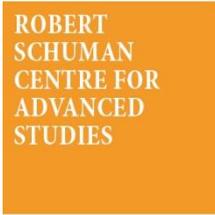




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Government Procurement in US Trade Agreements

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Abstract

The United States has played an essential role in driving the agenda for the world trading system since the Second World War. An important component of that agenda has been the liberalization of government procurement, with the first plurilateral agreement signed in 1979 as part of the Tokyo Round. Since then, procurement has become a staple of other trade agreements, both in the WTO and in bilateral and regional pacts. This paper briefly outlines the government procurement commitments the United States has sought from its trading partners and the commitments which the US made in return, with a particular focus on how these positions have evolved over time.

Keywords

US procurement policy; US trade agreements; WTO; GPA

Introduction*

The US public sector commands one of the world's largest procurement markets. In 2013, the total was roughly \$600 billion at the federal level and \$1 trillion at the state and local level, by our estimation, amounting to \$1.6 trillion for all levels of government.¹ This represented about 10 percent of US GDP, which is considerably lower than other developed countries. The OECD estimated that general government procurement (federal plus sub-federal) accounted for 17 percent of GDP in Germany, 18 percent in France, and 19 percent in the United Kingdom when state-owned utility procurement was included. For comparison, the same dataset reports US general government procurement as 11 percent of GDP, somewhat higher than we have estimated above. But even so, government procurement is clearly a meaningful share of US economic activity and an important market for both foreign and domestic producers.

In terms of import penetration, Messerlin and Miroudot (2012) calculated that around 4.6 percent of US government procurement was sourced from foreign producers. This was roughly equal to the figure for Japan (4.7 percent), notably higher than for the EU (2.7 percent, with members countries weighted by their GDP), and notably lower than Canada and China (6.9 percent and 6.1 percent, respectively). These figures do not include foreign procurement for investment purposes, such as infrastructure construction. However, the study noted that import penetration ratios were steadily increasing for most individual countries and for the world as a whole.

The increasing globalization of procurement markets has, in part, been driven by the same forces that drive globalization in general. Falling transportation costs and improved communications technology encourage international supply chains for all purchasers, governments included. But the increasing internationalization of government procurement has also coincided with substantial liberalization programs undertaken by some of the world's largest markets, the United States included.

US Law, Federal and State

The Buy American Act of 1933 and the executive orders that followed it are the basis for much of the discrimination faced by foreign entities seeking to compete in US federal procurement markets. The specifics of the Act's implementation have varied substantially across government entities and different time periods, but generally US producers are given some quantitative price advantage over foreign producers in awarding contracts. These preferences can be expanded for projects that will generate employment in so-called "Labor Surplus Areas" designated by the Department of Labor, as stated in Executive Order 10582.² The "Buy American Act of 1988" (Title VII of the Omnibus Trade and Competitiveness Act of 1988) amended the 1933 Buy American Act, limiting US procurement of goods and services from countries which discriminate against US suppliers in their procurement procedures.

US authority for implementing commitments in WTO agreements and Free Trade Agreements (FTAs, also known as Preferential Trade Agreements or PTAs) generally falls under the umbrella of the Trade Agreements Act of 1979. The stated purpose of the Act was to "to approve and implement the trade agreements negotiated under the Trade Act of 1974." One such agreement was a predecessor

* The authors are affiliated with the Peterson Institute for International Economics. Views expressed are their own.

¹ Figures calculated based on the Bureau of Economic Analysis's National Income and Product Account (NIPA) tables. For our purposes, procurement is equal to expenditures on intermediate goods and services (less own-account investment) plus gross investment, for both federal and state and local procurement. The data are located in NIPA tables 3.9.5 and 3.10.5, available at www.bea.gov/national/pdf/dpga.pdf.

² Section 3. Text available at <http://www.archives.gov/federal-register/codification/executive-order/10582.htm> 1

to today's Government Procurement Agreement (GPA). In order to allow the United States to comply with its commitments in the 1979 Agreement on Government Procurement, as well as future agreements on procurement, the Act gave the President the authority to waive discriminatory requirements associated with federal government procurement. Waivers can be issued for countries that provide similar treatment to US products and suppliers, including WTO GPA members and most US FTA partners, or for least developed countries. Although the Code did not initially apply to some government enterprises, such as the Tennessee Valley Authority, coverage was later extended to most of these entities in subsequent trade agreements that covered government procurement.

These waivers do not, however, cover all procurement. First, programs designed specifically to benefit small and minority owned businesses are exempt from waivers authorized by the Trade Agreement Act of 1979. Even for covered entities, the GPA and procurement chapters in US FTAs always establish some threshold for coverage, with smaller contracts being exempt. Thresholds are typically expressed in terms of "Special Drawing Rights" (SDRs), an accounting unit established by the IMF. The US Trade Representative (USTR) is tasked with reporting an equivalent US dollar amount on an annual basis.

The USTR is also tasked with interpreting US commitments on procurement, with the exception of commitments covering the Department of Defense (DoD), for which the Secretary of Defense controls the interpretation. In fiscal year 2013, the Department of Defense purchased roughly \$965 million worth of goods under waivers to the Buy American Act, out of \$19 billion in total purchases from foreign entities.³ About half of the \$965 million worth of products purchased under waivers were from GPA members and FTA partners, while the remaining goods were purchased from other designated countries.

With respect to state government procurement, there is little doubt that the US federal government has the authority to impose restrictions on state "Buy American" rules or similar measures. The Commerce Clause of the US Constitution grants the Congress the power to regulate interstate and foreign commerce, a provision that covers the procurement of foreign goods and services by state and local governments. Therefore, an agreement or federal law limiting state and local "Buy American" provisions could preempt sub-federal practices. However, the federal government is generally unwilling to "meddle" in the affairs of the states without a strong imperative, so no existing agreements have forced procurement rules on state and local governments. Moreover, US Supreme Court decisions have allowed states to enact numerous preferences for their own residents and business firms, such as lower college tuition fees and preferential procurement from small and medium-sized in-state firms, even without explicit authorization from the US Congress.⁴ Since states have enjoyed a somewhat free hand in discriminating against each other, they expect to enjoy the same latitude in discriminating against foreign firms.

The US federal government might be willing to impose more serious commitments on the states if partner countries offered comparable access to large sub-federal procurement markets. However, there is a political tradeoff between how desirable a country's sub-federal procurement markets are to US negotiators and how difficult it is for foreign negotiators to liberalize those markets. Sub-federal governments with large budgets are more likely to enjoy substantial political independence, making it more difficult for negotiators to make commitments on their behalf (as is true in the United States). On the other hand, sub-federal governments abroad that are more easily cajoled are less likely to enjoy the

³ DoD report on purchases from foreign entities,

[http://www.acq.osd.mil/dpap/cpic/cp/docs/RTC_FY13_Foreign_Entities_\(Auth\)_signed_7_May_14.pdf](http://www.acq.osd.mil/dpap/cpic/cp/docs/RTC_FY13_Foreign_Entities_(Auth)_signed_7_May_14.pdf)

⁴ Some states have a policy of reciprocal treatment, requiring them to keep track of procurement policy. For reference, see "Procurement Services and Policy, State by State Preference Data" from Oregon: http://www.oregon.gov/DAS/EGS/ps/Pages/detail_a_main_page.aspx

degree of spending power that would tempt US federal policymakers. We discuss potential solutions to this conundrum at the end of this chapter.

The Government Procurement Agreement

The Tokyo Round of Multilateral Trade Agreements, which ran from 1973 to 1979, established a number of agreements (commonly known as “codes”) among participants. One such code was the “Tokyo Round Code on Government Procurement,” which was signed at the conclusion of the Round in 1979. In addition to restricting outright discrimination by covered entities, the Code also tackled more clandestine methods of putting foreign suppliers at a competitive disadvantage. The Code mandated that technical specifications in procurement contracts “be in terms of performance rather than design” and that they “be based on international standards, national technical regulations, or recognized national standards.” Moreover, the Code required that national government adopt transparent tendering procedures for selecting qualified suppliers.⁵ These rules, along with several others, reduced the risk of cronyism in the procurement process. The threshold for coverage was initially set at 150,000 SDR, roughly \$220,000 in 2014.

Not all entities were covered by the Code; notably sub-federal government entities were not covered. The text, however, did instruct members to attempt to bring their non-covered entities on board by “draw[ing] their attention to the overall benefits of liberalization of government procurement,” but no formal targets or requirements were established. The United States had initially sought to extend coverage to “all entities under the direct or substantial control of [central] governments”⁶, but instead negotiations took place on an agency-by-agency basis. Ultimately, the United States excluded the following federal entities in the Tokyo Round Code: Department of Transportation; Department of Energy; Bureau of Reclamation of the Department of the Interior; Army Corp of Engineers, the Tennessee Valley Authority (TVA); three parts of the General Services Administration (Automated Data and Telecommunications Service, Region 9, and the National Tool Center); COMSAT, AMTRAK; CONRAIL; and the U.S. Postal Service⁷ Even among the covered entities, construction contracts were wholly excluded and services contracts in general were excluded unless “incidental to the purchase of goods, provided that the value of such services does not exceed the value of the goods.” State and local governments were explicitly excluded. The Tokyo Round Code was amended in 1987 to, among other things, extend coverage to leasing contracts. The update also lowered the minimum contract value to 130,000 SDR, which would be equal to roughly \$190,000 at present.

When the WTO was created in 1995, several parties drafted the “Agreement on Government Procurement”, commonly referred to as the “Government Procurement Agreement” or GPA. Six parties acceded to the new GPA on January 1, 1996 (counting the European Union as a single party; the EU included 15 countries at the time). Since then, nine more parties have implemented the agreement, bringing the total number to 15.⁸ These countries made commitments beyond those of the Tokyo Round Code in several regards. Service contracts were included for covered entities, as well as construction contracts (albeit at higher thresholds). Moreover, the number of covered entities was sharply increased. Some previously excluded entities, such as the TVA, were added to the US

⁵ Agreement on Government Procurement, available at: http://www.wto.org/english/docs_e/legal_e/tokyo_gpr_e.pdf

⁶ Code of Federal Regulations, 1979 Compilation and Parts 100 and 101

⁷ Oversight on Government Procurement Code and Related Agreements: Hearing Before the Subcommittee on Finance of the United States Senate. 97th Cong. 2 (1982)

⁸ http://www.wto.org/english/tratop_e/gproc_e/memobs_e.htm#parties. The parties are Armenia, Canada, the EU for its 28 member states, Hong Kong, Iceland, Israel, Japan, South Korea, Lichtenstein, Aruba (via the Netherlands), Norway, Singapore, Switzerland, Taiwan, and the United States.

schedule of commitments. The United States still maintains a few exceptions carried forward from the Tokyo Round Code, such as procurement by the Federal Aviation Administration.

More significantly, several American states made commitments under the GPA. In fact, 37 states made varying commitments. Some listed specific covered agencies, while others simply stated that “all executive agencies” were subject to the agreement. Some states went further and added state universities to their commitments. There were some exceptions: for example, Mississippi excluded services and Montana covered only services and construction. Moreover, twelve states specifically excluded construction grade steel, motor vehicles, and coal. Several states specifically excluded all construction contracts. State commitments are listed in Annex 2 of US schedules to the GPA. The following states made some level of commitment: Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, New York, Nebraska, New Hampshire, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, and Washington.

In addition to the expansion of coverage, the GPA also required countries to improve their procurement procedures. For example, so called “offsets” (defined as “measures to encourage local development or improve the balance-of-payments accounts by means of domestic content, licensing of technology, investment requirements, counter-trade or similar requirements”⁹) are specifically forbidden, except for developing countries that negotiated such an exception. The agreement also reaffirmed the Code’s commitment to transparency, requiring that laws, decisions, and rulings be made public when they are relevant to procurement by a covered entity. GPA Article XIX took an additional step, requiring that members collect and report statistics on the total amount of procurement that was subject to the agreement on an annual basis. Statistics are supposed to be broken down by the purchasing entity and the category of good or service that was procured. The reports must also, to the greatest extent possible, identify the countries of origin for procured goods and services. Some of these reports are available, although there is significant lag for many countries.¹⁰ For the United States, reports are only available for 1996 through 2008.

In 2013, the GPA parties completed an update to the GPA, which was centered on general improvements to increase user friendliness. The update amended provisions to better reflect changing procurement practices that governments have adopted in recent years, primarily driven by increasing adoption of digital technology. Many countries also expanded the scope of their commitments in the 2013 update, although the United States does not appear to have made major changes in this area. Of the 15 parties to the agreement, all but Armenia, South Korea, and Switzerland had opted to join the revised GPA by July 2014.

Procurement under US Free Trade Agreements

US-Israel

The first US FTA to touch on government procurement, and indeed the first modern US bilateral free trade agreement, was the agreement with Israel. The “Israel Free Trade Agreement”, as it is known in the United States, was concluded, signed, and entered into force in 1985, after just over one year of negotiations. The agreement contains a section on government procurement, although it is very brief. In that section, the United States resolved to waive all “Buy National” restrictions for all government agency purchases exceeding \$50,000 “ which would be subject to the Agreement on Government Procurement at the time of entry into force of this Agreement but for the threshold provided for in

⁹ http://www.wto.org/english/tratop_e/gproc_e/gpa_overview_e.htm

¹⁰ http://www.wto.org/english/tratop_e/gproc_e/gpstat_e.htm

Article I (l) (b) of the Agreement on Government Procurement.”¹¹ In other words, the Israel FTA effectively lowered the threshold for the then-current Tokyo Round Code. Israel made comparable commitments, agreeing to waive “Buy National” requirements for covered entities.

Israel was permitted to make exceptions for certain purchases made by its Ministry of Defense, so long as those exceptions were comparable to exceptions made by the US Department of Defense. Moreover, Israel agreed to relax its offset arrangements, except for those employed by the Ministry of Defense. Currently, Israel still imposes offsets on its military purchases to a notable degree.

Both countries implemented the WTO Government Procurement Agreement at its inception in 1996, which superseded the earlier Tokyo Round Code. Under current US law, Israel maintains its preferential threshold for supply contracts (\$50,000).¹² Israeli suppliers do not benefit from a lower threshold with respect to construction contracts, relative to other GPA parties.

Canada-US FTA and NAFTA

The Canada-US FTA (CUSFTA) was more comprehensive than the Israel FTA, both in general and with respect to government procurement. CUSFTA was the culmination of sectoral trade pacts that Canada and the United States had forged over the several prior decades, most notably the Canada–United States Automotive Products Agreement. The agreement came more or less on the heels of the agreement with Israel, with negotiations finishing late in 1987 and implementation occurring in 1989. CUSFTA has since been supplemented, in a major way, by the North American Free Trade Agreement (NAFTA).

Procurement obligations under CUSFTA were detailed in Part Three of the Agreement, Chapter Thirteen (both of which were titled “Government Procurement”). As a statement of principle, the introduction of Part Three states that “The chapter broadens and deepens the obligations both countries have undertaken in the Tokyo Round Code, commits each country to work toward the multilateral liberalization of government procurement and to negotiate further improvements in the bilateral agreement once multilateral negotiations are concluded.”

As noted, treatment of foreign suppliers in government procurement markets was already subject to the Tokyo Round Code, discussed earlier. The most significant change resulting from CUSFTA was the decrease in the threshold for coverage. Both Canada and the United States adopted a \$25,000 threshold for national treatment obligations to apply, some 80% lower than the threshold set in the Code. The thresholds only applied to the entities listed under Annex I of the Government Procurement Code (central government entities), and were subject to the same exclusions and exceptions. Thus, services contracts and construction were not covered initially and procurement by American states was wholly excluded, since these were not covered under the Tokyo Round Code. Moreover, the same US government entities were excluded, and the exceptions for certain defense spending and small business programs persisted.

In 1994, NAFTA supplemented CUSFTA for the United States and Canada, in addition to and most importantly adding Mexico. Chapter 10 of NAFTA (“Government Procurement”) substantially expanded on the procurement obligations present in CUSFTA, much like the 1996 Government Procurement Agreement would improve on the Tokyo Round Code. For goods and services contracts, and for covered entities, the threshold was set at \$50,000 and indexed to the US inflation rate. Government enterprises were also bound by NAFTA with a threshold of \$250,000, with the same

¹¹ http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_005439.asp. Note that the linked text refers to “Article I(l) (b)”, which is assumed to be a typo.

¹² <http://www.law.cornell.edu/cfr/text/48/25.406>. Specifically, the text reads: “Acquisitions of supplies by most agencies are covered by the Israeli Trade Act, if the estimated value of the acquisition is \$50,000 or more but does not exceed the WTO GPA threshold for supplies.”

indexing scheme. The United States scheduled seven such enterprises for coverage, including the TVA and the four federal Power Marketing Administrations (Bonneville Power Administration, Southeastern Power Administration, Southwestern Power Administration, and the Western Area Power Administration). Construction contracts were covered with substantially higher thresholds for both government entities and enterprises (\$6.5 million and \$8 million, respectively).

Some provisions of CUSFTA have persisted exclusively for the United States and Canada, bilaterally. One such provision is the aforementioned \$25,000 threshold, which still applies to the purchase of goods by US and Canadian federal government agencies. Mexican suppliers face the higher standard threshold applied by both of the other two NAFTA partners, and vice-versa.¹³

NAFTA Chapter 10 also contained provisions to encourage sub-central governments to join the agreement on a voluntary basis. Specifically, Article 1024 states that, upon completion of NAFTA Chapter 10, parties shall: “immediately begin consultations with their state and provincial governments with a view to obtaining commitments, on a voluntary and reciprocal basis, to include within this Chapter procurement by state and provincial government entities and enterprises.” Thus far, the effort to induce voluntary participation by sub-federal governments has not been successful within NAFTA. Canada and the United States have substantial access to each other’s sub-federal procurement markets through the 1996 GPA, following an agreement dated February 2010 covering Canadian provinces,¹⁴ but Mexico has concluded no such arrangement.

The February 2010 US-Canada agreement resulted from bilateral disputes over US implementation of the American Recovery and Reinvestment Act (ARRA), the \$800 billion stimulus law that was passed following the economic turmoil of 2008. Among other objectionable provisions, the ARRA only waived the Buy American requirements for projects involving “iron, steel, or manufactured goods” when the use of US produced equivalents would raise the overall cost of project by more than 25 percent. This ran afoul of multiple US commitments and caused concern among several US trade partners, most notably Canada.

To assuage Canadian concerns, the two governments reached the aforementioned agreement in 2010. In theory, the agreement precluded restrictions on purchases of Canadian goods through the ARRA. However, the federal government also took measures to ensure that the bulk of funds were committed before the agreement actually entered into force, so Canadian manufacturers were largely shut out from stimulus spending.¹⁵

Other US Trade Agreements

Almost all US FTAs negotiated after NAFTA contain substantive procurement obligations. Most contain procurement obligations similar to those in the Government Procurement Agreement. Of these, South Korea and Singapore are already parties to the GPA, so two those free trade agreements offer lower thresholds similar to Canada-US FTA. The agreement with Jordan contains its own set of procurement obligations, recognizing that Jordan is seeking to join the GPA. Jordan originally applied for accession in July 2000, but has yet to become a member nearly 15 years later; meanwhile Jordan maintains its observer status in the GPA.

While procurement obligations under these US agreements are not identical, they tend to be very similar in structure. Therefore, giving each individual agreement the same description offered for NAFTA and US-Israel would be highly repetitive. Instead, procurement commitments in US FTAs are

¹³ http://tcc.export.gov/trade_agreements/exporters_guides/list_all_guides/nafta_chapter10_guide.asp

¹⁴ <http://www.ustr.gov/about-us/press-office/press-releases/2010/february/us-canada-sign-agreement-government-procurement>

¹⁵ Hufbauer, Schott, and Cimino. *Local Content Requirements: A Global Problem*. Washington, DC: PIIE, 2013.

summarized in Table 1. US FTA partners that are also GPA signatories are denoted by asterisks. Evidently, despite agreements in the GATT and WTO, and in FTAs, much US federal and sub-federal procurement remains “off limits” to foreign suppliers. We wrap up this essay with thoughts as to what can be done to expand coverage, thereby benefiting US taxpayers as well as foreign firms.

Table 1. Government Procurement Obligations in Concluded US FTAS

	Threshold for Coverage		
	Goods and Services	Construction	States covered
Israel*	50,000	7,864,000	0
Canada*	25,000	n/a	0
NAFTA	79,507	10,335,931	0
WTO GPA	204,000	7,864,000	37
Jordan	n/a	n/a	n/a
Australia*	79,507	7,864,000	31
Chile	79,507	7,864,000	37
Singapore*	79,507	7,864,000	37
Bahrain	204,000	10,335,931	0
Morocco	204,000	7,864,000	23
Oman	204,000	10,335,931	0
Peru	204,000	7,864,000	10
CAFTA-DR	79,507	7,864,000	22
Panama	204,000	7,864,000	8
Colombia	79,507	7,864,000	8
Korea*	100,000	7,864,000	0

Note: Asterisks designate GPA signatories

What Can Be Done?

The United States should expect to face increased demands from trade partners in future trade negotiations. Already, the European Union is seeking broad access to state and local procurement, as well as entities operating under those governments.¹⁶ However, requests from foreign governments do not do much to change the US political context, particularly with respect to the states. If US negotiators are going to make offers that match the new requests, while also making agreements that can pass muster in the Congress, innovative approaches will be required.

State-Level Reciprocity

One solution, attempted in the past, is state-level reciprocity. Under this approach, suppliers from a state only gain non-discriminatory access to sub-federal procurement in the partner’s market if the state itself offers comparable access. This was implemented in US FTAs with Peru, Colombia, and Panama. However, US partners might be skeptical of this system, since states have been relatively unwilling to sign up. Very few states signed the aforementioned agreements, so some additional

¹⁶ <http://insidetrade.com/Inside-US-Trade/Inside-U.S.-Trade-12/12/2014/eu-seeks-broad-access-to-local-us-procurement-under-ttip-paper-shows/menu-id-172.html>

legwork might be needed in future agreements. As for the TTIP, it seems likely that states will be more eager to gain access to sub-federal markets in Europe than in Latin America.

Firm-Level Reciprocity

A related, untested, concept would be relying on firm-specific characteristics to determine that firm's eligibility to bid on foreign contracts. FTA commitments could require that a firm would gain access to sub-federal procurement markets in the partner country if and only if the majority of its employment was located in states that voluntarily subscribed to the FTA procurement chapter.

Tracing Federal Funds

Another approach could entail "tracing" federal funds. Projects which rely on funding from the federal government to a significant degree could be required to abide by the federal government's agreements with respect to procurement, even if the project is administered by a state or city government. If it had been in force, this provision would have ruled out the abuses involved in ARRA projects.

Expedited Dispute Resolution

Another aspect deserves mention. As happened with the ARRA, governments take advantage of the fact that enforcement mechanisms generally act very slowly. If an individual government program, such as the ARRA, can be carried out to completion before the cheated party can win a judgment, then ultimately the rules have little practical impact when a government is determined to skirt its obligations.

A possible solution to this problem would be a "fast track" system for dispute resolution, designed to resolve procurement commitments in a timely manner. Ideally, this service would be provided by the WTO, possibly in the next iteration of the GPA. If built into the GPA, the same fast track process could be made available to government procurement disputes in FTAs, with costs paid by the litigating parties.

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