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INTERNATIONAL TRADE

Efforts to Open Foreign Procurement Markets

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EFFORTS TO OPEN FOREIGN PROCUREMENT MARKETS

SUMMARY OF STATEMENT BY ALLAN I. MENDELOWITZ, MANAGING DIRECTOR INTERNATIONAL TRADE, FINANCE, AND COMPETITIVENESS GENERAL GOVERNMENT DIVISION

The value of the original General Agreement on Tariffs and Trade (GATT) Tokyo Round Agreement, or code, on Government Procurement in 1979 did not meet expectations. That situation prompted passage of the Buy American Act of 1987, creating an instrument to further open foreign procurement markets. This legislation became title VII of the Omnibus Trade and Competitiveness Act of 1988. It requires an annual report identifying countries that discriminate against U.S. goods and services and the imposition of sanctions if negotiations to end the discriminatory procurement practices are unsuccessful within specific time frames. The United States also negotiated in the Uruguay Round to improve the code. Its three negotiating objectives were to: (1) broaden the code's coverage to those "entities," or agencies, that purchased telecommunications and heavy electrical equipment; (2) expand the code to include services and construction contracts; and (3) strengthen the code by improving the procedures it requires for the procurement it covers.

A new GATT government procurement agreement was reached on December 15, 1993, and a supplementary U.S.-European Union (EU) bilateral agreement was initialed on April 15, 1994. These new agreements should, if approved, fulfill many U.S. negotiating objectives because they cover services and construction, some government-owned utilities, and would add new provisions to improve the code's procedures; the new agreements also cover some state government level procurement.

Nevertheless, the United States did not gain access to some important foreign procurement, including the annual $15 billion EU government-controlled telecommunications market. Also, the United States considered the Japanese and Canadian offers for additional code coverage to be insufficient and only extended them further access at the central government level; it withheld access to U.S. state and government-owned utility procurement until more Japanese construction services and Canadian provincial procurement, including electric utilities, are covered by the code.

The new code would cover many new areas, but its effectiveness will depend on how well it is implemented. Evaluations of the Tokyo Round agreement showed that implementation was problematic in the past. Therefore, consideration should be given to careful monitoring of how the code is carried out in new areas, such as, services and construction contracts, and by other levels of government and government-owned utilities.

In its 1994 report, the U.S. Trade Representative did not identify any new countries under title VII. However, USTR said that it will continue sanctions against the EU for its discrimination in the telecommunications sector, based on an earlier report. While the Uruguay Round resulted in each signatory expanding its code coverage, only a few new signatories have joined the code. Title VII can be of future use in getting other countries to join the code, as well as in achieving unfulfilled U.S. negotiating objectives.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here this morning to testify on our preliminary analysis of recent negotiations involving international government procurement and our observations about the President's April 30, 1994, title VII report on discrimination in foreign government procurement.

BACKGROUND

Governments are the largest single purchasers of goods and services in every major country, creating a potential annual world market that is in the hundreds of billions of dollars. Most of this vast market has traditionally been closed to foreign businesses due to formal and informal administrative systems that discriminate in favor of domestic firms.

GAO has worked on this issue for over a decade. In 1983, we reported on problems with the Agreement, or code, on Government Procurement, which was negotiated during the General Agreement on Tariffs and Trade's (GATT) Tokyo Round of Multilateral Trade Negotiations. These problems included noncompliance with the code and difficulties with its implementation. Consequently, the code did not result in the expected overall value from opening foreign markets to U.S. goods. We concluded that the U.S. government needed to strengthen its efforts to monitor and enforce compliance with the code and suggested ways in which this goal could be accomplished.[1] In 1987, we testified before this Subcommittee that U.S. expectations for creating foreign procurement opportunities for U.S. goods and services had still not been fulfilled. Furthermore, the total value of foreign opportunities opened by the code versus the value of U.S. opportunities opened to foreign goods was still balanced against the United States.[2]

That situation prompted this Subcommittee to approve the Buy American Act of 1987, which became title VII of the Omnibus Trade and Competitiveness Act of 1988 (P.L. 100-418). It required the President to identify countries that discriminate against U.S. companies and goods and then impose sanctions if negotiations to correct their inequitable practices were unsuccessful. In response to your concerns about how the U.S. Trade Representative (USTR) would implement this new law, we reported to you in 1990 that USTR's first investigation started late, was not focused, and faced various difficulties in gathering the needed evidence.[3] The annual title VII report and your annual oversight hearings helped focus USTR's attention on international procurement issues and signaled other countries that there was serious

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[1]See The International Agreement on Government Procurement: An Assessment of its Commercial Value and U.S. Government Implementation (GAO/NSIAD-84-117, July 16, 1984) and Data Collection Under the International Agreement on Government Procurement Could Be More Accurate and Efficient (GAO/NSIAD-84-1, Oct. 25, 1983).

[2]See Combating Foreign Use of Discriminatory Government Procurement Practices (GAO/T-NSIAD-87-21, Mar. 25, 1987).

[3]See International Procurement: Problems Identifying Foreign Discrimination Against U.S. Companies (GAO/NSIAD-90-127, Apr. 5, 1990).

congressional concern about their failure to open up their procurement markets to U.S. goods and services.

U.S. NEGOTIATING OBJECTIVES TO IMPROVE THE CODE DURING THE URUGUAY ROUND

Since the original Agreement on Government Procurement in 1979, USTR's strategy has been to focus on broadening the code to cover more of each signatory's procurement. The goals were to achieve unfulfilled Tokyo Round expectations and to rectify the imbalance in procurement opportunities between the United States and other signatories. To meet these goals, the United States had three specific objectives. The first was to broaden the code's coverage to those "entities," or agencies, that represented the "excluded sectors."[4] Negotiators hoped to trade U.S. coverage of subcentral entities (that is, state and local governments' procurement) for access to other signatories' public utilities, most notably telecommunications and electrical utilities. The second objective was to broaden the code to include service and construction contracts. And the third objective was to make the code work better by tightening the rules it applied to the procurement it covered.

RESULTS OF THE URUGUAY ROUND

A new GATT agreement on government procurement was reached in Geneva on December 15, 1993. A supplementary U.S.-European Union (EU) bilateral agreement was initialed in Marrakesh, Morocco on April 15, 1994. These new agreements should, if approved, fulfill many of the objectives established in the early 1980s. While these procurement agreements may be a significant advance over the Tokyo Round, there are areas still not covered.

Under the December agreement in Geneva, each signatory offered to cover more central government procurement, subcentral government procurement, and procurement by other government-controlled entities, including utilities. However, under the new procurement agreement, signatories extended code benefits to each other only on a reciprocal basis, not a most-favored-nation basis.[5]

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[4]The code applies only to "entities," or agencies, explicitly named in the agreement. The original code generally did not cover those entities, including government-owned utilities, that purchased large amounts of telecommunications, heavy electrical, and transportation equipment. These were not covered at the time because the European Community (now the European Union) lacked jurisdiction over its member states' procurement in these "excluded sectors."

[5]Most-favored-nation treatment is a principle of nondiscrimination that commits all GATT signatories to extend the same treatment to all other signatories.

Generally, entities were added to each signatory's lists of coverage, and thresholds were established for new areas of coverage.[6] One major accomplishment of this agreement was that for the first time it covered services and construction.[7] This coverage could create significant additional foreign opportunities for U.S. suppliers. Nevertheless, the United States maintained some general exclusions from coverage, such as preference programs for small and minority businesses. It also excluded some sensitive service sectors from coverage, such as transportation, research and development, and the federal research centers and laboratories.

Procedural improvements to the code were also agreed to in December 1993. The code would generally prohibit "offsets."[8] Signatories would have to provide a bid challenge mechanism for appealing their government procurement decisions. This improvement would create legal rights for foreign firms in each country under that country's national law.[9] Signatories would now be required to notify others when they privatize government entities and remove them from code coverage; they may have to provide compensation if there are objections to this removal from coverage. The code's dispute settlement provisions would be brought into conformity with the new Uruguay Round dispute settlement procedures, but with some modifications (e.g., shorter time frames for dispute resolution.)

Despite these accomplishments, U.S. negotiators were unable to reach agreement on opening up some important areas with EU, Japanese, and Canadian negotiators by the December 1993 deadline. However, last-minute negotiations between the EU and the United States were successfully concluded on April 13, 1994, and would enhance the December agreement. Further agreement was not reached with Japan and Canada.

The U.S.-EU bilateral agreement was initialed in Marrakesh, Morocco, and it would extend code coverage beyond that agreed to in Geneva on December 1993. The April agreement gave the EU access to the procurement of goods, services, and construction by 37 U.S. states. It also gave the United States access to the procurement of goods (only) by all EU levels through the code. The agreement also added procurement by government-controlled entities.

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[6]The code does not cover purchases costing less than a minimum "threshold" value of 130,000 Special Drawing Rights, which is an international reserve asset used as the International Monetary Fund's official unit of account. Its value is based on a trade-weighted basket of major currencies and was equal to about $182,000 in 1992 for central government purchases of supplies and services. The threshold for state-level purchases would be about $497,000; for other government-controlled entities, such as the Tennessee Valley Authority, it would be about $560,000; and it would be about $7 million for construction contracts.

[7]The Buy American Act does not apply to services.

[8]"Offsets" are various concessions sometimes required by a purchaser. They include requiring bidders to provide (1) local content in the goods, (2) technology transfer to the purchaser, (3) some investment in the country, or (4) trade in other areas.

[9]A similar provision is part of the North American Free Trade Agreement.

In this category, the EU granted code coverage for the procurement of goods, services, and construction by electric utilities and ports in return for access to certain U.S. federal electric utilities (e.g., the Tennessee Valley Authority) and several port authorities (including their airports).[10] The additional U.S. (subcentral) coverage given to the EU under the April bilateral agreement is expected to be extended to many other signatories once they reach agreement.

Nevertheless, the United States did not gain access to some important foreign markets. The one major U.S. objective not achieved was coverage of EU government-controlled telecommunications. This market is estimated to be worth about $15 billion annually. Also, the United States considered the Japanese and Canadian offers for additional coverage to be insufficient. Therefore the United States only extended them further access at the central government level; it withheld access to U.S. subcentral and government-owned utility procurement until more Japanese construction services and Canadian provincial procurement, including hydroelectric Crown Corporations, are covered by the code.

POTENTIAL IMPACT OF THE AGREEMENT

Together, the December and April agreements broaden code coverage significantly, primarily because of the inclusion of services and construction, subcentral-level procurement, and government-owned utilities. U.S. negotiators are confident that the imbalance between U.S. and foreign procurement opportunities will end. The agreement also adds new disciplines, or provisions, that are designed to improve enforcement of the code's procedures.

However, we cannot with any certainty calculate the total benefit of the new agreement from all signatories, nor can we say whether it would correct the imbalance in code-covered opportunities between the United States and other signatories. Some estimates of new total code coverage have been given, but they vary in reliability. In December, GATT estimated that the agreement would broaden coverage tenfold annually, to $700 billion, but some negotiators did not consider this figure accurate. Furthermore, any estimate of total code coverage would not necessarily reveal the benefits for the United States. The results of the Uruguay Round must be evaluated through the bilateral negotiations with each signatory because the code was negotiated on a reciprocal rather than a most-favored-nation basis. The most reliable figures available are based on an independent study of procurement data conducted as part of the U.S.-EU bilateral negotiations. This study estimates that the United States would gain reciprocal access to EU code-covered opportunities of $103 billion, and the United States would open up comparable opportunities to the EU.[11] Unfortunately, estimates

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[10]Procurement of goods and construction (not services) by electrical utilities had already been covered by an earlier, but temporary, bilateral memorandum of understanding between the United States and the EU.

[11]See European Union--Government of the United States Study of Public Procurement Opportunities, Deloitte Touche Tohmatsu International (Houston, Texas: Mar. 22, 1994).

for other countries' coverage, including Japan, Canada, and the Nordic countries, are educated guesses and are not based on studies of historical procurement data.

The new agreement, if approved, would enter into force at the beginning of 1996. Even so, it may take many years for the changes to be fully implemented, new procurement opportunities to be created, and actual purchases of U.S. goods and services to be affected. Over time, the procedural improvements should help the code's enforcement and eliminate market barriers. For example, the creation of local bid challenge mechanisms would allow suppliers to take individual actions to enforce their rights directly in foreign countries. The prohibition against offsets removes a burden placed on U.S. companies trying to enter foreign procurement markets.

Representatives of the private sector generally supported the new agreement. No Industry Sectoral Advisory Committees (ISAC) opposed the December 15, 1993, agreement, though two reserved judgment pending further negotiations.[12] However, after the April Marrakesh agreement, an industry association representing U.S. telecommunications equipment manufacturers told us their members were very frustrated with the final outcome. They felt that 5 years of difficult negotiations had brought them no benefit.

USTR told us U.S.-EU negotiations on telecommunications will continue. Also, USTR hopes that future bilateral discussions with Japan and Canada may resolve differences over limits on covering construction procurement and provincial-level procurement, including hydroelectric corporations, respectively. Then, U.S. subcentral and government-owned utility procurement might be offered to these two countries as well. While U.S. negotiators hope that future talks will address all of the previously mentioned omissions, USTR has no immediate plans to restart negotiations.

POTENTIAL IMPLEMENTATION ISSUES

The effectiveness of the code depends on its enforcement, both at home and abroad. We know from evaluating the implementation of the Tokyo Round procurement agreement that implementation was problematic, so similar problems might be expected as the code is broadened. New problems may arise because the code is to be extended into new areas, namely services and construction, and would be applied by new levels of government. Furthermore, all areas and levels would be subject to new provisions, such as the creation of local bid challenge mechanisms. U.S. and foreign government problems with implementing the code would remain subject to action under the agreement's dispute settlement provisions.

There are also unanswered questions about the new agreement. For example, U.S. subcentral-level procurement was offered for code coverage only after 37 state governors responded to a request from USTR. The governors were asked to volunteer entities for code coverage. USTR took this voluntary approach to address a concern that the federal government might

[12]ISAC 5 (Electronics and Instrumentation) and ISAC 7 (Ferrous Ores and Metals) did not take a position on the initial agreement.

appear to be preempting states' control of this area. USTR officials told us that specific legislation is not needed to formalize the governors' volunteer commitments. While such federal legislation was considered to ensure consistency and stability in the states' commitments, there were concerns about how to craft the legislation and avoid the preemption issue. Instead, USTR officials told us that overall congressional approval of the GATT agreement would secure the state governments' procurement for code coverage. Nevertheless, a representative of the National Conference of State Legislatures still expressed concern that the code would still preempt the states' ability to legislate in this area and that there could be state court challenges to state laws that might conflict with the code.

Another potential implementation issue is whether actual foreign procurement opportunities meet expectations for code coverage and whether foreign opportunities would balance U.S. opportunities under the code. If problems exist, there are at least two methods to address deficiencies and gain access to specific sectors or countries not covered by the new agreement. First, future negotiations can seek access to markets having good potential for U.S. suppliers. Second, discrimination in areas or countries not covered by the code are subject to action under U.S. trade laws, such as title VII--the Buy American Act of 1988.

If the agreement is approved by Congress, the next challenge for the administration is implementing and enforcing the agreement, as well as broadening it further. Some of the potential issues include:

-- how to best facilitate domestic implementation of the code by covered federal, state, and government-controlled entities for the procurement of goods, services, and construction to ensure that the United States is fulfilling its code obligations;

-- what information needs to be gathered for monitoring foreign signatories' implementation of the code to ensure that U.S. goods and services receive fair treatment; then, if access to foreign markets is denied or discrimination takes place, what actions the U.S. government should consider taking to remove these barriers and ensure that U.S. rights under the code are enforced;

-- what new initiatives are needed to achieve unfulfilled objectives, such as gaining access to EU telecommunications, Japanese construction, and Canadian hydroelectric procurement markets.

OBSERVATIONS ON TITLE VII

Now I would like to make some observations about the USTR's 1994 title VII report on discrimination in foreign government procurement, issued on April 30. Countries identified under title VII are potentially subject to sanctions if consultations do not address the discrimination within specific time frames.

USTR did not newly identify any country under title VII as meeting the statute's criteria for discriminating against U.S. products or services in making government procurement. USTR

is continuing the identification of the EU for its discrimination in the telecommunications sector. Again, this was the one objective on which the United States and the EU failed to reach agreement in bilateral negotiations. Key issues between U.S. and EU negotiators on telecommunications remain unresolved. The United States insists that state-owned European telephone companies be covered by the code. The EU wants the United States to include the regional bell operating companies (RBOC); the United States refuses, because RBOCs are private companies and their procurement decisions are commercially driven and thus outside of government control. Alternatively, the EU would have covered telecommunications, if federally mandated Buy American restrictions were eliminated for U.S. mass transit, airport, highway, and waste water projects; in the end the two sides considered these areas too sensitive to be included.

As a result, the United States is continuing trade sanctions against the EU for its discrimination in telecommunications procurement. These sanctions originated from a 1992 title VII investigation. These sanctions were put in place in May 1993, after a title VII review in February 1992 found the EU Utilities Directive to be a discriminatory procurement policy with regard to government-owned telecommunications.[13] USTR reported that these sanctions restricted EU access to U.S. contracts worth $20 million- $25 million in 1992. The EU responded by imposing sanctions against the United States worth $15 million. However, USTR has also reported that these sanctions are being imposed in an effort to open an EU market worth about $15 billion. Now that the Uruguay Round has ended and U.S.-EU bilateral agreements have been reached, the EU has been given access to billions of dollars in new U.S. procurement opportunities. Thus, it appears to us that even with these sanctions, U.S. negotiators have reduced leverage to compel the EU to open its government-controlled telecommunications market.

The 1994 title VII report discussed other countries as well. USTR announced it would not identify Japan under the statute, but because of "serious concerns" Japan will be subject to an "early review" of its telecommunications and medical technology procurement markets. The 1994 report also provided information on USTR's concerns over the procurement practices of Australia, Brazil, China, and the computer and supercomputer sectors in Japan. While not naming these countries under title VII, USTR said that it "will follow closely developments in these markets over the coming year."

USTR's strategy, used by previous administrations since title VII became law is to give priority to negotiating access to foreign procurement markets before officially identifying countries under the statute. For example, in 1990, no countries were named under the statute as discriminating, but USTR provided information on its concerns about the practices of certain members of the EU, Japan, and Australia in its report to Congress. In 1991, USTR named Norway for discrimination in a toll road collection system procurement and again described concerns about certain members of the EU, Japan, and Australia. In 1992, USTR continued to name Norway and named the EU for its discrimination in procurement of

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[13]USTR noted that Germany, Greece, Spain, and Portugal are not included in the sanctions because they "do not discriminate against the United States in this sector."

telecommunications and heavy electrical equipment. USTR then expressed concern about the practices of Australia, China, and Japan. In 1993, USTR named Japan for discrimination in its construction market; maintained its identification of the EU; and described concerns about Australia, China, and Japan regarding its supercomputers, computers, and telecommunications sectors.

While USTR's strategy has led to an expansion in each signatory's code coverage in the Uruguay Round and the U.S.-EU bilateral procurement agreements, only a few countries have joined the code as new signatories; only Israel, and Greece, Portugal, and Spain (as new members of the EU) have joined the code since the original Tokyo Round agreement. Also, one new signatory, South Korea, will join the code when the new agreement goes into effect. Offsetting these additions, Singapore and Hong Kong, both original signatories to the code, did not join the new agreement.

USTR's may now turn attention to encouraging other countries join the code, even though there are still areas that code signatories have yet to cover, such as telecommunications and transportation equipment. USTR has said that Australia, China, and Taiwan are priority countries for negotiating future procurement agreements. Title VII can be of importance in initiating negotiations with nonsignatory countries about joining the code and to opening their procurement markets to U.S. goods and services.

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Mr. Chairman and members of the Subcommittee, this concludes my prepared remarks. I will be pleased to respond to any questions you may have.

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