

Submission to the Senate Select Committee on the Free Trade Agreement between Australia and the United States of America:

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30 April 2004

Chapter 15: Government Procurement:

This submission relates only to the issue of government procurement under Chapter 15 of the proposed USA-Aust FTA.

This submission addresses the question of whether the prospect of gaining access to the USA government procurement market is or is not an argument in support of ratifying the proposed FTA.

This submission argues that the prospect of gaining access to the USA government procurement market is not a sound argument for ratifying the proposed USA-Aust FTA.

The essence of this submission is that:

- (1) the benefits that Australian contractors may obtain by obtaining access to government procurement in the United States under the US-Aust FTA can also be obtained by Australia acceding to the World Trade Organization (WTO) plurilateral Agreement on Government Procurement ("GPA").
- (2) by acceding to the WTO GPA, Australian contractors can obtain benefits that go far beyond those obtainable through the USA-Aust FTA.
- (3) that by ratifying the USA-Aust FTA, it may become more difficult politically for Australia to accede to the WTO GPA.

Introduction

At present, Australia is not a party to the WTO GPA Agreement. Therefore, Australia is able to give preference to Australian suppliers over all foreign suppliers (subject to compliance with certain existing bilateral treaty obligations). Australia is also able to require foreign suppliers to assume other obligations, which the relevant level of government decides, are appropriate for economic development in Australia (usually called "offsets").

In essence, under the WTO GPA, the Australian government would be prohibited from giving preferences to Australian suppliers but in return all of the other WTO Members, which are parties to the GPA, would be prohibited from giving less favourable treatment to Australian suppliers than they give to their own nationals. Australia would no longer be able to require foreign suppliers to assume other

obligations but all the other GPA parties would likewise be prevented from imposing additional economic development conditions upon Australian suppliers. Being a party to the GPA would give Australian exporters the opportunity to tender on an equal basis in 29 countries including the United States and all the members of the European Union (15) and Canada.

Under the USA-Aust FTA, Australian governments would be prohibited from giving preferences to Australian suppliers over USA suppliers but would still be able to give both USA and Australian suppliers preference over suppliers from other countries. Whilst Australia remains outside the GPA, the preference given to US suppliers would rank them ahead of suppliers from all other countries (except NZ or Singapore or under any similar obligation given by Australia in a bilateral FTA).¹

The United States is a signatory to the WTO GPA, has signed several previous FTAs, and has signalled that it intends to enter into more FTAs. Under the USA – Aust FTA, USA governments would be prohibited from giving USA suppliers preference over Australian suppliers. However the effect of this commitment when considered in the context of the USA's obligations under the GPA and existing FTAs is that the USA could give a preference to a group consisting of the 29 GPA parties plus Mexico, Chile and any other country with which the USA has a similar commitment under a bilateral FTA (and in the future, any other country with which the USA enters into a similar commitment under a bilateral FTA) over any other country not included in that group of countries.

In order to explain the consequences of Australia signing the US-Aust FTA on its government procurement, it is necessary to explain the provisions of the FTA and the WTO GPA on:

- (1) National treatment;
- (2) Coverage of the agreement
- (3) Thresholds
- (4) Offsets

National Treatment

National treatment in government procurement means that there should be no discrimination between domestic and foreign suppliers.

The national treatment provision in the WTO GPA provides:

National Treatment and Non-discrimination

Article 3.1 With respect to all laws, regulations, procedures and practices regarding government procurement covered by this Agreement, each Party shall provide immediately and unconditionally to the products, services and suppliers of other Parties offering products or services of the Parties, treatment no less favourable than:

¹ *Australia New Zealand Closer Economics Relations Trade Agreement*, Canberra 28 March 1983 ATS [1983] No.2; Article 11; *Singapore – Australia Free Trade Agreement* Singapore, 17 February 2003; ATS [2003] No 16; chapter 6 Article 3

- (a) that accorded to domestic products, services and suppliers; and
- (b) that accorded to products, services and suppliers of any other Party.

The National treatment in the USA-Aust FTA provides:

Article 15.2 National Treatment and Non-Discrimination

Para 1. With respect to any measure and any procurement covered by this Chapter, each Party and each procuring entity, respectively, shall accord unconditionally to the goods and services of the other Party and to the suppliers of the other Party offering the goods or services of that Party, treatment no less favourable than the most favourable treatment the Party or the procuring entity accords to domestic goods, services and suppliers.

The national treatment obligation only applies to procurement by specific government entities specified in the GPA and in the FTA. It also only applies to procurement contracts with a value exceeding certain monetary thresholds specified in the GPA and the FTA.

Coverage of the agreement

The coverage provision in the WTO GPA provides:

Scope and Coverage

Article 1.1. This Agreement applies to any law, regulation, procedure or practice regarding any procurement by entities covered by this Agreement, as specified in Appendix I.1

Article 1.2. This Agreement applies to procurement by any contractual means, including through such methods as purchase or as lease, rental or hire purchase, with or without an option to buy, including any combination of products and services.

The coverage provision USA-Aust FTA provides:

ARTICLE 15.1 : SCOPE AND COVERAGE

Application of Chapter

1. This Chapter applies to any measure regarding a procuring entity's procurement of goods, services or any combination thereof that is covered by this Chapter.

2. This Chapter applies to procurement:

- (a) by any contractual means, including purchase, lease or rental, with or without an option to buy, build-operate-transfer contracts and public works concessions contracts; and
- (b) for which the value, as estimated in accordance with paragraphs 6 and 7, equals or exceeds the relevant threshold specified in Annexes 15-A, 15-B, and 15-C.

To compare the coverage by the WTO GPA and the USA-Aust FTA, the US appendix in the GPA and the Annexes 15 of the FTA must be compared to check which government entities are included or excluded in each agreement.

Included in the FTA (but not included in the WTO GPA)	Not included in the FTA (but included in the WTO GPA)
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Central government entities	
Broadcasting Board of Governors	ACTION
Corporation for National and Community Service	Administrative Conference of the United States
	Board for International Broadcasting
	United States Information Agency
	Panama Canal Commission
	United States Arms Control and Disarmament Agency
	Interstate Commerce Commission
	Resolution Trust Corporation Oversight Board
	Uranium Enrichment Corporation
Sub-central government entities	
Georgia: Department of Administrative Services: Georgia Technology Authority	Arizona: Executive Branch Agencies
Idaho: Central Procurement Agency	California: Executive Branch Agencies
	Illinois: Department of Central Management Services
	Kentucky: Division of Purchases, Finance and Administration Cabinet, excluding Construction Projects
	Massachusetts: 11 Executive offices (see full list in WTO appendix)
	Mississippi: Department of Management and Budget
	Montana: Executive Branch Agencies (only for services and construction)
	Oklahoma: Office of Public Affairs
	Tennessee: Executive Branch Agencies (excluding services and construction)
	Wisconsin: 18 departments (see full list in WTO appendix)
Government enterprises	
Rural Utilities Service (the WTO GPA only includes Rural Electrification Administration Financing)	Port of New York and New Jersey
	Port of Baltimore
	New York Power Authority

The FTA includes certain government entities which the WTO GPA does not include and vice versa. Overall, it seems that more government entities are covered by the WTO GPA than by the FTA.

By acceding to the WTO GPA, Australian suppliers would receive national treatment from the USA governments listed on the right side of the table. If Australia ratified the FTA but not the GPA then those governments would not be obliged to provide

national treatment to Australian suppliers. Of those the most significant would appear to be the executive agencies of the state governments of some of the more significant economies of the USA: California, Massachusetts, Illinois and Tennessee.

Thresholds

The WTO GPA and the US-Aust FTA apply only to contracts of a certain minimum value. This minimum value is called a 'threshold'. There are differences in thresholds between the two agreements. Obviously, the lower the threshold is, the greater the access for foreign suppliers. Here is a comparison (using 15 April 2004 conversion rates for special drawing rights SDRs):

	Goods and services	Construction
Central government entities	FTA: A\$81,800 WTO: A\$ 256,000	FTA: A\$9,396,000 WTO: A\$9,860,000
Sub-central government entities	FTA: A\$666,000 WTO: A\$700,000	FTA: A\$9,396,000 WTO: A\$6,725,000
Government enterprises A	FTA: US\$292,751 WTO: US\$250,000 ¹	FTA: US\$6,725,000 WTO: US\$7,263,641
Government enterprises B	FTA: US\$538,000 WTO: US\$581,000	Same as above

Thresholds applied in the US/Australia FTA are usually lower. The difference is important for central government entities but very small for sub-central ones.

Offsets

Apart from the national treatment obligation, the other major substantive obligation is an undertaking not to require offsets. In general terms, offsets are some kind of quid pro quo for the award of the contract outside of the negotiated transparent price. The provisions relating to offsets in the WTO GPA and the US-Aust FTA are similar, and the definitions of offsets in the two treaties are also similar.

The offsets provision in the WTO GPA provides:

Offsets

Article 1. Entities shall not, in the qualification and selection of suppliers, products or services, or in the evaluation of tenders and award of contracts, impose, seek or consider offsets.

Offsets are defined in a footnote 7:

Offsets in government procurement are measures used to encourage local development or improve the balance-of-payments accounts by means of domestic content, licensing of technology, investment requirements, countertrade or similar requirements.

There is an exception for developing countries but that would not apply to Australia if it became a signatory.

The offsets provision in the US-Aust FTA provides:

Article 15.2

Offsets

para 5. With regard to procurement covered by this Chapter, a procuring entity may not seek, take account of, impose or enforce offsets in the qualification and selection of suppliers, goods or services, in the evaluation of tenders or in the award of contracts, prior to or in the course of a procurement process.

The US-Aust FTA provides:

Article 15.5 Definitions

Para 7 Offsets means any conditions or undertakings that require use of domestic content, domestic suppliers, the licensing of technology, technology transfer, investment, counter-trade or similar actions to encourage local development or to improve a Party's balance-of-payments accounts.

Therefore, both the WTO GPA and the US-Aust FTA prohibit the use of offsets in similar terms.

In theory, ratifying the USA- Aust FTA and not the WTO GPA would leave Australian governments free to impose offset requirements on suppliers from countries with which Australia does not have an FTA with a similar provision.

In practice, over time, the difference between agreeing not to use offsets in relation to tenders from suppliers from the USA (or other countries with which Australia has an FTA containing a similar provision) and agreeing not to use offsets at all is likely to be minimal, if there is in fact any difference at all. (In practice, choosing a supplier from country Z because they had undertaken an offset commitment over a supplier from the USA would probably be regarded by the USA as a breach of the proposed USA-Aust FTA.)

In practice, therefore, the USA – Aust FTA does not restrict the freedom of action to use offsets any less than that freedom of action would be restricted by acceding to the WTO GPA.

Economics and Politics of Government Procurement

It is worth reflecting on the standard economic analysis of government procurement and a simple public choice analysis of government procurement and noting an important ramification, which would flow from acceding to a bilateral FTA without acceding simultaneously to the GPA.

The standard welfare economics of using government procurement is that an economic development objective could be achieved at a lower cost using a targetted subsidy. Therefore, when governments choose procurement policies that prefer Australian suppliers, they inflict a net loss of wealth on the Australian community as a whole, which is greater than that which is necessary to achieve the economic development objective. They could avoid that loss and still achieve the economic development objective by buying from the lowest cost supplier (regardless of which country that supplier came from) and using a targetted subsidy to achieve the economic development objective.

The standard public choice theory analysis would be that those most interested in the issue will exert the most influence over government decision makers. Therefore, those Australian suppliers who gain from the “Buy Australian” preferences have an incentive to lobby the government against acceding to the WTO GPA. This may explain why until this point Australian governments have chosen not to accede to the WTO GPA.

If the USA-Aust FTA proceeds, then it will be both Australian suppliers and USA which benefit from preferential procurement policies of Australian governments. Therefore, it may be all of those USA and Australian suppliers that will have an incentive to lobby the Australian government against acceding to the WTO GPA.

Conclusion

- 1 under the proposed FTA, the scope of government procurement activities to which the United States would apply national treatment for Australian suppliers is less than the scope of government procurement activities to which the USA would be obliged to apply national treatment for Australian suppliers, if Australia were to accede to the WTO Agreement on Government Procurement;
- 2 under the proposed FTA, in the Australian government procurement market, suppliers from the United States might receive a preferences over suppliers from all but a few countries (with which Australia has FTAs) but, in the USA government procurement market, suppliers from Australia will not be able to receive any preference over any supplier other than those which are not from any of the 29 States that are parties to the GPA and which do not have FTA with the USA (currently including Canada, Mexico, Israel, Singapore and Chile – but this list may expand to include most Latin American countries);
- 3 under the proposed FTA, Australian suppliers would gain access only to the United States but by acceding to the WTO GPA would gain access to 29 countries, including the United States, Canada and the Members States of the European Union (15).
- 4 **The desire of the Australian government to gain access to the US government procurement market is not a reason to ratify this proposed FTA. The same benefits to Australian suppliers and additional benefits could be obtained by acceding to the WTO Government Procurement Agreement.**
- 5 Acceding to the proposed FTA may cause it to be more difficult for Australia to acced to the GPA.
- 6 Apart from the direct benefits to Australian firms supplying foreign government procurement markets, acceding to the WTO GPA would also confer greater economic benefits on the Australian community in situations in which a supplier from the rest of the world would win contracts with

Australian governments but for the preference to Australian suppliers or, in the event of the FTA being in force, but for the preference to Australian or USA suppliers.

The prospect of gaining access to the USA government procurement market is not a sound argument for ratifying the proposed USA-Aust FTA.

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