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# U.S. Government Procurement and International Trade

The COVID-19 pandemic has demonstrated that U.S. companies and the federal government rely heavily on global supply chains. This has prompted congressional interest in better understanding the role of international trade in U.S. government procurement. In particular, Members have sought ways to incentivize U.S. domestic production by prioritizing the procurement of domestic goods and services, while upholding U.S. commitments under various international trade agreements. Separately, the Trump Administration issued executive orders that aim to incentivize companies to relocate to the United States by limiting waivers that would allow government purchases of foreign goods. Within this context, Members have raised questions regarding how federal agency acquisitions comply with two domestic sourcing laws: namely, the Buy American Act of 1933 (BAA, 41 U.S.C. §§8301–8305) and Trade Agreements Act of 1979 (TAA, 19 U.S.C. §§2501–2581). Although both BAA and TAA have provisions that affect trade, there is a critical difference between their respective requirements. Whereas BAA operates as a *price preference* for U.S. products, TAA establishes a *prohibition* on procuring products and services from non-designated foreign countries, unless one of TAA's exceptions applies.

## Background

During the past 50 years, the United States has played a prominent role in the development of international trade rules on government procurement. The most notable of U.S. international agreements addressing procurement and trade are the World Trade Organization (WTO)'s plurilateral Agreement on Government Procurement (GPA) and the procurement chapters in most U.S. free trade agreements (FTAs), all of which are implemented primarily through TAA. Data limitations and other factors make it difficult to quantify accurately the size of the global government procurement market. However, these international agreements have opened many procurement opportunities around the world to international competition, worth trillions of U.S. dollars annually, while also requiring parties to establish transparent and non-discriminatory rules for certain procurements among the parties. U.S. federal procurement expenditures are estimated to have been equivalent to 9.3% of U.S. gross domestic product (GDP) in 2017.

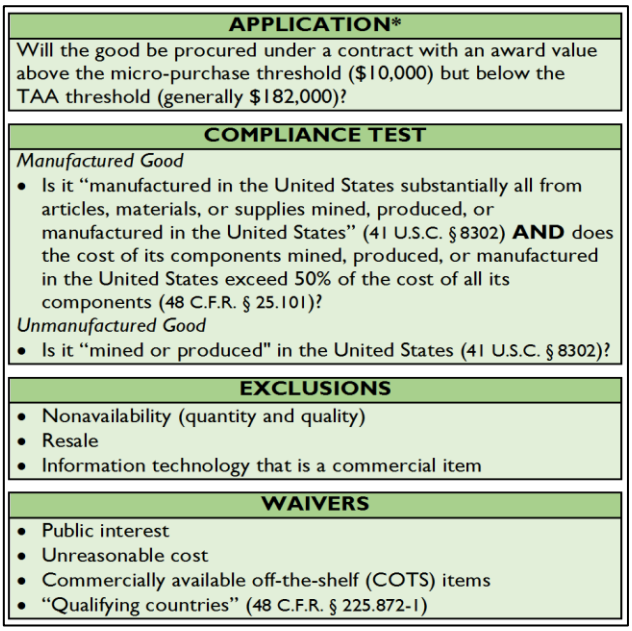
International regimes on government procurement do not cover every country or sector. For example, the 48 parties bound by the GPA negotiate market access commitments on a reciprocal basis. In addition, the United States, while among the most open markets, maintains restrictions on foreign sourcing under BAA, and state and local governments may also have similar preferential policies. A 2017 study estimates that while the United States opens as much as 80% of federal contracts to foreign suppliers, South Korea and Japan, for example, may do the same for 13% and 30%, respectively.

Determining the conditions under which federal agencies must open contracts to foreign suppliers, which legal framework applies in a given procurement, or how agencies determine whether goods and services are BAA- or TAA-compliant is a challenging task. What follows is an overview of BAA and TAA, and issues of congressional interest with implications for U.S. trade policy.

## Buy American Act of 1933

BAA is the major U.S. domestic preference statute that governs procurement by the federal government. As implemented, it establishes a price preference for federal agencies' purchases of domestic end products to be used in the United States. It generally does not prohibit federal agencies from purchasing a foreign product if they determine that it is less costly after a comparative price evaluation test. For civilian agency procurement, the contracting officer typically adds a price evaluation "penalty" to the low foreign offer equal to 6% or 12%, depending on whether the low domestic offer is from a large or small business. For U.S. Department of Defense (DOD) procurements, the "penalty" is typically 50%. (If a foreign offer is accepted, contracting agencies pay the proposed price and not the increased evaluated price.) Notably, BAA does not apply to contracts for services.

**Figure 1. Applicability of the Buy American Act**




**Source:** CRS, BAA, and 48 C.F.R. Subpart 25.1.

**Notes:** * A variety of factors determine applicability. BAA may also apply above the TAA threshold if, among other things, the relevant trade agreement excludes a product or agency from TAA coverage. (1) USTR establishes TAA thresholds bi-annually. (2) There is no statutory definition of "manufactured" or "substantially all." Agencies have long construed "substantially all" to mean that the costs of a product's U.S. components exceed 50% of the cost of all its components, but this definition is not set forth in statute. (3) COTS items are exempt from BAA's component cost test. (4) DOD also treats end products from 27 "qualifying countries"—those with which it has signed reciprocal defense procurement memoranda of understanding—as domestic end products for BAA purposes.

## Trade Agreements Act of 1979

TAA implements several international trade agreements that guarantee that the products and services of signatory countries and other eligible countries receive non-discriminatory treatment for TAA-covered procurements. Specifically, it authorizes the president to waive domestic procurement restrictions and discriminatory provisions, such as BAA, for eligible or covered products and services from designated-countries. These are countries that (1) are parties to the WTO GPA, (2) have signed an FTA with the United States that provides appropriate reciprocal competitive government procurement opportunities to U.S. products, services, and suppliers, or (3) benefit from U.S. unilateral trade preferences (e.g., Caribbean Basin countries). The president has delegated TAA's waiver authority to the U.S. Trade Representative (USTR), who establishes TAA thresholds depending on the agreement and type of contract covered.

**Figure 2. Applicability of the Trade Agreements Act**

| APPLICATION* |
|---|
| Will the good or service be procured under a contract with an award value at or above the TAA threshold (generally $182,000)? |
| **COMPLIANCE TEST** |
| *Good*<br>• Is it wholly the growth, product, or manufacture of the United States or a designated country? If no, has it been substantially transformed in the United States or a designated country into a new and different article of commerce with a name, character, or use distinct from that of the article or articles from which it was transformed (19 U.S.C. § 2518)?<br>*Service*<br>• Is the firm that is providing it established in the United States or a designated country (48 C.F.R. § 25.402)? |
| **EXCLUSIONS** |
| • Acquisitions set aside for small businesses<br>• Acquisitions of arms, ammunition, or war materials, or purchases indispensable for national security or for national defense purposes<br>• Acquisitions of end products for resale<br>• Nonavailability or insufficient availability<br>• Contracts for certain services (e.g., research and development, utility services, dredging, and military support services) |
| **DESIGNATED COUNTRIES** |
| • WTO GPA countries<br>• Certain U.S. FTA countries<br>• Least developed countries ("United Nations List")<br>• Caribbean Basin countries |

**Source:** CRS, TAA, and 48 C.F.R. Subpart 25.4.

**Notes:** * A variety of factors determine applicability. BAA may apply above the TAA threshold if, among other things, the relevant trade agreement excludes a product or agency from TAA coverage. (1) USTR establishes TAA thresholds bi-annually. (2) There is no statutory definition of "manufactured" or "substantial transformation." However, these terms have been interpreted by agencies and courts.

## Issues for Congress

The COVID-19 pandemic has exposed gaps in U.S. understanding of how much domestically produced goods rely on foreign inputs. Key questions such as "how does an agency ensure that a good procured is manufactured in the United States from substantially all U.S. components?" are not easily answered. The lack of statutory definitions of various terms (e.g., "manufactured" and "substantially all") and the difference in standards among procuring agencies often yield different determinations for the same product. Moreover, the "substantial transformation" test used to determine a product's country of origin for trade purposes is complex, fact-specific, and thus inherently subjective in nature. A simplified example of government procurement of pharmaceuticals illustrates the challenge (see **textbox**).

**Determining Pharmaceuticals' Country of Origin: A Hypothetical Case Study**

A U.S. drug manufacturing company imports active pharmaceutical ingredients (API) from China, which it then subjects to a series of processing procedures (e.g., testing and mixing) and then encapsulates it in its U.S. laboratory. The U.S.-made components of the pill account for 55% of its overall cost, while the China-sourced API accounts for the remaining 45%. What is its country of origin and can it be procured?

***Food and Drug Administration (FDA).*** Neither the Federal Food, Drug, and Cosmetic Act nor FDA regulations require drug manufacturers to identify a pill's "country of origin." The FDA requires that each drug label bear the place of business of the manufacturer (defined as one who performs mixing, granulating, milling, molding, lyophilizing, tableting, encapsulating, coating, or sterilizing). In this case study, only the company's U.S. address would be required to be listed on the pill's label.

***Customs and Border Protection (CBP).*** The "substantial transformation" test is what CBP uses to determine how a product should be marked under the Tariff Act of 1930, which requires all imports to be marked with its country of origin. Under CBP regulations, in this case study the pill would be determined to be a product of China and should be marked accordingly. CBP does not consider processing procedures and encapsulation in the United States a "substantial transformation" of the API. (See, for example, CBP Customs Ruling HQ 561975.)

***Federal Acquisition Regulation (FAR).*** FAR defines a "foreign end product" as an article that it is wholly the growth, product, or manufacture of a foreign country or that has been substantially transformed there into a new product. The FAR definition for a "U.S.-made end product" omits the term "wholly." It is unclear in this case study if the pill would qualify for high-value government contracts (above the TAA threshold) under current FAR guidelines. A recent decision by the U.S. Court of Appeals for the Federal Circuit (*Acetris Health, LLC v. United States*) suggests that a U.S.-made end product may be partially—not "wholly"—manufactured in the United States for it to be TAA-compliant.

***Trade Agreements Act (TAA).*** The substantial transformation test is also used under the TAA to determine whether a product is made in the United States or a "designated foreign country," and thus eligible for high-value government contracts. In this case study, it would be determined, under the substantial transformation test, that the pill is a product of China—not a TAA-designated country. Therefore, unless it were granted a waiver, the pill could not be placed on a Federal Supply Schedule.

***Buy American Act (BAA).*** The pill in this case study would qualify for sale as a "domestic end product" under lower-value government contracts (above the micro-purchase threshold and below the TAA threshold), as the cost of the components manufactured in the United States exceeds 50% of the cost of all its components.

As the 117th Congress reviews processes and contemplates amending legislation to prioritize federal procurement of U.S. goods and services, Members may consider clarifying provisions in BAA and TAA. Members may wish to clearly define terms and requirements and set uniform guidelines regarding foreign sourcing in federal procurement. This could promote transparency, consistency, and proper application of standards in procurement decisions, thereby ensuring that agencies carry out procurement objectives as prescribed by Congress.

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