements of goods and services equal to or exceeding $175,000, and to procurements of construction services equal to or exceeding $6,725,000. The threshold for goods and services procurements for listed sub-central government entities is higher, and the NAFTA thresholds differ from those under the WTO Procurement Agreement. *Federal Register*, Vol. 68, No. 244, Dec. 19, 2003, p. 70861.

[8] "Federal Acquisition of Foreign Products," retrieved at *http://www.sellingtothefeds.com/t62.html* from the website of GovernmentVideo (United Entertainment Media) on Mar. 25, 2004.

Government procurement restrictions typically include a waiver process that allows the procuring authority to purchase imports if doing so "serves the public interest" or if an appropriate domestic product is not available. For example, imported bananas may be purchased under the National School Lunch Program because there are usually no domestically grown bananas available.[9] Although some aspects of the waiver process are discussed in the report, the lack of data on the value of waivered imports makes it difficult to quantify the significance of waiver programs on the trade restrictiveness of procurement programs.

Public Transportation

The Federal Transit Administration (FTA) of the U.S. Department of Transportation (DOT) oversees the Buy America program as it applies to public transit agencies in the United States.[10] Buy America restrictions regulate FTA grantee purchases of steel, iron, and manufactured goods.[11] Although such restrictions may affect transit agencies' operating expenses, they are most likely to increase the cost of capital expenditures for transit. U.S. public transit agencies' capital expenditures in 2000 totaled $9.06 billion.[12] Of these expenditures, $4.28 billion, or approximately 47 percent,[13] were financed by the Federal Government.

FTA regulations put somewhat lower domestic content restrictions on purchases of transit vehicles[14] (e.g. buses, locomotives, ferries) than on purchases of iron and steel products and other manufactured goods (e.g. facilities, rail track). Absent a waiver from the FTA, Buy America restrictions require that transit agencies using Federal funds purchase vehicles that have

[9] Telephone conversation with USDA Food and Nutrition Service staff, Feb. 11, 2004.

[10] For a history of Buy America provisions in public transit, a comprehensive discussion of the Buy America restrictions, and a guide to waiver and compliance issues see "Guide to Federal Buy America Requirements," Legal Research Digest, Transit Cooperative Research Program, Federal Transit Administration, Number 17, Sept. 2001.

[11] Ibid. p.10

[12] *2000 National Transit Database*, Table 6. Transit Capital Funds Applied: Details By Transit Agency, p. 2–79, *http://www.ntdprogram.com/ntd/NTDData.nsf/2000+TOC/Table-6/$File/t06_32.pdf*, retrieved on January 17, 2004.

[13] ITC calculation based on data from 2000 National Transit Database, table 6.

[14] FTA regulations refer to "rolling stock," which is defined as "transit vehicles such as buses, vans, cars, railcars, locomotives, trolley cars, ferry boats, and vehicles used for supportive services." Rolling stock regulation also applies to train control, communications, and traction power equipment. TRCP 2001, p.13.

been assembled in the United States, and that at least 60 percent of the cost of the vehicles' components be made in the United States. For purchases of iron, steel and other manufactured goods, assembly must be done in the United States and 100 percent of the components must be U.S. made. Pre-award and post-delivery audits are conducted to ensure compliance. Both transit agencies and their supplying firms are responsible for demonstrating Buy America compliance.

Under certain circumstances, the FTA can waive Buy America restrictions on transit agencies. General waivers apply to purchases of Chrysler 15-passenger vans, microcomputer equipment, and small purchases of under $100,000.[15] Specific waivers, which require an application to the FTA, may be given if domestically produced goods are not available, if imposing the requirements are judged to be against the public interest, or if the price of the imported product is more than 25 percent lower than the price of the domestic good. Specific waivers are most often granted for non-availability, although occasionally price differential and public interest waivers are also given.[16]

Highway Construction

Buy America restrictions for highway construction require the use of domestically produced iron and steel products in Federal-aid highway construction. Total capital outlays on Federal-aid highway projects totaled $45.9 billion in 2002.[17] Federal Highway Administration (FHWA) grants to States and local government for these projects totaled $25.9 billion, or 56.4 percent of the total.[18]

The Buy America program for highway construction requires that "all steel and iron materials used in the project be manufactured in the United States."[19] Products made of iron and steel may be assembled outside the United States, as long as iron and steel used in the project was produced in the United States. In

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[15] TCRP 2001, p. 19.

[16] Communication with FTA staff, July 17, 2003.

[17] Table SF–21, "State Funding for Highways – Summary 2002," *Highway Statistics 2002*, FHWA, available at *http://www.fhwa.dot.gov/policy/ohim/hs02/sf21.htm*, retrieved Jan. 18, 2004.

[18] Table FA–4D, "Allocation of Federal Funds Administered by the Federal Highway Administration for Fiscal Year 2002," *Highway Statistics 2002*, FHWA, available at *http://www.fhwa.dot.gov/policy/ohim/hs02/fa4d.htm*, retrieved Jan. 18, 2004.

[19] See "Buy America: Application to Federal–aid Highway Construction Projects, July 9, 2002" FHWA, available at *http://www.fhwa.dot.gov/programadmin/contracts/buyamgen.htm*, retrieved on January 18, 2004.

highway construction as well as in transit, a waiver program exists, but waivers are rarely given.[20] Imported iron and steel products may be used if their price is at least 25 percent lower than the price of similar products using domestically produced iron and steel. Steel accounts for approximately 4.4 percent of the cost of Federal-aid highway construction.[21]

Airport Construction

Buy American[22] restrictions on State and local government procurement for airport construction are administered by the Federal Aviation Administration (FAA). FAA restrictions apply most notably to the Airport Improvement Program (AIP), a Federal grant program that aids State and local governments in construction and maintenance of airports, including runways, facilities, lighting, and signage systems.[23] Federal expenditures on the AIP were $3.223 billion in 2002.[24] Data on expenditures by the grantees are not available, but FAA staff estimate that 80 to 90 percent of spending on AIP projects comes from Federal AIP grants.[25]

Buy American restrictions on airport improvements are similar to Buy America rules for highways and transit.[26] Steel and manufactured products used in construction must be made in the United States, unless purchase of domestic products is against the public interest, domestic products are unavailable, or using domestic products would increase the cost of the contract by 25 percent. Furthermore, 60 percent of the cost of components used in assembly of manufactured products used in airport construction must consist of goods made in the United States.

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[20] Communication with FHWA staff, July 30, 2003.

[21] FHWA data available at *http://www.fhwa.dot.gov/ohim/hs01/pdf/ptcht.pdf*, retrieved January 18, 2004.

[22] The legislation associated with airport improvement grants (49 U.S.C. Chapter 501, Section 50101) does not follow the convention that uses the "Buy America" terminology when the restrictions are on non-Federal purchases. This appears to be a legislative quirk, though the existence of non-governmental grantees such as privately operated airports in airport construction may also justify the difference.

[23] For a description of the AIP, see *http://www1.faa.gov/arp/financial/aip/overview.cfm?ARPnav=aip*, retrieved Jan. 18, 2004.

[24] Phone conversation with AIP staff, Mar. 9, 2004.

[25] Ibid.

[26] See Federal Aviation Administration, *Airport Improvement Program Handbook*, Chapter 9, Paragraph 922(h) for the FAA's non-technical guidance to grantees.

Food Assistance

A wide variety of U.S. government programs provide food assistance to various parts of the U.S. population. These programs are administered by the U.S. Department of Agriculture, through its Food and Nutrition Service, as well as other Federal agencies.[27] Much of this assistance comes through the food stamp program, which gives individual recipients substantial latitude as to their purchases and imposes no restrictions as to whether foods purchased are domestic or foreign in origin. Other forms of Federal nutrition aid take the form of Federal grants to State and tribal governments, which then redistribute a mix of foodstuffs and funds to local providers of food. These programs include the National School Lunch Program (NLSP) and School Breakfast Program (SBP) in the public schools; the Child and Adult Care Food Program (CACFP), which includes both adult and child day care centers; the Summer Food Service Program (SFSP), which involves summer youth activities outside of school; the Nutrition Services Incentive Program (NSIP), with a target population of elderly citizens; the Food Distribution Program for Indian Reservations (FDIR); the Commodity Supplemental Food Program (CSFP), which targets the same populations as NSIP and WIC (Women, Infants, and Children); and The Emergency Food Assistance Program (TEFAP), which provides food to food banks and soup kitchens. In cases of natural disaster, food stockpiles from these programs can be diverted in the short run.

In these programs, preferences for U.S.-produced foods are implemented in several different ways. One is the direct provision of U.S. commodities acquired in agricultural price-support programs. Donated commodities, which form a significant part of the commodities available for distribution, also must be of domestic origin.[28] In addition, the law governing the National School Lunch Program and National School Breakfast Program require that school food authorities purchase, to the maximum extent possible, domestic commodities.[29] The United States reserves the right under both NAFTA[30] and the Uruguay Round[31] to exempt the "procurement of agricultural goods made

[27] For example, the Department of Health and Human Services, Agency on Aging, administers the Nutrition Services Incentive Program.

[28] USDA Food and Nutrition Service, Food Distribution Fact Sheet, "Schools/Child Nutrition Commodity Programs," Mar. 2003, p.1.

[29] 42 U.S.C. § 1760(n). Found at *http://www.caselaw.lp.findlaw.com/scripts/ts_search.pl?title=42&sec=1760* (website of Findlaw.com), and retrieved on February 3, 2003.

[30] NAFTA, Chapter 10, Annex 1001.1a–1.

[31] WTO Agreement on Government Procurement, Schedule of the United States, Annex I.

in furtherance of agricultural support programs or human feeding programs" from the government procurement provisions of those agreements.

In FY 2002 the Federal costs of the National School Lunch Program and School Breakfast Program amounted to $8.437 billion, of which approximately $803 million represented direct distribution of Federally acquired commodities and the rest were cash payments.[32] In addition, Federal costs of various other food distribution programs including NSIP, FDIR, CSFP and TEFAP amounted to $785 million in FY 2002.[33] By comparison, the food stamp program, in which purchases are largely directed by individual recipients, cost $18.275 billion in FY 2002.[34]

In the area of international food assistance, Title I of the Agricultural Trade Development and Assistance Act of 1954, as amended (commonly known as Public Law 480, or "Food for Peace") provides for U.S. government financing of sales of U.S. agricultural commodities to developing countries and private entities (hereafter called "participants") on concessional credit terms, including extended credit periods and low rates of interest. Sales are made by private business firms on a bid basis in response to Invitations for Bids or "IFB's" issued in the United States by the participant.[35] PL 480 Title I is administered by the U.S. Department of Agriculture. Titles II and III of PL 480, which involve food donations and government-to-government economic development grants, are administered by the U.S. Agency for International Development.[36]

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[32] USDA Food and Nutrition Service data, found at *http://www.fns.usda.gov/pd/cncosts.htm* and retrieved on Feb. 12, 2004. These totals do not include Federal contributions to State administrative costs or costs paid by State and local governments.

[33] USDA Food and Nutrition Service data, found at *http://www.fns.usda.gov/pd/fd$sum.htm* and retrieved on Jan. 14, 2004.

[34] USDA Food and Nutrition Service data, found at *http://www.fns.usda.gov/pd/fssummar.htm* and retrieved on Mar. 10, 2004. The total reported includes program benefits and excludes the Federal share of State administrative and program costs and miscellaneous Federal costs such as printing and processing of stamps, anti-fraud funding, and program evaluation.

[35] "Public Law 480 Sales Program: A Brief Explanation of Title I," USDA Foreign Agricultural Service, found at *http://www.fas.usda.gov/excredits/FoodAid/pl480/pl480brief.html* and retrieved on June 7, 2003.

[36] National Agricultural and Fishery Council, found at http://www.nafc.com.ph/pl-480.php and retrieved on June 7, 2003.

Small Business Set-Asides

The Small Business Act, as amended,[37] sets specific numerical goals for the percentage of Federal prime and subcontracts for goods and services awarded to small businesses, both in general and by specific categories of small business. These goals are administered by the U.S. Small Business Administration (SBA) and include:[38]

- 23 percent of prime contracts for small businesses;
- 5 percent of prime and subcontracts for small disadvantaged businesses (primarily minority-owned businesses);
- 5 percent of prime and subcontracts for women-owned small businesses;
- Prime contracts for HUBZone (Historically Underutilized Business Zone) small businesses phased in from 1.0 percent in fiscal year 1999 to 2.5 percent in FY 2002 and 3 percent in FY 2003 and each year thereafter;
- 3 percent of prime and subcontracts for service-disabled veteran-owned small businesses.

SBA negotiates annual procurement preference goals with each Federal agency and reviews each agency's results. Monitoring of achievement of the overall goals is the responsibility of SBA.

The Small Business Act directly specifies that small business owners must be U.S. citizens only for certain specific categories of programs (e.g. HUBZone small businesses). The Canadian Department of Foreign Affairs and Trade reports that Canadian firms are generally not eligible for U.S. small business set-asides, except in occasional cases.[39] The SBA regulations for size determination count the receipts and employees of all domestic and foreign

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[37] Retrieved from the U.S. Small Business Administration site at *http://www.sba.gov/regulations/sbaact/sbaact.html* on Feb. 27, 2004. The original Small Business Act (PL 85-536) was enacted in 1958, and established the Small Business Administration as the successor to the Depression-era Reconstruction Finance Corporation.

[38] Retrieved from the SBA website at *http://www.sba.gov/GC/goals* on Feb. 27, 2004.

[39] Retrieved from the Canadian Department of Foreign Affairs and International Trade website at *http://www.dfait-maeci.gc.sa/sell2usgov/smallbusasides-en.asp* on Feb. 27, 2004.

affiliates of the business applying for a determination of small size.[40] This requirement probably precludes most U.S. affiliates of foreign-owned multinationals from being certified as "small" regardless of how small the U.S. affiliate is, because the larger firm including the foreign parent is more likely to be found to be "non-small." Federal purchases made under the Small Business Act are generally also subject to the Buy American Act of 1933, unless they are covered by a specific waiver. As stated above, Federal purchases under $2,500 in value are granted a general waiver from the Buy American Act, but this applies to the size of the purchase, not of the selling firm.[41]

The Federal Procurement Data Center reports[42] that approximately $250.2 billion of Federal prime contracts were awarded in FY 2002. Data on the procurement preference goaling achievements are reported with respect to $235.4 billion of these contracts. Of the value of these, approximately $53.3 billion (22.6 percent) were awarded to small businesses. Within that total, $15.9 billion (6.8 percent) were awarded to small disadvantaged businesses, $1.7 billion (0.7 percent) to HUBZone small businesses, $6.8 billion (2.9 percent) to women-owned small businesses, and $300 million (0.1 percent) to service-disabled-veteran-owned small businesses. Thus, the SBA goals are approximately met in the aggregate, though not for every category of small business for which SBA is required to administer the goals.

The degree to which the various departments and agencies of government contribute to the meeting of the SBA goals varies substantially across the government. In FY 2002, most Federal departments and agencies equaled or significantly exceeded the SBA goals. The Department of Defense (DOD) accounted for $155.2 billion (65.9 percent) of the procurements for which data on the SBA goals are available and purchased $32.8 billion (21.2 percent of DOD procurements for which data are available) from small-business sources, just short of the 23 percent statutory goal. Thus, the degree to which DOD procurements are able to be sourced from small business is a major factor in overall achievement of the SBA goals.

[40] Retrieved from the SBA website at *http://www.sba.gov/size/2003regns/121.103.html* on Feb. 27, 2004.

[41] "How the Government Buys," *http://www.sba.gov/gopher/Government-Contracting/buy.txt* , retrieved from the SBA website on Mar. 25, 2004.

[42] Retrieved from the SBA website at *http://www.fpdc.gov/fpdc/FPR2002a.pdf* on Feb. 27, 2004.

Defense Procurement

Domestic sourcing requirements for defense procurement are governed by the Buy American Act of 1933 (49 USC 10 (a)-(d)) as well as by the rules of the Defense Federal Acquisition Regulations System, known as DFARS (48 CFR Ch. 2)[43] and other Federal legislation. The DFARS regulations are intricate and have been modified frequently by legislation imposing additional domestic-sourcing requirements on particular products, such as food, clothing, and fibers; vessel acquisition and refit, and anchor chain. A substantial portion of the DFARS regulations is devoted toward complying with the Memorandum of Understanding (MOU) between DOD and SBA with respect to the small-business goals referred to above.

In practice, there are numerous circumstances under which DOD's domestic preferences can be waived, and most NATO countries and major non-NATO allies of the United States have signed MOUs to benefit from such waivers. Product-specific requirements for U.S. domestic sourcing may take precedence in some cases over the waivers granted in MOUs to U.S. allies.[44]

State and Local Government Procurement

State government procurement procedures impose a variety of import-restraining procurement restrictions over and above the restrictions imposed by Federal guidelines. Negotiated trade agreements have not required State action, but have called on Federal parties to seek commitments from State and Provincial governments.[45] Most U.S. States retain explicit preferences for in-state contractors.[46] However, some States have mitigated the restrictiveness of their programs as a result of bilateral international negotia-

[43] The DFARS regulations are available at the Defense Acquisition Regulations Directorate website at *http://www.acq.osd.mil/dp/dars/dfars/html/r20040113/tochtml.htm*, retrieved on Feb. 27, 2004. See, in particular, part 225, "Foreign Acquisition."

[44] As characterized in the EU Market Access Database, "DoD Defence Acquisitions" at *http://mkaccdb.eu.int/cgi-bin/stb/barrierdesint.pl?bnumber=960056*, retrieved on Feb. 27, 2004.

[45] See NAFTA, Article 1024, Section 3.

[46] See *http://www.dfait.gc.ca/sell2usgov/statelawsreg-en.asp* for a sample of State-level restrictions.

tions.[47] The large number of State programs, their heterogeneity, and their propensity to overlap with Federal programs, increases the complexity of procurement, and so may increase the efficiency costs of such restrictions.

[47] For example, 39 of 50 States are covered by a bilateral agreement on government procurement between the United States and the European Union (European Commission, *Report on U.S. Barriers to Trade and Investment*, December 2003). The results of these provisions were largely extended on a plurilateral basis in Annex 2 of the United States schedule of the Uruguay Round Agreement on Government Procurement (Office of the United States Trade Representative, *Uruguay Round of Multilateral Trade Negotiations: General Agreement on Tariffs and Trade* (1994), Washington, DC: Government Printing Office, pp. 330-36). Annex 2 does not cover 13 States (Alabama, Alaska, Georgia, Indiana, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, South Carolina, Virginia, and West Virginia) or the District of Columbia. For the other States, Annex 2 provides a positive list of State agencies which purchase in conformance with the agreement, and specifically exempts certain purchases of some or all of the States from the agreement, including those covered under the various Buy America provisions related to Federal grants discussed above.