

BUY AMERICA

An analysis of U.S. domestic preference legislation for
the North American Strategy for Competitiveness

May 2016



Buy American Legislation

A Policy Analysis Prepared for the North American Strategy for Competitiveness
(NASCO)

May 2016

Capstone of

Texas A&M Bush School of Government and Public Service *and* School of Law

Team Members

James Dean, *Bush School*

Charles Edward Andrew Lincoln IV, *School of Law*

Stephanie Gullo, *Bush School*

Michael Scott Sankey, *School of Law*

Rachel Marsh, *Bush School*

Faculty Advisors

Jeryl L. Mumpower, *Bush School*

Andrew P. Morriss, *School of Law*

William H. Henning, *School of Law*



ACKNOWLEDGEMENTS

The capstone team wishes to acknowledge and thank the following persons who provided information, advice, guidance, and counsel about the content of this report.

Dr. Laura Dague, Bush School
Dr. Lori Taylor, Bush School
Marcos Hernandez, COFOCE
Alexander Marquez, COFOCE
Paola Caranza Ortega, COFOCE
Mauricio Preciado, COFOCE
Yiovan Reynoso, COFOCE
Margarita Soto, COFOCE
Douglass Cullen, Grupo SSC
Jesus Garcia, Grupo SSC
Federico Legorreta N., Hacienda Santa Clara
Pablo Marvin, Hacienda Santa Clara
Barbra Marvin, Hacienda Santa Clara
Roberto Buenrostro, MR. LUCKY
Michael K. Young, Texas A&M University President

Executive Summary

Every Congress since 1933 has enacted domestic preference legislation mandating that the federal government favor U.S. products in contracting. The Buy American Act of 1933 is the first and most comprehensive piece of domestic preference legislation. It was initially enacted with the purpose of protecting U.S. industries and jobs during the Great Depression. The Buy American Act, as well as the other forms of domestic preference legislation, gives preference to domestic goods in federal procurement.

Characteristics of Domestic Preference Legislation

Domestic Preference Legislation is Economically Inefficient

- Subsidizing American businesses requires the U.S. government to pay up to 12 percent more for goods and services.
- The American consumer collectively loses more under protectionist legislation than the protected producers gain.

Exemptions for Trade Agreements

- 129 countries are exempt from the legislation for contracts above varying dollar-value thresholds. This leaves only 66 countries that are not exempt to the requirements.
- Products from exempt countries are given equal consideration to domestic goods in federal procurement.
- Domestic preference legislation does not violate international law or U.S. treaties.

Legally Inconsistent

- Courts have interpreted the Act differently, leading to cases with the same facts resulting in different court decisions.

Public Support

- Support for domestic preference legislation
 - Increases when the economy is weak.
 - Is higher among people with lower education and lower incomes because the legislation artificially insulates jobs within the U.S.

- Is higher among people affiliated with the U.S. manufacturing industry because manufacturing is artificially protected from competition by the legislation.

This analysis recommends implementing a policy that is politically feasible, improves economic efficiency, and does not skew the distribution of wealth among the stakeholders.

It finds that expanding trade agreements so that exempt countries have increased access to U.S. federal procurement would reduce the Buy American Act's scope and economic inefficiencies, while avoiding a direct confrontation with the Act's supporters. This is accomplished by increasing countries' exemptions to the legislation to include lower value contracts.

The benefit of the recommended policy, lowering the thresholds for the exemptions so that the producers operating in the 129 exempt countries are able to pursue more United States federal contracts, is that it avoids strong political opposition from beneficiaries of the legislation. It also sidesteps the argument that domestic procurement is necessary for national security by leaving the Berry Amendment of 1941, which applies stringent requirements to the Department of Defense, in place. However, our analysis indicates that domestic producers, low-wage workers, and labor unions are likely to openly oppose this policy. Ways to compensate those harmed by the recommended policy changes should be researched. In order to make an alternative policy politically feasible and equitable, policy makers should incorporate these crucial stakeholders into the process of developing alternatives.

TABLE OF CONTENTS

ACKNOWLEDGEMENTS	3
Executive Summary	4
I. Explanation & History	7
A. Introduction	7
B. Overview of the Buy American Act.....	8
C. Overview of the Buy America Provisions for the Department of Transportation...	9
D. Overview of the Berry Amendment for the Department of Defense.....	10
E. Overview of the Buy America Provision of the American Recovery and Reinvestment Act.....	11
II. Goals and Criteria	12
III. Stakeholders	13
IV. Effects on Economic Efficiency	18
V. Effects on International Relations	22
VI. Effects on Federal Deficits	32
VII. Effects on Federal Contracting	34
VIII. Effects on Distribution of Wealth.....	38
IX. Determinants of Support for Free Trade.....	42
X. Effects on National Security.....	45
XI. Policies Options.....	46
XII. Recommendation.....	48
XIII. Conclusion.....	49
Appendix A. List of Other Domestic Preference Legislation	50
Appendix B. Detailed Legal Analysis of <i>United States v. Rule Industries, Inc</i>....	51
Appendix C. Examination of Act and International Treaties.....	56
Appendix D. Cost Estimate of Buy American Act	59

I. EXPLANATION & HISTORY

A. INTRODUCTION

The United States government has passed domestic preference legislation every year since 1933, creating a complicated set of federal procurement regulations, which favor products made in the United States over those made elsewhere.^{1, 2} The Buy American Act, dating back to the Great Depression, is a well-known example of this type of legislation.³ It mandates that federal agencies give preference to goods and services made in the United States when awarding contracts.^{4, 5} This protectionist sentiment has been embodied in various forms of legislation throughout the years, creating many concurrent, overlapping federal procurement regulations. This report will describe and evaluate this legislation, and will conclude with policy recommendations.

The Federal Acquisitions Regulation (FAR) provides a comprehensive view of the regulations. The FAR is a manual for federal procurement officers on how to apply the legislation.⁶ It gives the scope of domestic preference legislation, the various exemptions and varying requirements, and the list of exempt items.⁷ A list of this legislation is provided in Appendix A.⁸ Though there is variance among the iterations of legislation, they all require between 50 percent and 100 percent of materials to be domestically produced.⁹ The primary exemption to the mandate to procure domestic products is “reasonableness of cost.” A foreign product can only be purchased if the

¹ Gantt, P. H., & Speck, W. H. (1958). Domestic v. Foreign Trade Problems in Federal Government Contracting: Buy American Act and Executive Order. *J. Pub. L.*, 7, 378, 382.

² Luckey, J. R. (2012). THE BUY AMERICAN ACT: REQUIRING GOVERNMENT PROCUREMENTS TO COME FROM DOMESTIC SOURCES*. *Current Politics and Economics of the United States, Canada and Mexico*, 14(1), 9.

³ Weiss, L., & Thurbon, E. (2006). The business of buying American: Public procurement as trade strategy in the USA. *Review of International Political Economy*, 13(5), 701-724.

⁴ McCarl, L. I. (2011). Foreign Competition in US Defense Contracts: Why the US Government Should Favor Domestic Companies in Awarding Major Defense Procurement and Acquisition Contracts. *Pacific McGeorge Global Business & Development Law Journal*, 24(1).

⁵ Granzin, K. L., & Painter, J. J. (2001). Motivational influences on “Buy Domestic” purchasing: Marketing management implications from a study of two nations. *Journal of International Marketing*, 9(2), 73-96. *See generally*. Frank, D. (2000). *Buy American: The untold story of economic nationalism*. Beacon Press. Chicago

⁶ Kelman, S. (2002). Remaking federal procurement. *Public Contract Law Journal*, 581-622.

⁷ *Id.*

⁸ Luckey, J. R. (2012). Domestic Content Legislation: The Buy American Act and Complementary Little Buy American Provisions.

⁹ 48 C.F.R. § 225.105(b). *See also*. Luckey, J. R. (2012). The Buy American Act: Requiring Government Procurements to Come from Domestic Sources*. *Current Politics and Economics of the United States, Canada and Mexico*, 14(1), 9. Chicago

domestic alternative is unreasonably costly or is not available domestically in sufficient quantity and quality. The different acts vary on how much costlier the domestic alternative must be before a foreign product may be purchased, ranging from around 6 percent to 50 percent more costly. In this section, the most prominent instances of domestic preference legislation will be summarized so that domestic preference legislation can be evaluated comprehensively.

B. OVERVIEW OF THE BUY AMERICAN ACT

The earliest instance of domestic preference legislation that is still in place is the Buy American Act, which was enacted in 1933 as a reaction to the Great Depression. This Act has been amended four times as the U.S. Congress went through periods of protectionist and free trade ideologies, but still remains in effect.¹⁰

The BAA has stringent requirements for federally purchased goods to be produced and manufactured in the United States. All raw materials for public use must be mined or produced in the United States and all manufactured goods for public use must be manufactured in the United States from goods that were produced in the United States.¹¹ The BAA uses a two-part test to define domestic products: (1) the goods must be manufactured in the United States, and (2) over 50 percent of components, determined by their cost, must be domestically produced.¹²

The regulations have numerous exemptions to ensure federal agencies can purchase needed goods without sacrificing too much on quality or cost. Exemptions are included when the cost of U.S. goods is substantially higher or purchasing them is inconsistent with the public interest.¹³ In order to determine the “reasonableness of cost” of the domestic end product, a procurer must add 6 percent if the domestic end product is from a large business or 12 percent if from a small business to the price of the lowest offer that is not a qualifying item.¹⁴ The ambiguity of the broad exemption of “inconsistent with the public interest” has created controversy. Further exemptions are included for cases in which goods are to be used outside the United States, goods are not able to be produced in the United States, United States-made goods are of low quality, or the purchase is less than \$3,000.¹⁵ The FAR defers to the

¹⁰ Knapp, L. A. (1961). The Buy American Act: A Review and Assessment. *Columbia Law Review*, 430-462.

¹¹ 41 U.S.C.A. § 8301

¹² The Federal Acquisition Regulation Section 25.105 2005

¹³ 41 U.S.C.A. § 8301

¹⁴ The Federal Acquisition Regulation Section 25.105 2005

¹⁵ The Federal Acquisition Regulation Section 2.101 2005

Small Business Association to define "small business." The Small Business Association, in turn, defines small businesses on a "industry-by-industry basis." The FAR does not provide a definition for a large business, so it can be assumed that anything not defined as a small business is counted as a large business.¹⁶

C. OVERVIEW OF THE BUY AMERICA PROVISIONS FOR THE DEPARTMENT OF TRANSPORTATION

There are five Buy America Acts that are applicable only to the Department of Transportation, each of which applies to a different transportation-related department.¹⁷ Most provisions apply to funds granted by federal government agencies rather than to direct federal spending and they generally require 100 percent United States-made products, though some have less stringent requirements.¹⁸ The Surface Transportation Assistance Act of 1982 was the first to extend domestic preference legislation to the Department of Transportation.¹⁹ Requirement waivers can be granted if the purchase of domestic materials would be inconsistent with the public interest, the materials are not produced in sufficient quantity and in high enough quality in the United States, or the purchase of American-made goods would increase the cost of the project by more than 25 percent. U.S. international agreements do not apply to any of these, except the High Speed Rail Program.^{20, 21}

¹⁶ "Small business concern" means a concern, including its affiliates, that is independently owned and operated, not dominant in the field of operation in which it is bidding on Government contracts, and qualified as a small business under the criteria and size standards in 13 CFR part 121 (see 19.102). Such a concern is "not dominant in its field of operation," "when it does not exercise a controlling or major influence on a national basis in a kind of business activity in which a number of business concerns are primarily engaged. In determining whether dominance exists, consideration must be given to all appropriate factors, including volume of business, number of employees, financial resources, competitive status or position, ownership or control of materials, processes, patents, license agreements, facilities, sales territory, and nature of business activity. (See 15 U.S.C. 632.) "Small business subcontractor" means a concern, including affiliates, that for subcontracts valued at— (1) \$10,000 or less, does not have more than 500 employees; and (2) More than \$10,000, does not have employees or average annual receipts exceeding the size standard in 13 CFR Part 121 (see 19.102) for the product or service it is providing on the subcontract.

¹⁷ Department of Transportation (2010). Buy America Provisions Side By Side. Retrieved from: https://www.transportation.gov/sites/dot.dev/files/docs/buy_america_provisions_side_by_side.pdf.

¹⁸ Luckey, J. R. (2012). Domestic Content Legislation: The Buy American Act and Complementary Little Buy American Provisions.

¹⁹ Surface Transportation Assistance Act of 1982, H.R. 6211, 97th Cong. (1983).

²⁰ World Trade Organization Government Procurement Agreement, U.S. Free Trade Agreements, U.S.-EC Exchange of Letters [May 15, 1995], and Canada-U.S. Agreement on Government Procurement

²¹ "Buy America." *Transportation.gov*. Department of Transportation, 4 Mar. 2015. Web. 13 Apr. 2016.

Federal Aviation Administration (FAA): The FAA must assure that the steel and manufactured products used in every project that it funds are produced in the United States.²²

Federal Highway Administration (FHWA): Funds must only be supplied for projects in which the steel, iron, and manufactured products used are produced in the United States.²³ This applies to iron and steel products and their coatings that are to be permanently incorporated into a FHWA project. In 1983, the FHWA ruled that these requirements did not apply to raw materials and used the public interest exemption to waive the requirements for manufactured goods. In 1995, the FHWA made exemptions for three types of iron due to lack of adequate domestic supply.

Federal Railroad Administration (FRA) High Speed Rail Program: The steel, iron, and manufactured goods used in every project must be produced in the United States.²⁴

National Railroad Passenger Corporation (AMTRAK): Amtrak can only buy raw materials mined or produced domestically and U.S. manufactured goods made substantially from goods mined or produced in the United States.²⁵

Federal Transit Administration (FTA): The FTA may only fund projects that assure that all iron, steel, and manufactured products used are produced in the United States.²⁶

D. OVERVIEW OF THE BERRY AMENDMENT FOR THE DEPARTMENT OF DEFENSE

Another piece of domestic preference legislation, the Berry Amendment, states that certain Department of Defense (DoD) purchases must be 100 percent American in origin. The Berry Amendment has a national security justification.²⁷ The Berry Amendment was first put into place in 1941 in order to maintain a domestic industry for essential goods during World War II and to bolster a faltering economy. It mandates that all food, clothing, textiles, and specialty metals purchased by the DoD must be produced in the United States.²⁸ This requirement applies to both components and end products. Clothing includes belts, badges, and shoes, but

²² 49 U.S.C. § 50101

²³ 23 U.S.C. § 313 – Buy America; 23 C.F.R. § 635.410

²⁴ 49 U.S.C. Chapters 244, 246; § 24405

²⁵ 49 U.S.C. § 24305

²⁶ 49 U.S.C. § 5323(j); 49 C.F.R. Part 661

²⁷ Grasso, V. B. (2014, February). The Berry Amendment: Requiring Defense Procurement to Come from Domestic Sources. LIBRARY OF CONGRESS WASHINGTON DC CONGRESSIONAL RESEARCH SERVICE.

²⁸ Luckey, J. R. (2012). Domestic Content Legislation: The Buy American Act and Complementary Little Buy American Provisions.

excludes electronics attached to clothing. It also applies to textiles for tents and any item of individual equipment. In 2014, a requirement was added that all American flags purchased by the DoD must be American made. There are exemptions for items that cannot be practically purchased in the United States and for purchases less than \$3,000. Only if the foreign bid is below 50 percent of the price of the lowest priced domestic bid can it be chosen, and this is usually a prohibitively high requirement for foreign products.²⁹ The legislation is so complex that companies are encouraged to consult a contracting officer, who will decide whether it applies on a case-by-case basis.³⁰

E. OVERVIEW OF THE BUY AMERICA PROVISION OF THE AMERICAN RECOVERY AND REINVESTMENT ACT

In 2009, the American Recovery and Reinvestment Act (ARRA) of 2009 was enacted with the explicit goal of stimulating U.S. industry; therefore, it is not surprising that it includes particularly strict domestic preference requirements. Funds from the Act can only be used for construction, alteration, maintenance, or repair of public works in which all of the iron, steel, and manufactured goods used in the project are produced in the United States.³¹

The requirements only apply to construction or public works. When ARRA funding is granted for projects that will be privately owned, the Buy America provision does not apply. Additionally, a product can be considered to be manufactured in the United States if it has been “substantially altered” during a process in the United States, even if the procurement of its subcomponents or earlier processing occurred in another country.

There are several exemptions to these requirements. If the particular goods are not available in the United States in sufficient quantity, procuring them in the United States increases the entire project cost by over 25 percent, or it is against the national interest to procure them in the United States, then an exemption can be made.

²⁹ 48 C.F.R. § 225.105(b)

³⁰ "Berry Amendment." *Berry Amendment*. International Trade Association, n.d. Web. 13 Apr. 2016.

³¹ "Buy America." *Transportation.gov*. Department of Transportation, 4 Mar. 2015. Web. 13 Apr. 2016.

II. GOALS AND CRITERIA

In order to evaluate domestic preference legislation, a framework of goals and criteria must be established. For the purposes of this study, economic efficiency, distribution of costs and benefits, and political feasibility are used as the three goals because of the centrality of each in forming a successful policy. In terms of economic efficiency, employment and administrative efficiency are applicable criteria to assess the effects. In the case of the distribution of costs and benefits, the analysis will extend to the taxpayers, consumers, workers, and industries, both domestic and international. Finally, in order to assure political feasibility, the study will consider the legality of alternative policies, public opinion, and the political pressures coming from different North American stakeholders.

III. STAKEHOLDERS

This section provides an overview of the various stakeholders in domestic preference legislation. Stakeholders are defined as people or organizations that are either benefited or harmed by the policy. It is necessary to analyze the stakeholders in order to determine whether they will be benefited or harmed, the stance that they will likely take toward the policy, and the resources they have to advocate for or against the policy.

The first group is domestic stakeholders. This includes producers and manufacturers that operate in the United States, the domestic workers employed by these firms, and unions representing these workers. Another domestic stakeholder is the American public, which can be conceptualized as taxpayers and interest groups that represent the public. Government policy makers- Congress, the President, and the federal agencies- are another domestic stakeholder.

The second group is stakeholders within countries with exemptions to the United States' domestic preference legislation. The stakeholders within these countries include producers and manufacturers, workers, the public, and elected officials. This group comprises producers and manufacturers of any nationality who are operating in exempt countries.

The third group is stakeholders operating within countries that are not exempt from the United States' domestic preference legislation. The stakeholders include firms operating in these countries, the governments, and the citizens.

A. Domestic Producers: Support the legislation

Producers who are operating in the United States, whatever the nationality of the producer, benefit from domestic preference legislation. The legislation protects them and allows easier access to contracts and higher revenues.

However, this only occurs if three conditions are met. The first is that firms subject to the United States' domestic preference requirements would choose to sell to the U.S. government in absence of the legislation. Without this condition being met, the legislation would have no effect. Secondly, domestic competition must be limited, allowing producers to extract profits they could not have otherwise. Without this condition, domestic producers would compete among themselves, lowering economic profits. Third, the U.S. government must have market power as a buyer,

meaning that there are limited alternative buyers to purchase a product. If there are many potential buyers, then having a protected ability to sell to the U.S. government does not benefit firms. It is likely that in the context of some products these conditions are met part of the time, but not in all cases.

In order to keep domestic preference legislation in place, domestic producers can lobby the U.S. government or contribute to advocacy groups that lobby the U.S. government.

B. Employees of Domestic Producers: Support the legislation

Workers in industries in which U.S. producers do not have a comparative advantage have more employment opportunities because the legislation allows their employers to continue production. Employees with industry-specific skills especially gain from the legislation because without it those skills would lose relevance in the U.S. economy. The resources available to them to support the legislation include forming unions and interest groups to lobby the U.S. government and voting or pressuring representatives to keep the legislation in place.

C. Domestic Public: Mixed

To the extent that the law has an impact on government procurement decisions, it can increase the price paid for goods. The increased prices paid by the government must have one of three effects. First, this could increase deficits, which is a cost borne by the taxpayer. Second, it could decrease quality or quantity of government services, which affects the American public. Finally, there could be an increased debt burden, which is borne by all people affected by stability of the United States and by future generations.

However, the domestic public may also benefit by redistribution of wealth or utility based on people's sense of patriotism. Those who are dependent on domestic production of goods benefit from redistribution of wealth, while those who derive intangible benefits from supporting U.S. production, independent of prices or quality of goods, support the legislation as well.

The domestic public can advocate for or against domestic preference legislation by electing representatives that support their interests and forming advocacy groups to lobby the U.S. government.

D. Domestic Government Officials: Mixed

Government officials represent the interests of their constituencies, both citizens and industries. Representatives responding to constituencies dependent on domestic production will support the legislation, while representatives responding to constituencies more affected by the disadvantages of the legislation will not support it.

Elected officials can use political positions to pass laws, while civil servants can shape regulations.

E. Producers Operating in Exempt Countries: Mixed

Producers in exempt countries can bid for U.S. products, but only within certain threshold prices of the bid. To the extent that they are eligible for U.S. government contracts, the legislation protects them. To the extent that they cannot because they do not meet the pricing thresholds to their exemption, they are unable to win potentially lucrative contracts due to the legislation.

These producers are only affected, however, when two conditions are met. Only if they are interested in selling to the U.S. government will this have an effect. This would require the producers to deal with the complexity and potential language barriers of understanding how U.S. government procurement operates. Secondly, the legislation cannot affect these producers unless the U.S. government has market power as a buyer, so that these producers cannot just as easily sell to another buyer.

The means available to these producers to change the legislation include lobbying their governments and forming advocacy groups to lobby their governments to pressure the United States or to enact retaliatory legislation.

F. Employees of Producers Operating in Exempt Countries: Mixed

If employees have job skills that are not easily transferred to other industries, and if their industries could not easily find other buyers for their products, then to the extent that their employers benefit or are harmed, they will be too.

These employees can attempt to change the legislation through forming unions and advocacy groups to lobby their governments to pressure the United States or to enact retaliatory legislation.

G. Public of Exempt Countries: Mixed

If the conditions are met so that producers in their countries are affected by the legislation, the public of exempt countries faces both positive and negative effects. Producers are able to charge higher prices for their products because the United States, as a buyer with market power, increases demand for products. Thus, the public must pay more for goods. At the same time, the public may benefit from higher employment or from a more prosperous society. This depends on the market structure of the country, the nature of the product, and whether economic institutions are more extractive or inclusive (i.e., how evenly wealth is shared among the population).

The public may elect representatives to pursue their interests and form advocacy groups to lobby their governments to pressure the United States or to enact retaliatory legislation.

H. Government of Exempt Countries: Mixed

Each government's incentive structure determines whether it is more responsive to producers or the public.

Exempt governments may pressure the United States or enact retaliatory legislation in order to influence the policy.

I. Producers Operating in Non-Exempt Countries: Against

If the conditions discussed above are met (they would choose to sell to the U.S. government without the legislation and the U.S. government has market power), then the producers operating in non-exempt countries, whatever their nationalities, are negatively affected by the lost opportunity.

They can seek to influence the legislation through lobbying their governments and forming advocacy groups to lobby their governments to pressure the United States or to enact retaliatory legislation.

J. Employees of Producers Operating in Non-Exempt Countries: Against

The employees of affected firms, who would otherwise have expanded job opportunities, are negatively affected by the lost opportunity if there are limited alternatives for employment.

They can attempt to change the legislation by forming unions and advocacy groups to lobby their governments to pressure the United States or to enact retaliatory legislation.

K. Public of Non-Exempt Countries: Mixed

If the conditions are met so that producers in their countries are affected by the legislation, the public of exempt countries faces both positive and negative effects. Producers must charge lower prices for their products because the United States, as a buyer with market power, decreases demand for products. Thus, the public can purchase goods for less money. At the same time, the public may lose the opportunity for employment and shared prosperity. This depends on the market structure of the country, the nature of the product, and whether economic institutions are more extractive or inclusive (i.e., how evenly wealth is shared among the population).

The public may elect representatives to pursue their interests and form advocacy groups to lobby their governments to pressure the United States or to enact retaliatory legislation.

L. Government of Non-Exempt Countries: Mixed

Each government's incentive structure determines whether it is more responsive to producers or the public. For products that the country's public wouldn't be interested in buying but the United States government would, such as customized defense equipment, this legislation harms the country's industry and does not benefit its public with lower prices, and thus the government would be against the restriction.

Non-exempt governments may pressure the United States or enact retaliatory legislation in order to influence the policy.

IV. Effects on Economic Efficiency

A. Creation of Superfluous Steps of Production

Domestic preference legislation incentivizes wasteful steps of production. Courts have interpreted the BAA to mean that the last two stages of production have to occur in the United States for an end product to be considered American (the stages of production are ambiguously defined).³² As a result, manufacturers can sell their products to the U.S. government by doing two superfluous steps of production within the United States, wasting resources.³³

B. Disruption of Integrated Supply Chains

The American Recovery and Reinvestment Act (ARRA), the stimulus bill designed to alleviate the Great Recession in 2009, provides a good example of domestic preference legislation's disruption to supply chains because, unlike the rest of the legislation, it excluded Canadian and Mexican sources of goods. As a result, the ARRA's domestic preference requirements were especially disruptive to established United States-Canadian supply chains. Thanks to NAFTA, Canada has nondiscriminatory access to U.S. government procurement. However, the ARRA was designed so that there were not country exemptions. ARRA applied to government grants, rather than to government procurement, and thus was not covered by international agreements. Given the highly interconnected nature of the United States-Canadian supply chain, the ARRA created much confusion among U.S. producers about how to make their products while excluding their Canadian suppliers.

C. Trade Barriers Have Negative Effects on Economy

Domestic preference legislation is a form of a trade barrier. Given that there is a dearth of academic literature on the effects of domestic preference legislation specifically, but an extensive body of literature on trade barriers, a review of the literature on trade barriers will help inform this analysis. Trade barriers create economic inefficiency and inhibit free trade. Thus, domestic preference legislation inhibits free trade and creates economic inefficiency.

Under the neoclassical economic model, removing trade barriers allows countries to specialize in the industry where they have a comparative advantage. This means that

³² *United States v. Rule Indus., Inc.*, 878 F.2d 535 (1st Cir. 1989).

³³ Gantt, P. H., & Speck, W. H. (1958). Domestic v. Foreign Trade Problems in Federal Government Contracting: Buy American Act and Executive Order. *J. Pub. L.*, 7, 378.

countries are focused on the industries in which they are most efficient. As long as countries have reasonably effective internal institutions and competition, then as a result of free trade products are available for better prices and all countries are wealthier. Thus, the United States' domestic preference legislation, by inhibiting trade, has negative effects on the US economy.

The neoclassical economic model has been used for decades to inform efforts for economic development. While “there is a wealth of theoretical and empirical critiques challenging the relationship between free trade and economic growth which was taken for granted when the WTO was created”³⁴, the neoclassical model remains the general consensus by economists.

D. Net Economic Loss

In either an import situation or an export situation, a supply and demand analysis of removing trade barriers (such as domestic preference legislation) shows that it results in a net gain for the nation.³⁵ An import-competing producer, meaning a domestic producer who faces competition from producers abroad, will lose from free trade when a product can be purchased for less from an international source than a domestic one, which will force the product price down.³⁶ At the same time, consumers gain by purchasing lower priced goods, which increases their purchasing power. The nation is better off because consumer gains exceed producer losses. In an export situation, in which a domestic producer wishes to sell products abroad, the inverse is true. Consumers gain from reducing trade barriers and producers lose, but the result is an economic net gain.

Thus, within the neoclassical economic model, when protectionist legislation is introduced, the nation as a whole loses. This outcome requires the condition that fungible international goods can be purchased at a lower cost than domestic goods, or else the policy will have no effect. This is usually the case, as protectionist legislation is implemented in order to protect losses of domestic producers to international producers.

³⁴ Alvaro Santos, *Carving Out Policy Autonomy for Developing Countries in the World Trade Organization: The Experience of Brazil & Mexico*, 52 Va. J. Int'l L. 551, 559 (2012).

³⁵ Coughlin, C. C., Chrystal, K. A., & Wood, G. E. (1995). Protectionist trade policies: A survey of theory, evidence, and rationale. *International political economy: perspectives on global power and wealth*, 3, 323-338.

³⁶ AKemp, M. C. (1962). The gain from international trade. *The Economic Journal*, 72(288), 803-819.

With protectionist legislation raising the price of imported goods relative to domestic goods, a few things happen. First, consumers will pay more for the goods resulting in a loss for the consumer (this is called a deadweight consumption loss). Domestic producers will gain because demand for the domestic goods increases but because of the reduction in international competition for the good, inefficiencies will increase in the domestic production of the goods (this is called a deadweight production loss). The government benefits from tariff revenue generated.³⁷ The nation will experience a net loss because the losses from the higher price consumers pay for the goods in addition to the deadweight production and consumption losses will exceed the gains of the domestic producer and the government.³⁸

Thus, domestic preference legislation is economically inefficient, both for the U.S. economy and for the international economy. Protectionist legislation creates an economic inefficiency that impacts all countries involved. Products that could be purchased for less from other countries are instead bought at a higher cost from U.S. manufacturers. This is essentially subsidizing the U.S. manufacturers to produce something that can be created elsewhere at a lower price. This redistributes money that could be used for other purposes into the hands of U.S. manufacturers. According to The Centre for Trade and Economic Integration, “[i]t has been shown that protectionist policies run the risk of creating higher unemployment as well as higher prices and burgeoning debt. Consumers in protected countries are invariably disadvantaged by way of limited choice of goods and uncompetitive prices.”

E. Indeterminate Effects on U.S. Labor Market

The effect on the U.S. labor market, however, is indeterminate. This is because domestic preference legislation has two, opposing effects: it increases U.S. manufacturing employment through discriminating against manufacturing in other countries and it decreases U.S. employment through reducing economic efficiency. An example of how this type of legislation affects employment comes from a critique of the 2009 ARRA: the prices charged to public agencies would likely be higher for U.S. iron and steel and other manufactured products.³⁹ Higher prices would mean that fewer roads and schools could be built with the stimulus money. Higher iron and steel

³⁷Rose-Ackerman, S. (1997). The political economy of corruption. Corruption and the global economy, 31, 60.

³⁸ Deardorff, A. V., Tariffs, I., & Market, B. D. (1999). Nontariff Barriers and Domestic Regulation. World Bank on April, 6.

³⁹ Hufbauer, G. C., & Schott, J. J. (2009). *Buy American: bad for jobs, worse for reputation*. Peter G. Peterson Institute for International Economics.

prices could also hurt steel-using firms that are major U.S. exporters. On the other hand, prices might fall for foreign steel sold by countries where the steel industry depends on exports to the United States, such as Mexico and Canada. Private U.S. buyers might in turn switch their purchases to those foreign producers. Depending on the size of the switch, the jobs created by the Buy American provisions could be significantly reduced by a loss of sales to private business in the United States.”⁴⁰ In the context of the permanent domestic preference legislation, economists could empirically observe which effect is larger and determine whether this law increases or decreases the United States’ employment rate, but there is little reliable, empirical study on this subject.

⁴⁰ Hufbauer, G. C., & Schott, J. J. (2009). *Buy American: bad for jobs, worse for reputation*. Peter G. Peterson Institute for International Economics.

V. Effects on International Relations

A. Domestic Preference Legislation Does Not Violate International Law or U.S. Treaties

Authority to Make Treaties

Article I, Section 8, Clause 3, the “Commerce Clause” grants Congress the power “[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes...”⁴¹ This power is absolute: [t]he plenary authority of Congress over both interstate and foreign commerce is not open to dispute.⁴² The Commerce Clause gives Congress the authority to pass legislation such as domestic preference legislation, which is a form a regulation on commerce with foreign nations because it excludes foreign market participants.

Alternatively, Article II, Section 2, Clause 2 gives the President the power to make treaties: “[h]e shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur....”⁴³ This gives the President the power to grant exemptions to domestic preference legislation in treaties.

Because treaties are given the same effect as legislation passed by Congress, a later-in-time treaty that conflicts with prior legislation will preempt that legislation. The effect given to treaties is found in Article VI, Clause 2 which states: “[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.”⁴⁴ This is why the President and Congress can grant exemptions to domestic preference legislation in treaties that the President or Congress makes with foreign nations.

⁴¹ U.S. Const. art. I, § 8, cl. 3

⁴² *California Bankers Ass'n v. Shultz*, 416 U.S. 21, 46, 94 S. Ct. 1494, 1510, 39 L. Ed. 2d 812 (1974).

⁴³ U.S. Const. art. II, § 2, cl. 2

⁴⁴ U.S. Const. art. VI, cl. 2

Applicable U.S. Treaties

The Federal Acquisition Regulation (FAR) explicitly states United States' international treaties preempt U.S. domestic preference legislation.⁴⁵

1. General Agreement on Tariffs and Trade of World Trade Agreement:

The General Agreement on tariffs and trade (GATT) was created by World Trade Organization members to eliminate protectionist policies.⁴⁶ Specifically, "GATT Article III prohibits internal taxes and other regulations that enhance the competitive position of domestic producers relative to that of foreign producers."⁴⁷

GATT was signed by twenty-three nations on October 30, 1947 and took effect January 1, 1948.⁴⁸ The U.S. and Canada were initial signatories of the agreement, and Mexico joined August 24, 1986.⁴⁹

The GATT prohibits protectionist legislation except for government procurement. While Section 1 and Section 5 prohibits tariffs, trade quotas, and local content requirements for the private sector, Section 8 allows countries to require domestic preference for government procurement.⁵⁰⁵¹

Section 8 states "the provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale".⁵²

2. North American Free Trade Agreement:

The United States, in connection with Mexico and Canada, established the North American Free Trade Agreement (NAFTA) in 1994 in order to reduce trade barriers in North America. Article 301 of NAFTA includes an exemption for U.S. domestic

⁴⁵ The Federal Acquisition Regulation Section 25.4 2005

⁴⁶ James H. Snellson, Note, Can GATT Article III Recover From Its Head-on Collision With United States--Taxes on Automobiles?, 5 Minn. J. Global Trade 467 (1996).

⁴⁷ *Id.*

⁴⁸ Oct. 30, 1947, 61 Stat. pt. 5, at A-11 (1947), T.I.A.S. No. 1700, 55 U.N.T.S. 194 [hereinafter GATT].

⁴⁹ *Id.*

⁵⁰ GATT, art. III(1). https://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm

⁵¹ GATT, art. V

⁵² GATT, art. VIII(a)

preference legislation for goods and services contracts above minimum dollar value thresholds.⁵³

B. Countries with Exemptions to Domestic Preference Legislation

The United States' domestic preference requirements are subject to exemptions based on the World Trade Organization Government Procurement Agreement (WTO GPA), Fair Trade Agreements, and classification as a Least Developed Country. Products coming from the 129 countries covered under these agreements are able to bid for U.S. government contracts and be given the same consideration as domestic products. An important exception is the ARRA, a temporary stimulus package that made no exemptions for goods from other countries.

⁵³ More specifically, the current threshold is for contracts over “US\$25,000 for goods, US\$79,507 for general services and US\$10,335,931 for construction services.” This means the threshold is a floor, not a ceiling.

Annex 1001.2c
Country-Specific Thresholds
As between Canada and United States,

- (a) for any entity listed in the Schedule of Canada or of the United States in Annex 1001.1a-1, the applicable threshold for goods contracts, which may include incidental services such as delivery and transportation, shall be US\$25,000 and the equivalent in Canadian dollars, as the case may be;
- (b) Annex 1001.1c, except paragraphs 2 and 3 of that Annex for the purpose of calculating and converting the value of the threshold set out in subparagraph (a), does not apply to such goods contracts; and
- (c) Chapter Thirteen of the *Canada - United States Free Trade Agreement* shall govern any procurement procedures that began before January 1, 1994, and that Chapter is hereby incorporated and made a part of this Agreement solely for that purpose.

Figure 1. Map of Countries that are Exempt from U.S. Domestic Preference Legislation by Treaties

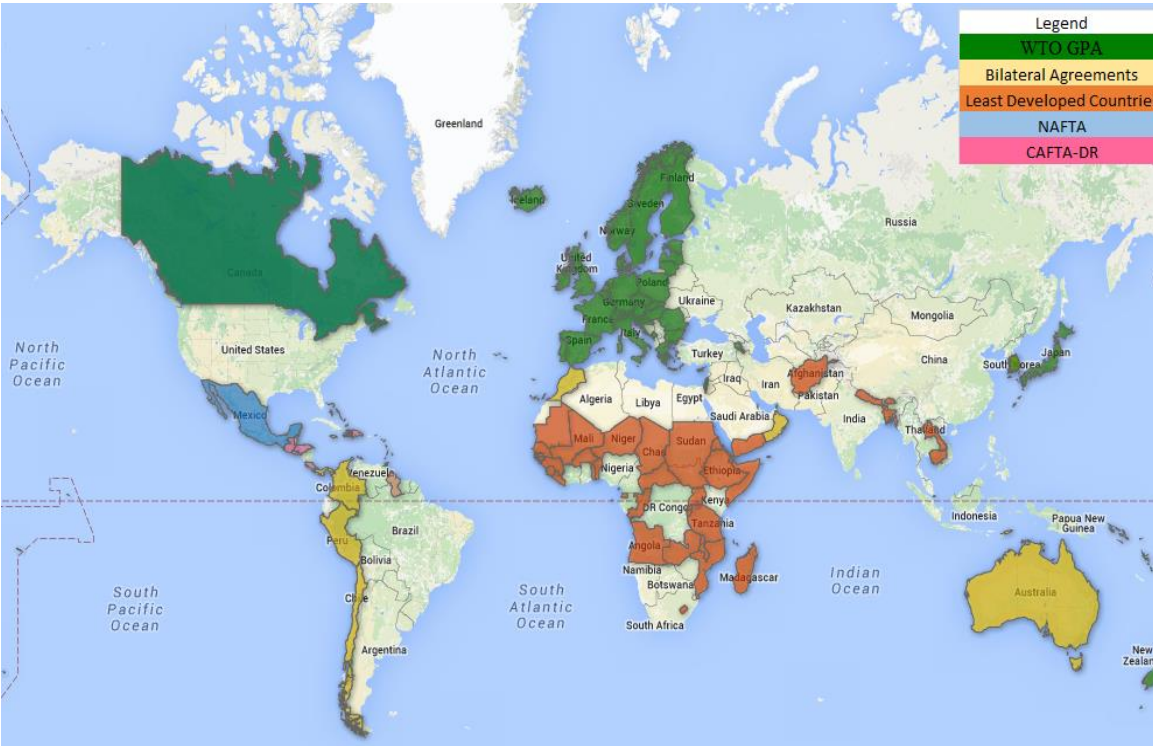


Figure 2. Table of Countries that are Exempt from U.S. Domestic Preference Legislation by Treaties

WTO GPA		
Armenia	Hong Kong	Netherlands
Aruba	Hungary	New Zealand
Austria	Iceland	Norway
Belgium	Ireland	Poland
Bulgaria	Israel	Portugal
Canada	Italy	Romania

Croatia	Japan	Singapore
Cyprus	Korea	Slovak Republic
Czech Republic	Latvia	Slovenia
Denmark	Liechtenstein	Spain
Estonia	Lithuania	Sweden
Finland	Luxembourg	Switzerland
France	Malta	Taiwan
Germany	Montenegro	United Kingdom
Greece		

North America Free Trade Agreement

Canada	Mexico
--------	--------

Bilateral Agreements

Chile	Bahrain	Colombia
Singapore	Oman	Israel
Australia	Peru	Panama
Morocco	South Korea	

Dominican Republic-Central America-United States Free Trade Agreement

Costa Rica	El Salvador	Honduras
Dominican Republic	Guatemala	

Caribbean Basin Trade Initiative

Antigua	Dominica	St. Lucia
Barbuda	Grenada	St. Vincent

Aruba	Guyana	The Grenadines
Bahamas	Haiti	Saint Eustatius
Barbados	Jamaica	Saint Maarten
Belize	Montserrat	Trinidad
Bonaire	Saba	Tobago
British Virgin Islands	St. Kitts	
Curacao	Nevis	

Least Developed Countries

Afghanistan	Gambia	Samoa
Angola	Guinea	Sao Tome
Bangladesh	Guinea-Bissau	Principe
Benin	Haiti	Senegal
Bhutan	Kiribati	Sierra Leone
Burkina Faso	Laos	Solomon Islands
Burundi	Lesotho	Somalia
Cambodia	Liberia	South Sudan
Central African Republic	Madagascar	Tanzania
Chad	Malawi	Timor-Leste
Comoros	Mali	Togo
Democratic Republic of Congo	Mauritania	Tuvalu
Djibouti	Mozambique	Uganda
Equatorial Guinea	Nepal	Vanuatu
Eritrea	Niger	Yemen
Ethiopia	Rwanda	Zambia

It is important to note that the domestic preference restrictions on government procurement do not depend on the country where a company is registered, but where its products are made. To be exempt, the end product must be manufactured in the United States or an exempt country from components substantially manufactured in the United States or an exempt country. Thus, firms from the United States or from exempt countries can still be subject to domestic preference requirements if they produce products outside of exempted countries. Alternatively, firms based in non-exempt countries may circumvent the requirements by producing in any of the exempt countries.

The following table shows the thresholds for each treaty's exemptions to the BAA. If contracts cost less than this amount, but more than \$3,000, then the Act applies to goods from the country. Above each threshold, the country's goods are given equal consideration to goods from the United States.

Figure 3: Thresholds for Exemptions to the Buy American Act

Trade Agreement	Supply Contract (equal to or exceeding)	Service Contract (equal to or exceeding)	Construction Contract (equal to or exceeding)
WTO GPA	\$204,000	\$204,000	\$7,864,000
FTAs			
Australia FTA	79,507	79,507	7,864,000
Bahrain FTA	204,000	204,000	10,335,931
CAFTA-DR (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua)	79,507	79,507	7,864,000
Chile FTA	79,507	79,507	7,864,000
Colombia FTA	79,507	79,507	7,864,000
Korea FTA	100,000	100,000	7,864,000
Morocco FTA	204,000	204,000	7,864,000
NAFTA			
—Canada	25,000	79,507	10,335,931
—Mexico	79,507	79,507	10,335,931
Oman FTA	204,000	204,000	10,335,931
Panama	204,000	204,000	7,864,000
Peru FTA	204,000	204,000	7,864,000
Singapore FTA	79,507	79,507	7,864,000
Israeli Trade Act	50,000	—	—

C. Exclusion as a Tool of Foreign Policy

Domestic preference legislation seems to be used as a tool of foreign policy to exclude certain countries from U.S. government contracts.⁵⁴ Given that there are 129

⁵⁴ See Richard N. Cooper, Trade Policy Is Foreign Policy, 9 Foreign Policy 18, 18 (Winter 1972-1973). "Historically trade issues frequently intruded into, and occasionally even dominated ... foreign policy among countries." *Id.* at 19

countries with exemptions out of nearly 200⁵⁵ in the world, it appears that the legislation is targeted at the countries it excludes, rather than the countries it exempts. Of the excluded countries, the ones with the highest exports per capita (in order of magnitude) are China, Russia, United Arab Emirates, India, Saudi Arabia, and Brazil.⁵⁶

D. Potential for Retaliation

The United States' domestic preference legislation, which is the most stringent domestic preference legislation in the developed world, creates the potential for retaliatory legislation.⁵⁷ The United States is one of the top five countries worldwide with the most protectionist policies implemented since 2008.⁵⁸ The Centre for Trade and Economic Integration describes protectionist policies as "contagious," stating that once a country enacts protectionist policies, others are likely to follow. This increases the amount of economic inefficiencies, hurting not only the United States, but also Canada and Mexico. In 2014, Canada and other countries expressed concerns about U.S. protectionist policies, especially the BAA, during the WTO's biannual Trade Policy Review of the United States. They stated that the Act distorts the playing field for imported products.

The ARRA's domestic preference requirements created anger and condemnation from Canadian stakeholders.⁵⁹ Many groups pushed the Canadian government to retaliate with an equivalent protective measure, though the Canadian government resolved the issue through negotiations and did not heed the calls for retaliation in the end.⁶⁰

⁵⁵ There is some controversy over the number of countries, but there are at least 189 that are universally recognized and including marginally recognized countries the number becomes 196.

⁵⁶ "COUNTRY COMPARISON :: EXPORTS." *Central Intelligence Agency*. Central Intelligence Agency, n.d. Web. 23 Apr. 2016. <<https://www.cia.gov/library/publications/the-world-factbook/rankorder/2078rank.html>>.

⁵⁷ Noorzoy, M. S. (1968). "Buy American" as an Instrument of Policy. *The Canadian Journal of Economics/Revue canadienne d'Economie*, 1(1), 96-105.

⁵⁸ Centre for Economic Policy Research. (n.d.). Statistics for Category: Implementing Jurisdiction. Retrieved May 03, 2016, from <http://www.globaltradealert.org/site-statistics/table/3>

⁵⁹ Hale, G. (2010). The 'Buy American' Controversy: A Case Study in Canada-US Trade Relations. *document de travail, Portal for North America, The Centre for International Governance Innovation, Waterloo, Canada, mars*.

⁶⁰ Turi, P. G. (2011). Begging Their Neighbour: Understanding Canada's Limited Options in Resolving Buy America. *Can.-USLJ*, 35, 237.

E. Damages U.S. International Reputation as Free Trade Advocate

Politicians and executive officials in the United States often make statements supporting free trade,⁶¹ but U.S. policy does not always reflect this approach. As mentioned previously, the United States is in the top five for countries with the most protectionist trade policies, and its procurement restrictions are more explicit than those found in any other country.⁶² Inconsistency between U.S. policies and its promotion of a world order based on free trade thus undermines the United States' international reputation and credibility.

This legislation engenders resentment against the United States, detracting from its desired reputation as a proponent of free markets. While the United States pushes other countries to remove their trade barriers, it contradicts its stance by maintaining severe trade barriers.⁶³ In maintaining these practices, the United States presents an anti-foreign face to the rest of the world⁶⁴ and loses its "high moral ground" on free trade.⁶⁵

The Gray Report, commissioned by President Eisenhower on the effects of the BAA, found that the Act is "in direct conflict with the basic foreign economic policies of the United States."⁶⁶ Additionally, the Randall Commission recommended liberalizing U.S. trade policies, including the BAA, condemning it "in concept and consequence."⁶⁷

⁶¹ Alvarez, J. E. (1996). Critical Theory and the North American Free Trade Agreement's Chapter Eleven. *U. Miami Inter-Am. L. Rev.*, 28, 303. *See also*. Bush, G. W. (2009). *The national security strategy of the United States of America*. 25-30 Wordclay.

⁶² Linda Weiss & Elizabeth Thurbon (2006) *The business of buying American: Public procurement as trade strategy in the USA*, *Review of International Political Economy*, 13:5, 701-724, DOI: 10.1080/09692290600950597

⁶³ Linda Weiss & Elizabeth Thurbon (2006) *The business of buying American: Public procurement as trade strategy in the USA*, *Review of International Political Economy*, 13:5, 701-724, DOI: 10.1080/09692290600950597; Gantt, P. H., & Speck, W. H. (1958). Domestic v. Foreign Trade

Problems in Federal Government Contracting: Buy American Act and Executive Order. *J. Pub. L.*, 7, 378.

⁶⁴ Knapp, L. A. (1961). The Buy American Act: A Review and Assessment. *Columbia Law Review*, 61(3), 430-462.

⁶⁵ Gantt, P. H., & Speck, W. H. (1958). Domestic v. Foreign Trade Problems in Federal Government Contracting: Buy American Act and Executive Order. *J. Pub. L.*, 7, 378.

⁶⁶ Knapp, L. A. (1961). The Buy American Act: A Review and Assessment. *Columbia Law Review*, 430-462.

⁶⁷ Knapp, L. A. (1961). The Buy American Act: A Review and Assessment. *Columbia Law Review*, 430-462.

VI. Effects on Federal Deficits

A. Costs of Increased Deficits

As domestic preference legislation mandates that the United States pay more for most goods, it likely increases deficits. The costs of these deficits, in turn, must ultimately be borne by one of three groups: the taxpayer whose taxes must be increased, the recipient of government services (all people residing in the United States) who must experience a decrease in services, or all people connected to the U.S. economy. The economy would be impacted because increased debt makes it unstable, slows investment, and leaves a larger debt burden to future generations.⁶⁸ In the commission created by President Eisenhower, the resulting Bell Report found that the government was paying more for goods, and the Act was essentially equivalent to a tariff on goods used by the government.⁶⁹ The Randall Commission then found that the BAA “was costing the United States government up to \$100,000,000 annually in higher prices, and another \$100,000,000 in foregone customs revenues.”

B. Indeterminate How Many Firms Would Choose to Sell to U.S. Government

A limitation to domestic preference legislation’s effects is that federal contracting is prohibitively complicated for foreign firms. The Federal Acquisition Regulation (FAR) is nearly 2,000 pages long, necessitating specialists in U.S. federal acquisitions to be able to interpret it. Especially for someone whose native language is not English, it can be a prohibitive obstacle to bidding for U.S. procurement contracts. In-depth field research could help elucidate how prepared firms around the world are to compete for and win U.S. federal contracts, as well as how interested they are in competing for such contracts.

On one extreme is the possibility that no firms operating in non-exempt countries would attempt to sell to the U.S. government without domestic preference legislation. In this case, the legislation has no effects on federal deficits. On the other extreme, in the absence of the legislation firms operating in non-exempt countries would bid for and win every single contract that they are now not eligible for. The actual number of contracts that would be awarded differently in the absence of this legislation is unlikely to be at either extreme, but the exact number is unclear.

⁶⁸ Trainor, C. W. (1974). Buy American Act: Examination, Analysis and Comparison, *The. Mil. L. Rev.*, 64, 101.

⁶⁹ Knapp, L. A. (1961). The Buy American Act: A Review and Assessment. *Columbia Law Review*, 430-462.

C. Our Calculation of the Maximum: \$2 billion Increase in Federal Deficits / Year

In seeking to evaluate the magnitude of the impact on deficits, we estimated the maximum possible impact using 2007 data from the Federal Procurement Data System.⁷⁰ The data on the value of contracts unavailable to foreign firms due to domestic preference legislation does not exist because the contracting process intentionally does not release information on who fails to secure contracts. Even more difficult to determine is the value of contracts that foreign firms would have won in the absence of domestic preference legislation. Thus, we attempted to establish the maximum value of contracts that foreign firms were unable to apply for. One of the assumptions was that federal contract bidding is a perfectly competitive, neoclassical market, meaning that there are a large number of firms wishing to compete for the contracts who all have full information about the contract. Under this assumption, domestic firms will price bids higher than they would otherwise because of the reasonableness of costs thresholds. When domestic firms know that foreign firms cannot win the bid unless their prices are six percent or twelve percent lower, the domestic firms will charge just under six percent or twelve percent more than they would otherwise to still win the bid.

The resulting estimate of the maximum amount that it could cost is \$2 billion. In reaching this number, the different thresholds of the reasonableness of costs tests for small and large business firms were taken into account. This estimate still suffers from the following biases:

1. Available data includes contracts above NAFTA thresholds that are excluded from domestic preference regulation.
2. Competition between domestic firms would probably not allow a domestic firm to capture the full six percent or twelve percent over a foreign firm allowed by the reasonableness of cost test.
3. The data is not available to tell how many of the excluded contracts were awarded to large and small businesses. It is likely that most of them went to large businesses, making the percentages used to divide the contracts inaccurate.

The methodology for estimating the cost estimate is included in Appendix D.

⁷⁰ FPDS 2007

VII. Effects on Federal Contracting

A. Impact Statement

In 2015, the United States government spent \$437.9 billion on contracts. Contracting averaged 15.5 percent of the government's budget from 2010-2015.⁷¹ With 3.8 million contracts in FY 2015, federal government procurement represents a substantial amount of government spending activity.⁷² Defense spending makes up a large majority of contract spending. In 2014, defense spending was 66 percent of all contracts, with civilian agencies making up the other 34 percent. That means approximately \$148.7 billion in contracts is subject to domestic preference requirements, with the rest being subject to the military's more restrictive provisions.

B. Purpose of Federal Contracting Processes

The purpose of government procurement is not to get the most economically efficient price for goods. Instead, its focus surrounds three principles: system transparency, procurement integrity, and competition.⁷³ An important goal it is to ensure that money is being equitably dispersed to different producers within the United States.

C. Arbitrary Application Undermines Goals of Federal Contracting

The cases analyzing the BAA demonstrate an arbitrary application of the Act. The courts suggest that the Act has been arbitrarily applied due to not clearly defining "manufacturing" and the requirement that products must be made from at least 50 percent components manufactured domestically. The arbitrary application of the Act undermines the goals of federal contracting by lacking transparency and integrity.

The definition of a domestic end product determines which products are given preference based on the location of manufacturing. The Act defines it as goods manufactured in the United States with 50 percent of the cost of their components also manufactured in the United States. Courts have interpreted this to mean that only

⁷¹ USASpending.gov. (2016). OVERVIEW OF AWARDS BY FISCAL YEAR. Retrieved from <https://www.usaspending.gov/>.

⁷² USASpending.gov. (2016). OVERVIEW OF AWARDS BY FISCAL YEAR. Retrieved from <https://www.usaspending.gov/>.

⁷³ Schooner, S. L. (2002). Desiderata: Objectives for a System of Government Contract Law. *Public Procurement Law Review*, 2-3.

the last two stages of manufacturing need to take place domestically. As a result, all other manufacturing stages may take place outside the United States. For example, a contractor could have only the last two manufacturing stages take place in the United States and the goods would comply with the Act without regard to where the antecedent stages of manufacture occurred. This would render earlier manufacturing stages irrelevant to the application of the Act.

In addition to this two-stage loophole, the lack of a clear definition of manufacturing leads to arbitrary applications of the Act. Two cases demonstrate how the Act has been applied inconsistently. In Comptroller Opinion (1969),⁷⁴ the product was deemed a foreign end product because its components were deemed to be foreign even though the supplier used three manufacturing processes in the United States on foreign components to produce cylinder liners. In contrast, in the *Re Davis Walker* (1976)⁷⁵ case, the product was deemed a domestic end product after undergoing two manufacturing stages in the United States. The supplier convinced the court the last two manufacturing steps had taken place in the United States by defining its process in discrete steps. The cases are substantially the same yet they have different outcomes, showing how the Act has been inconsistently applied. The court stated that the lack of a definition of 'manufacturing' prevents the legislation from achieving its purpose.

Because the legislation is ambiguous, there has been a large amount of inconsistency in application over time and across agencies as well as individual cases.⁷⁶ Interpreting this complex and diffusive legislation can be a deterrent to companies interested in competing for U.S. federal procurement contracts. An examination of the GAO's records shows the amount of legal confusion around the BAA. Most recently, the GAO ruled on a case in 2010 in which an agency had not considered bids from a country that should be exempt under the WTO.⁷⁷ In another typical case of confusion, in 1987 a contract was granted to a German firm and then withdrawn, and GAO investigated to find that the firm and the agency both misunderstood the intricacies of the act.⁷⁸

⁷⁴ 48 Comp. Gen. 727

⁷⁵ 76-2 Comp.Gen. Proc.Dec. P. 182

⁷⁶ Knapp, L. A. (1961). The Buy American Act: A Review and Assessment. *Columbia Law Review*, 430-462.

⁷⁷ "Decision: Matter Of: HID Global, Inc. File: B-403103." (2010): n. pag. Government Accountability Office. Web. 18 Apr. 2016. <<http://www.gao.gov/decisions/bidpro/403103.pdf>>.

⁷⁸ "BUY AMERICA REQUIREMENTS Federal Enforcement Questioned in Sacramento Mass Transit Procurement." *Fact Sheet for the Chairman, Subcommittee on Investigations and Oversight, Committee on Public Works and Transportation, House of Representatives* (1987): n. pag. Government Accountability Office. Web. 18 Apr. 2016. <<http://www.gao.gov/assets/90/87800.pdf>>.

Additionally, in 1996, the GAO was asked to help a federal agency understand whether it's contracting violated domestic preference legislation or not⁷⁹. The GAO has been asked to clarify whether domestic preference requirements apply to a bid retroactively many times over the years, leading to disincentives for foreign firms to apply for contracts that they are eligible for, to agencies discriminating against foreign firms without a legal basis, and to substantial waste as contracts are awarded and then withdrawn.

There are many different ways in which the legislation is unclear. When a product is made of many different parts, some of which are foreign, it's hard to tell what percentage of the cost of the product is for foreign goods, leading to bureaucratic nightmares and ambiguity.⁸⁰ It also isn't clear if "articles, materials, and supplies" includes the machinery used to produce goods, or items like books (the Comptroller held for years that books weren't included because they weren't supplies, and later that decision was reversed).⁸¹ Third, the original act was unclear on what would make the "difference in cost unreasonable" and it was established over time (with some variation) that it would be 25 percent, and it was also unclear whether the difference would include the tariffs that foreign companies pay and this changed over time and differed by agency.⁸² The way the BAA is administered often defeats its purpose, and administrative complexity prevents it from being efficiently applied.⁸³ Before the executive order that clarified confusion about what constituted an end product, this was decided arbitrarily in different cases; only the costs of physical components at the end stages are to be considered, and the labor, transportation, etc. must be excluded.⁸⁴

D. High Administrative Burden Undermines Competitiveness

Finally, the administrative burden of the legislation is high due to the extreme complexity of the legislation, with different pricing cutoffs of exemptions for different countries, different products having special exemptions, and different agencies

⁷⁹ "GAO/GGD-97-20R Buy American Act." (1996): n. pag. Government Accountability Office. Web. 18 Apr. 2016. <<http://www.gao.gov/assets/90/86071.pdf>>.

⁸⁰ Gantt, P. H., & Speck, W. H. (1958). Domestic v. Foreign Trade Problems in Federal Government Contracting: Buy American Act and Executive Order. *J. Pub. L.*, 7, 378.

⁸¹ Gantt, P. H., & Speck, W. H. (1958). Domestic v. Foreign Trade Problems in Federal Government Contracting: Buy American Act and Executive Order. *J. Pub. L.*, 7, 378.

⁸² Gantt, P. H., & Speck, W. H. (1958). Domestic v. Foreign Trade Problems in Federal Government Contracting: Buy American Act and Executive Order. *J. Pub. L.*, 7, 378.

⁸³ Trainor, C. W. (1974). Buy American Act: Examination, Analysis and Comparison, *The. Mil. L. Rev.*, 64, 101.

⁸⁴ Trainor, C. W. (1974). Buy American Act: Examination, Analysis and Comparison, *The. Mil. L. Rev.*, 64, 101.

having to apply different rules. As a result, firms without the resources for federal procurement specialists will often be unable to compete.

VIII. Effects on Distribution of Wealth

A. Between Canada and Mexico

Though Canada and Mexico are both exempt from the United States' domestic preference requirements due to NAFTA, they are still affected by it. Companies from Canada and Mexico cannot apply for contracts below certain dollar thresholds. In the range of contracts to which domestic preference legislation would apply, Canada is more disadvantaged than Mexico by domestic preference legislation because of higher wages. Canada's manufacturing compensation cost is similar to the United States' cost; in 2012, Canada's manufacturing employee labor cost was \$36.59 and the United States' was \$35.67, making it difficult for Canadian firms to bypass the United States' domestic preference legislation through the reasonableness of cost exemption, under which it would have to produce much cheaper products. This allows for domestic bidders' costs to be 6-12 percent higher than Canadian producers' bids.⁸⁵ In contrast, Mexico's hourly compensation cost is \$6.36, almost \$30 less per hour, making it more probable for a product manufactured in Mexico to be chosen over a product made in the United States due to the reasonableness of cost test.⁸⁶

B. Between Segments of American Workforce

Domestic preference legislation partially addresses a government procurement goal to distribute wealth across the workforce. The BAA was meant to "diffuse the benefits of the program over the nation", ⁸⁷ as argued by Mr. Pugh of the Common Brick Manufacturers Association of America.

Specifically, domestic preference legislation is a mechanism to redistribute wealth to low-skilled workers. Despite the economic benefits of removing trade barriers, this does have a distributional effect, meaning that it creates winners and losers in society. Evidence suggests "trade liberalization does have a systematic disadvantaging effect on one particular group of workers in rich countries: unskilled workers who are challenged by imports from developing countries."⁸⁸ Because free trade has led to the

⁸⁵ Bureau of Labor Statistics (2013). International Comparisons of Hourly Compensation Costs in Manufacturing, 2012.

⁸⁶ *Id.*

⁸⁷ Trainor, C. W. (1974). Buy American Act: Examination, Analysis and Comparison, *The. Mil. L. Rev.*, 64, 101.

⁸⁸ Daniel A. Zaheer, *Breaking the Deadlock: Why and How Developing Countries should Accept Labor Standards in the WTO*, 9 *Stan. J.L. Bus. & Fin.* 69, 87-88 (2003)., See Adrian Wood, How Trade Hurt Unskilled Workers, in *INTERNATIONAL TRADE AND LABOR MARKETS* 140, 144-145

erosion of the U.S. manufacturing sector, and thus the employment available to low-skilled workers, restricting trade is seen as a way to keep manufacturing jobs in the United States.

The United States has lost seven million manufacturing jobs to low wage countries. The peak for U.S. manufacturing jobs was in 1979 at 19.4 million.⁸⁹ In the 1960s, one out of three U.S. jobs was in manufacturing; today it is down to one in ten.⁹⁰ In addition, the effects of this structural change are not distributed evenly across the labor force. Those most likely to lose their jobs have less than a high school education,⁹¹ and industries that are less threatened are older and more capital intensive.⁹² This decrease has been caused by competition from low wage countries.⁹³ While recessions also affect the employment rate, one study found that most of the 1.5 million manufacturing jobs lost in 2001 were not caused by the recession.⁹⁴ Rather, it was largely caused by trade agreements with China, a low wage country.⁹⁵

However, given that the wage difference between the United States and developing countries can be larger than \$30 an hour,⁹⁶ it is unlikely that domestic end products can pass the reasonableness of cost test against many of these products. This implies that the Act does not protect jobs in low-skilled manufacturing.

With regard to “intermediate levels of trade barriers it turns out that reductions in barriers lead to a progressive reduction in the number of firms in the small country.”⁹⁷

⁸⁹ Bureau of Labor Statistics (2016). Employment, Hours, and Earnings from the Current Employment Statistics survey (National).

⁹⁰ Kemeny, T., Rigby, D., & Cooke, A. (2015). Cheap Imports and the Loss of US Manufacturing Jobs. *The World Economy*, 38(10), 1555-1573.

⁹¹ Kemeny et al., 2015

⁹² Kemeny et al., 2015

⁹³ Kemeny et al., 2015

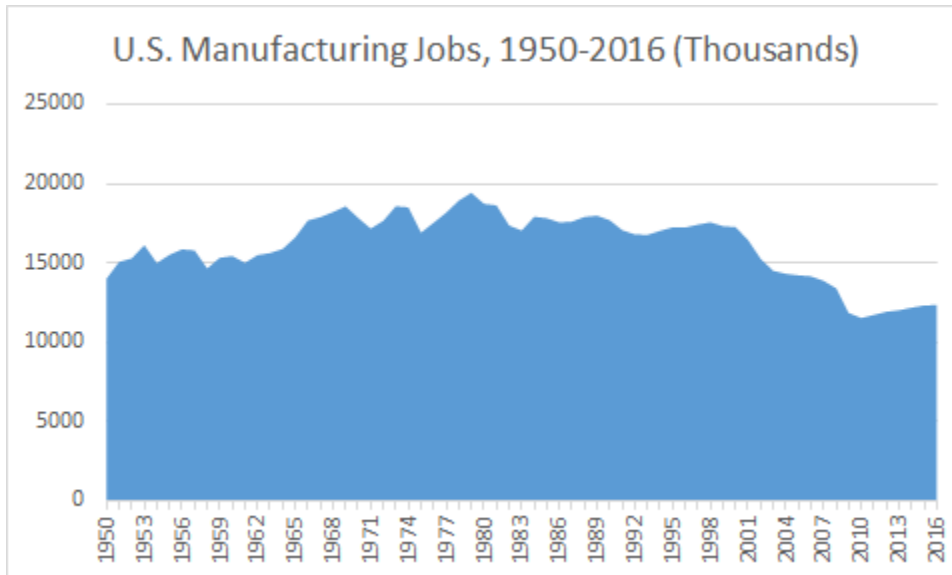
⁹⁴ Pierce, J. R., & Schott, P. K. (2012). The surprisingly swift decline of U.S. manufacturing employment (No. w18655). National Bureau of Economic Research.

⁹⁵ Pierce & Schott, 2012

⁹⁶ Bureau of Labor Statistics (2013). International Comparisons of Hourly Compensation Costs in Manufacturing, 2012.

⁹⁷ Unity with Diversity in the European Economy: The Community's Southern Frontier 66 (Christopher Bliss & Jorge Braga de Macedo eds. 1990).

Figure 4. U.S. Manufacturing Jobs, 1950-2016



An analysis of the ARRA's effect on the number of jobs in the steel industry is illustrative here. This analysis, written based on a version of the ARRA while it was under consideration, estimated that the act would translate into around 1,000 jobs in the steel industry. Because the industry is very capital intensive, a large amount of steel would only be correlated with a small amount of jobs.⁹⁸ It would also be detrimental to the United States' relations with other countries and raise the price of U.S. steel, lowering the United States' ability to export steel, and this could potentially result in a much larger amount of jobs lost.⁹⁹

This suggests that, though protecting the American worker is certainly a laudable goal, domestic preference legislation is not the most efficient or effective means of achieving it.¹⁰⁰ In forming trade policy, the government should consider the groups who are disadvantaged by free trade and who must be compensated in order to make the policy equitable and politically feasible. Though the more economically productive solution would be to allow free trade and use some of the gains to compensate low-skilled workers, perhaps through job training and transitional

⁹⁸ Hufbauer, G. C., & Schott, J. J. (2009). *Buy American: bad for jobs, worse for reputation*. Peter G. Peterson Institute for International Economics.

⁹⁹ Hufbauer, G. C., & Schott, J. J. (2009). *Buy American: bad for jobs, worse for reputation*. Peter G. Peterson Institute for International Economics.

¹⁰⁰ Knapp, L. A. (1961). The Buy American Act: A Review and Assessment. *Columbia Law Review*, 430-462.

welfare, there doesn't seem to be the political will to compensate them for their losses.

C. Between Domestic Industries

One common argument for domestic preference legislation is that it allows a domestic industry protected access to lucrative government contracts. Members of Congress desire this if an industry's powerful lobby supports them or if many of their constituents are employed by a particular industry.^{101 102}

¹⁰¹ Weiss, L., & Thurbon, E. (2006). The business of buying American: Public procurement as trade strategy in the USA. *Review of International Political Economy*, 13(5), 701-724.

¹⁰² Trainor, C. W. (1974). Buy American Act: Examination, Analysis and Comparison, The. *Mil. L. Rev.*, 64, 101.

IX. Determinants of Support for Free Trade

The determinants for public support for free trade provide evidence for policy reform. Those wishes to enact policy change should do so during a strong economy and partner with the political party of the President.

A. Strong Economy

The strength of the U.S. economy is the main determinant of the public's perception on trade. A strong economy is correlated with increased positive perceptions on trade for all education and income levels.^{103 104}

B. Higher Education Level

Positive perception of foreign trade is correlated with education levels.¹⁰⁵ Those with higher levels of education are significantly more likely to see trade as an "opportunity for the U.S."¹⁰⁶ It can be assumed those with low education levels feel less positive about foreign trade because they must compete with foreign workers.

In 2014, a college graduate was 16 percentage points more likely to support trade than a person with high school or less than high school education.¹⁰⁷ Even when positive perceptions of trade were less common across all education levels as a result of the 2008-2009 recession, college graduates' perceptions were more than 20 percent points higher.¹⁰⁸

C. Higher Income

Support for free trade also varies based on income levels. Individuals with higher levels of income are more likely to say that free trade has "helped family's

¹⁰³ McCarthy, Justin. (2015, MARCH 9). Majority In U.S. Still See Opportunity In Foreign Trade. Retrieved from http://www.gallup.com/home.aspx?g_source=logo

¹⁰⁴ Pew Research Center, 27 May 2015. "Free Trade Agreements Seen as Good for U.S., But Concerns Persist." Web. 17 Nov. 2015.

¹⁰⁵ McCarthy, Justin. (2015, MARCH 9). Majority In U.S. Still See Opportunity In Foreign Trade. Retrieved from http://www.gallup.com/home.aspx?g_source=logo

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

finances".¹⁰⁹ The difference between those with incomes above \$100,000 and those with incomes under \$30,000 is 15 percentage points.¹¹⁰

D. Political Party

Recent data imply that political parties may change their views on trade based on which party holds the White House. Throughout George W. Bush's presidency from 2001-2009, Republicans perceived trade more positively than Democrats.¹¹¹ After Bush's successor, Barack Obama took office, the two parties switched perspectives on trade.¹¹²

E. Public and Government Define "American" Companies Differently

Support for protectionist policies is possibly more emotional than rationally based. The public's identification of "patriotic" brands is not correlated with whether those brands produce their products in the United States. This could be because the public is unaware of the actual practices of the companies or because the public does not define patriotism based on where a company manufactures its products. Understanding the reason that the public considers a brand "patriotic" is significant because 76 percent of respondents support protectionist legislation on the grounds of patriotism.¹¹³

The evidence of this phenomenon abounds. Many top companies in the annual survey of "Most Patriotic Brands in America" manufacture outside the United States. Jeep, which was perceived to be the most patriotic brand, started production in four continents last year.¹¹⁴ Cars.com's list of cars with at least 75 percent American made parts has been steadily decreasing since 2010.¹¹⁵ Jeep and Ford, which is sixth on most patriotic list, do not make the list of cars with 75 percent American made

¹⁰⁹ Pew Research Center. (2014). "Does trade with other countries lead to job creation in (survey country), job losses, or does it not make a difference?", Spring 2014. Retrieved from <http://www.pewglobal.org/question-search/?qid=1890&cntIDs=&stdIDs=>

¹¹⁰ *Id.*

¹¹¹ McCarthy, Justin. (2015, MARCH 9). Majority In U.S. Still See Opportunity In Foreign Trade. Retrieved from http://www.gallup.com/home.aspx?g_source=logo

¹¹² *Id.*

¹¹³ Harris Interactive "In terms of buying American products, how important are each of the following to your purchase decision?" Survey. Polling the Nation. 6 March 2013. Accessed online. 9 October 2015.

¹¹⁴ Snavely, Brent. "Jeep: From Made in America to Made on Four Continents." Detroit Free Press. Detroit Free Press, 2 Mar. 2015. Web. 20 Nov. 2015.

¹¹⁵ Mays, Kelsey. "The 2015 American-Made Index." Cars.com. Cars.Com, 28 June 2015. Web. 20 Nov. 2015.

parts.¹¹⁶ Ralph Lauren, fourth most “patriotic” brand, also manufactures outside the United States.¹¹⁷ This demonstrates public support of domestic preference legislation is not completely based on manufacturing practices.

¹¹⁶ *Id.*

¹¹⁷ Passariello, Christina, Tripti Lahiri, and Sean McLain. "What Do Armani, Ralph Lauren and Hugo Boss Have in Common? Bangladesh." *WSJ*. Wall Street Journal, 1 July 2013. Web. 20 Nov. 2015.

X. Effects on National Security

Security, in the form of self-sustainability in the context of international conflicts, is often cited as an important reason for domestic preference legislation. If the United States were to enter a war with a country that supplied a crucial product, it would no longer be able to access that product and would not have the domestic capacity to produce it. This could undermine its ability to wage war and its ability to maintain a functioning economy. For this reason, proponents of trade barriers suggest that trade barriers would protect industries making critical war materials,¹¹⁸ which would protect a country's ability to produce these goods during times of conflict. A minority report commissioned by Eisenhower thus endorsed the act for "ensuring that the United States has basic industries and services essential in both peace and war."¹¹⁹ This is the rationale behind the Berry Amendment, which is the domestic preference requirement for the Department of Defense.¹²⁰ However, surveys¹²¹ and "theorists in the field of international relations have observed that military conceptualizations of national security are obsolete analytical tools for understanding global processes."¹²²

Additionally, a better functioning government and a more productive economy are essential for national security. The unprecedented prosperity of the modern economy is based on it being very interconnected and interdependent, and any attempt at full self-sufficiency would require losing the economic benefits of trade. As a result, there is a tradeoff between self-sufficiency and economic productivity that must be balanced to maximize national security.

¹¹⁸ C. Jeffrey Tibbels, *SECOND ANNUAL ACADEMIC CONVOCATION : Delineating the Foreign Affairs Function in the Age of Globalization*, 23 Suffolk Transnat'l L. Rev. 389, 405 (1999).

¹¹⁹ Trainor, C. W. (1974). Buy American Act: Examination, Analysis and Comparison, *The. Mil. L. Rev.*, 64, 101.

¹²⁰ 24 Pac. McGeorge Global Bus. & Dev. L.J. 303 (2011)

¹²¹ See generally, Cletus C. Coughlin et al., Protectionist Trade Policies: A Survey of Theory, Evidence, and Rationale, in *INTERNATIONAL POLITICAL ECONOMY: PERSPECTIVES ON GLOBAL POWER AND WEALTH* 330-31 (1995)

¹²² See Richard Falk, The Critical Realist Tradition and the Demystification of Interstate Power: E.H. Carr, Hedley Bull and Robert Cox, in *INNOVATION AND TRANSFORMATION IN INTERNATIONAL STUDIES* 39-55 (Stephen Gill & James H. Mittelman eds., 1997) Falk contrasts "theories of various scholars in approaching globalization and nation-state". Moreover, "[t]raditional security interests are no longer the main anxiety of the nation state; national security is now intertwined with vital environmental, social, and economic concerns." *SECOND ANNUAL ACADEMIC CONVOCATION : Delineating the Foreign Affairs Function in the Age of Globalization*, 23 Suffolk Transnat'l L. Rev. 389, 405 fn. 82 (1999). See also. SUSAN STRANGE, *THE RETREAT OF THE STATE: THE DIFFUSION OF POWER IN THE WORLD ECONOMY* 33 (1996).

XI. POLICIES OPTIONS

A. Status Quo: Keeping Domestic Preference Legislation in Place

The first option is leaving the legislation in place. As this report has shown, it has major costs that seem to outweigh its benefits. This is the worst choice for our goal of economic efficiency, medium for the goal of distributional equity, and the best choice for political feasibility, given that existing legislation is easiest to leave in place. Many stakeholder groups benefit from the legislation and will oppose policies that decrease its scope or impact.

B. Complete Elimination of Domestic Preference Legislation

This option entails removing all instances of domestic preference legislation, from the BAA to the Berry Amendment. For the goal of economic efficiency, this would work very well. However, for the goal of distributional equity this would be a poor choice, as it would further erode the job opportunities of low-skilled workers. For the goal of political feasibility this would be the worst choice, as it would require the support of policy makers with strong interests in maintaining the advantages enjoyed by their constituents in protected industries.

C. Negotiate Trade Agreements With Lower BAA Exemptions

This is the most balanced option as it recognizes the significant costs of domestic preference legislation, while acknowledging the intense support from the public, companies, and trade unions. The policy consists of leaving all domestic preference legislation in place, but lowering the contract value threshold of countries through new trade agreements. To increase political feasibility of new trade agreements, the concerns of those likely to lose their jobs must be addressed. This option involves establishing a commission to study the ways of mitigating the negative effects of removing the legislation.¹²³

This option is more economically efficient than the status quo because it limits the scope of domestic preference legislation, though it is less economically efficient than complete elimination of domestic preference legislation. Since the concerns of low-skilled workers are addressed, the distributional equity is equal to the status quo and much better than complete elimination of domestic preference legislation. Finally, political feasibility is moderate because there will not be strong opposition if stakeholders are compensated for their losses in conjunction with lowering the trade

¹²³ Autor, D. H. (2001). Wiring the labor market. *The Journal of Economic Perspectives*, 15(1), 25-40. Chicago

barriers, but making any change to laws is more politically difficult than leaving them in place.

XII. RECOMMENDATION

The optimal policy, based on our goals and criteria, is Option C: Negotiate Trade Agreements with Lower BAA Exemptions. The benefits of this policy are that it avoids strong political opposition and it leaves Department of Defense requirements in place, circumventing objections based on national security. It aligns free trade advocates with the political party of the President, whom generally support free trade. However, our analysis indicates that domestic producers, low-wage workers, and labor unions are likely to openly oppose this policy, unless they are compensated adequately. Thus, it is crucial to the recommendation that ways to address the concerns of those who will be harmed by the change should be incorporated into the new legislation. Organizations pursuing changing the legislation should incorporate these crucial stakeholders into the process of developing alternatives.

XIII. CONCLUSION

The United States has a complex set of regulations, known as domestic preference legislation, which limit the federal government's ability to buy products produced in other countries. However, 129 countries are exempt within varying price thresholds, leaving only 66 countries restricted from selling to the US government.

The legislation causes the United States government to pay more for equivalent goods and creates economic inefficiencies that outweigh the economic gains. It also strains the United States' relationships with other countries and contradicts its stance on free trade. However, despite domestic preference legislation's negative economic and foreign policy ramifications that outweigh its benefits, it has high political support from its beneficiaries, making its complete removal unlikely. It remains in place because it benefits some stakeholders who benefit from less competition for federal contracts.

Negotiating free trade agreements with lower Buy American exemption thresholds avoids strong political opposition from beneficiaries of domestic preference legislation, limits the scope of the legislation, and aligns free trade advocates with the political party of the President. While implementing this policy might be politically costly, it best balances economic efficiency, distributional equity, and political feasibility.

Appendix A. List of Other Domestic Preference Legislation¹²⁴

1. Procurement of Photovoltaic Devices: 10 U.S.C. § 2534 note
2. Workforce Investment Act and Other Funds: 20 U.S.C. §§ 9275
3. District of Columbia Mental Health Services Funds: 24 U.S.C §§ 225 et seq.
4. Indian Health Care Facilities: 25 U.S.C. §§ 1631 et seq.
5. Water Pollution Prevention and Control Grants for Construction of Treatment Works: 33 U.S.C. § §§ 1281 et seq.
6. Disaster Relief Funds: 42 U.S.C. § 5206
7. Local Public Works Grants: 42 U.S.C. § 6705(f)(1).
8. Other Department of Defense Buy American Requirements: 10 U.S.C. § 2534
9. Department of Homeland Security: 6 U.S.C. § 453b
10. Veterans' Burial Flags: 38 U.S.C. § 2301
11. Federal Crop Insurance Corporation: 7 U.S.C. § 1506(p)
12. Other Department of Agriculture Related Entities: 7 U.S.C. Ch. 98
13. Housing Assistance Programs: 12 U.S.C § 1735e-1
14. Small Business Financial Assistance Under the Small Business Act: 15 U.S.C. § 661
15. Arson Prevention Grants: 15 U.S.C. § 2221
16. Educate America Act: 20 U.S.C §§ 5801 et seq.
17. School Lunch Program Funds: 42 U.S.C. § 1760
18. Foreign Assistance Act of 1961: 22 U.S.C. § 2381
19. Engraving and Printing Currency, Postage Stamps, and Security Documents for Foreign Governments: 31 U.S.C. § 5114
20. Renewable Energy Technology Transfer Program: 42 U.S.C. § 13316
21. Clean Coal Technology Transfer Program: 42 U.S.C. § 13362
22. Environmental Technology Transfer Program: 42 U.S.C. § 13387

¹²⁴ Luckey, J. R. (2012). Domestic Content Legislation: The Buy American Act and Complementary Little Buy American Provisions.

APPENDIX B. DETAILED LEGAL ANALYSIS OF *UNITED STATES V. RULE INDUSTRIES, INC.*, 878 F.2d 535 (1989).

The seminal case for the Buy American Act is *United States v. Rule Industries, Inc.*¹²⁵ There are two reasons why this case is important. This is the highest-level court decision to guide our interpretation of the Act. The case shows that domestic preference legislation is unclear as to the terms “manufacture” and “component.”

A. PROCEDURAL POSTURE:

The government brought an action against Rule Industries (Rule) under the False Claims Act when it discovered that hacksaw blades being sold by Rule were made from foreign-made hacksaw blanks. The government argued, “the hacksaw blanks were a “component” of the hacksaw blades, and because the foreign-made blanks accounted for approximately 90 percent of the cost of all the hacksaw blade components, the blades were not a “domestic end product” as Rule had certified in the contract. Thus, the government alleged, defendants “knowingly present[ed], or cause[d] to be presented, to an officer or employee of the Government ... a false or fraudulent claim for payment or approval.”¹²⁶

The United States District Court for the District of Massachusetts originally heard this case. A jury found that Rule had violated the False Claims Act. Rule then appealed to the United States Court of Appeals for the First Circuit. The First Circuit held that the District Court acted properly in allowing the jury to apply the “fluid legal standards of the Buy American Act” to the facts of Rule’s manufacturing contract.

In reaching its decision to uphold the District Court’s ruling, the Court of Appeals first looked at the legal standard set out by the BAA to apply to this case.

B. FACTS:

The case’s facts originate in 1981 and 1982 when the U.S. General Services Administration (GSA) solicited bids for hacksaw blades. Any contract bids on the blades had to certify that the manufacture of the blades conformed to the BAA. Rule won the bid. In the contract, Rule certified that the hacksaw blades were domestic end products (i.e. conformed to the Act). Moreover, the space on the contract for any exemptions to the BAA was left blank on the certification. If Rule had not certified that

¹²⁵ *United States v. Rule Indus., Inc.*, 878 F.2d 535 (1st Cir. 1989).

¹²⁶ 31 U.S.C. § 3729(1).

the hacksaw blades were conforming to the BAA, Rule would have been subject to a 50 percent markup on its bid. Rule purchased hacksaw blanks from a Swedish and Japanese company in the form of thin strips of steel cut from coil steel. After purchasing the blanks, Rule cut out the blanks through a milling process at their United States plant in Gloucester, Massachusetts. Then Rule flame treated and tempered the blades. Then Rule painted, packaged, and supplied over 4.7 million-hacksaw blades to the GSA.

C. RULE OF LAW:

Discussing the rule in the case, the appellate court says, “this situation originates in the rather arbitrary standards and uncertain wording of the Act itself, a depression era law enacted in 1933 to create jobs for American workers and protect American industry.”¹²⁷ The Act permits “only such manufactured articles, materials, and supplies as have been manufactured in the United States substantially all from articles, materials or supplies mined, produced, or manufactured, as the case may be, in the United States, shall be acquired for public use. . . .”¹²⁸ This language opens the door to the use of foreign materials as long as they have been subjected to a certain amount of domestic manufacture.

Speaking more in depth, the appellate court continued, “The Act applies only to the last two stages: As the last stage, the end products acquired for public use must have been mined, produced or manufactured . . . in the United States. And as the next to the last stage, manufactured end products must have been manufactured from materials or components mined, produced, or manufactured in the United States.... If the supplier can introduce two stages of manufacture in the United States into the distribution process, he insulates earlier foreign mining, production, or manufacture from the application of the Act.”

Continuing on, the appellate court indicated that the Comptroller said, “In the case of manufactured products, the act is applied to the end product itself and to the

¹²⁷ See *Gantt & Speck, Domestic v. Foreign Trade Problems in Federal Government Contracting: Buy American Act and Executive Order*, 7 J.Pub.L. 378 (1958)

¹²⁸ 41 U.S.C. § 10a

components directly incorporated in the end product but is not applied to the supplies that are used in the manufacture of any such components.”¹²⁹¹³⁰

D. ANALYSIS:

Applying the law to the facts of the case, the Court started out with the rule for the two criteria for a product to be manufactured domestically. It stated that for Rule to succeed in conforming to the Buy American regulations that 1) the hacksaw blade, the end product, itself must have been "manufactured in the United States." The Court further stated, 2) the cost of the hacksaw blades' components "manufactured in the United States" must have accounted for more than 50 percent of the total cost of the components.

E. REASON BY ANALOGY:

After developing the legal standard for the case, the appellate court then performed an analysis of the case by applying the rule to the facts.

The appellate court started out with explaining the rule for the two criteria for a product to be manufactured domestically: "1) the hacksaw blade, the end product, itself must have been "manufactured in the United States". It further said, 2) the cost of the hacksaw blades' components "manufactured in the United States" must have accounted for more than 50 percent of the total cost of the components."

The appellate court said that as it appears at least the product was manufactured in accordance with regulation because the hacksaw blanks were processed in "milling, setting, flame-treating, tempering, and painting them." The other question is if the component was manufactured in the United States. In other words, were at least 50 percent of the components from the United States? Basically the Act and the Code of Federal Regulations (CFR) do not define manufacture or component. So then the court looked at the Comptroller, which has given limited guidance for deciding what is "manufacturing."

To reason by analogy, the appellate court looked to multiple decisions of the Comptroller.

¹²⁹ 45 Comp.Gen. 658 (1966). See, e.g., Hamilton Watch Co., Comp.Gen.Dec. B-179939, 74-1 Comp. Gen.Proc.Dec. P. 306 (1974) (watch was domestic end product even though American-made watch movement, the main component, was assembled entirely from foreign-made parts).

¹³⁰ *United States v. Rule Industries, Inc.*, 878 F.2d 535, 1989 U.S. App. LEXIS 8954, 35 Cont. Cas. Fed. (CCH) P75,678 (1st Cir. Mass. 1989).

In re Imperial Eastman Corp., (1974) the product was a tool kit and all the components of the tool kit. All the parts were foreign made, but the toolkit was put together in the United States. The meat of the case is the comment on component manufacturer: "if a manufacturing process performed on material results in a separately identifiable component that in turn is integrated into the end product being procured, the material does not constitute a component."¹³¹

In *In re Orlite Engineering Co.*, the court stated, "the basic test seems to be that if the operations performed on the foreign item create a basically new material or result in a fundamental change in the item, prior to incorporation into the end product, it becomes a component manufactured in the United States."¹³² ("The principal domestic content test is whether the domestic operations performed on a foreign item create a new item or result in some fundamental change in the item, prior to incorporation into the end product so that it then becomes a component manufactured in the United States.").

In its analysis, the Court juxtaposed two cases Comptroller Opinion: 48¹³³ and *In Re Davis Walker*.¹³⁴ In Comptroller Opinion: 48, "a domestic manufacturer imported Japanese forging and then subjected the foreign forging to three production processes (hone boring, chrome plating, machining) to produce the end product, cylinder liners."¹³⁵ The Comptroller General "...found that the cylinder liners were not domestic end products because they were made substantially from foreign components (the Japanese steel cylinder liner forging)." The reason for this is that the manufacturer failed the second prong of the test as the court explained, "it is clear that the articles, materials, or supplies which were incorporated into the end product during the overall manufacturing operation were substantially all foreign articles, materials, or supplies rather than domestic articles, materials or supplies as required by the act."

In contrast, in *In Re Davis Walker*, "the supplier imported steel rods from Japan and subjected the steel rods to two domestic production processes (drawing the rods into

¹³¹ *In re Imperial Eastman Corp.*, 53 Comp.Gen. 726 (1974).

¹³² *In re Orlite Engineering Co.*, 88-1 Comp.Gen.Proc.Dec. P. 300 (1988). See J. Cibinic & R. Nash, Formation of Government Contracts 633 (1982). D. Riley, *Federal Contracts Grants & Assistance* § 11.07, at 556 (1983)

¹³³ Comptroller Opinion: 48 Comp. Gen. 727 (1969).

¹³⁴ 76-2 Comp.Gen. Proc.Dec. P. 182 (1976).

¹³⁵ Comptroller Opinion: 48 Comp. Gen. 727 (1969).

"bright wire," and galvanizing the bright wire) to produce the end product, galvanized steel wire."¹³⁶ The comptroller general "found that the galvanized steel wire was a domestic end product. In doing so, the Comptroller General upheld the contracting officer's characterization of the bright wire as the component (the foreign steel rod was merely a "subcomponent"), and rejected the argument that "there is only one continuous [end product] manufacturing process involved in converting the Japanese steel rod into galvanized steel wire and that the component of the end product [was the] steel rod."

The court juxtaposed these two cases to show that under a similar set of facts, a different result can occur given the current ambiguity in the BAA. In fact, the court in *In Re Davis Walker*, (1976) tried to address this issue: "We believe this case illustrates the need for guidance in defining the term "manufacture" as used in the BAA so that procuring agencies will be able to insure that only domestic source end products are acquired for public use. Therefore, by letter of today to the director of the Defense Supply Agency, we are recommending that consideration be given to amending [the Armed Services Procurement Regulations] to define and clarify the requirement that items acquired for public use be "manufactured in the United States." ¹³⁷ Unfortunately, nothing came from this attempt to clarify: "The Comptroller General's letter was to no avail, however: the Department of Defense declined to amend the regulations."¹³⁸

F. CONCLUSION:

After its analysis, the Appellate court upheld the decision of the district court that the blades were not domestic end products because the strips of steel did not qualify as domestic components like in *In Re Davis Walker*. This case is important because it shows that Buy America legislation isn't clear. Comparing Comptroller Opinion 48, *In Re Davis Walker* and this case shows that a different result can occur under a similar set of facts. In each of these cases, the supplier purchased foreign metal products and refined those products in the U.S. to create the final product. Only one was found to comply with Buy America legislation. Adding to the confusion, the appellate court stated that whether the product is a domestic end product is an inquiry for the jury as a finder of fact. This adds to inconsistent results because there is little to guide the jury in their evaluation of the production processes. The court in *In Re Davis Walker* tried to address the ambiguity. They sent a letter to the director of the defense supply agency to clarify the "requirement that items acquired for public use be "manufactured in the United States."" There was no response.

¹³⁶ 76-2 Comp.Gen. Proc.Dec. P. 182 (1976).

¹³⁷ *In Re Davis Walker*, 76-2 Comp.Gen. Proc.Dec. P. 182 (1976)

¹³⁸ See *In re Scott Industries*, 79-1 Comp.Gen.Proc.Dec. P. 316 (1979).

APPENDIX C. EXAMINATION OF ACT AND INTERNATIONAL TREATIES

Authority of U.S. President to Sign GATT

"[A]n international agreement can become the law of the United States only if: (1) it is accompanied by the advice and consent of the Senate (a treaty), (2) it is authorized or approved by Congress and the matter falls within the constitutional authority of Congress (a Congressional-executive agreement), (3) it is authorized by a prior treaty which received the advice and consent of the Senate (an executive agreement pursuant to treaty), or (4) it is based on the President's own constitutional authority (a sole executive agreement)."¹³⁹

The GATT is not a treaty because it has not received Senate approval.¹⁴⁰ Instead it was issued as an Executive Order under President Truman.¹⁴¹ However, there was no Congressional authorization for the executive to make a treaty in 1947. Thus, arguably there must be a cross Executive-Congressional agreement to make GATT officially a treaty.¹⁴² However, "GATT is a valid executive agreement, entered into by the United States pursuant to authority of congressional legislation,"¹⁴³ because of "the authority granted by Congress to the President in section 350 of the Tariff Act of 1930 as amended by the Reciprocal Trade Agreements Act of 1934,¹⁴⁴ and further amended and extended¹⁴⁵ in 1945."¹⁴⁶

¹³⁹ Ronald A. Brand, "The Status of the General Agreement on Tariffs and Trade in United States Domestic Law," 26 Stan. J. Int'l L. 479, 482-483 (1990).

¹⁴⁰ See U.S. CONST. art. VI, cl. 2.

¹⁴¹ Protocol of Provisional Application, Oct. 30, 1947, 61 Stat. pt. 5 at A2051, T.I.A.S. No 1700, 55 U.N.T.S. 308, reprinted in IV BISD 77 (1969). See Proclamation No. 2761A, 12 Fed. Reg. 8863, 8866 (1947). Proclamations also accompanied the major amendments to the GATT text in 1948, Proclamation No. 2829, 14 Fed. Reg. 1151, 1154 (1949), and in 1955, Proclamation No. 3513, 28 Fed. Reg. 107, 115 (1963). Proclamation No. 3513 specifically stated that "GATT and agreements supplementary thereto shall be applied

¹⁴² Ronald A. Brand, "The Status of the General Agreement on Tariffs and Trade in United States Domestic Law," 26 Stan. J. Int'l L. 479, 483 (1990).

¹⁴³ Jackson, The General Agreement on Tariffs and Trade in United States Domestic Law, 66 Mich. L. Rev. 250, 312 (1967).

¹⁴⁴ Reciprocal Trade Agreements Act of 1934, pt. III, Pub. L. No. 316, 48 Stat. 943 (1934) (current version at 19 U.S.C. §§ 1351-1354 (1982)).

¹⁴⁵ Act of July 5, 1945, Pub. L. No. 130, 59 Stat. 410 (1945) (current version at 19 U.S.C. §§ 1351-1354 (1982)).

¹⁴⁶ Ronald A. Brand, "The Status of the General Agreement on Tariffs and Trade in United States Domestic Law," 26 Stan. J. Int'l L. 479, 483-484 (1990).

GATT Allows Domestic Preference Legislation

GATT prohibits protectionist legislation. Part II, Article III, Paragraph 1 states in part: "The contracting parties recognize that... regulations and requirements..., and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production." Also in Paragraph 5: "No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1."

There are two exemptions to the above prohibitions. The first is existing legislation at the signing of the GATT: "[t]he provisions of paragraph 5 shall not apply to any internal quantitative regulation in force in the territory of any contracting party on July 1, 1939, April 10, 1947, or March 24, 1948, at the option of that contracting party; *Provided* that any such regulation which is contrary to the provisions of paragraph 5 shall not be modified to the detriment of imports and shall be treated as a customs duty for the purpose of negotiation." The other exemption to the prohibitions in Article III relate to goods for government procurement: "[t]he provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale."

An example of legislation that is prohibited by the GATT is the Federal Crop Insurance Act passed 6/18/2009. The purpose of the act is to "to promote the national welfare by improving the economic stability of agriculture through a sound system of crop insurance and providing the means for the research and experience helpful in devising and establishing such insurance." The provision of the Act relevant to protectionist legislation is found in Section 1506(P)(1): "all equipment and products purchased by the Corporation using funds made available to the Corporation should be American-made." This act creates a government corporation for the commercial purposes of furthering stability in private agricultural firms. The requirements of the

legislation proscribe foreign equipment purchases. This is contradictory to the exemption in Article III, Paragraph 8(a) of the GATT.

APPENDIX D. COST ESTIMATE OF BUY AMERICAN ACT

A. METHODOLOGY

Estimating the cost of the BAA first requires identifying which contracts were subject to the regulations. The BAA has exemptions for trade agreements, for types of goods, and departments. According to NAFTA, Canada and Mexico are exempt from the regulation on contracts that meet the minimum threshold value. The current supply contract thresholds are \$25,000 for Canadian firms and \$79,507 for Mexican firms. The service contract threshold is at \$79,507 for both countries. FY2007 was the last time the federal procurement data systems database published a federal procurement report, which grouped contracts by value. Amount of money spent was divided into "< \$25,000", "Between \$25,000 and \$100,000", "Between \$100,000 and \$1,000,000", and ">=\$1,000,000". All money spent on contracts "Between \$100,000 and \$1,000,000" and ">=\$1,000,000" were subtracted from the total amount spent in FY2007 to account for the NAFTA minimum threshold values. Due to only ordinal data being available, contracts valued at \$79,508 to \$100,000 were not subtracted from the total. This biases the final cost estimate upwards.

The BAA treats small and large companies differently when evaluating reasonableness of cost. Small business bids can be 12 percent higher than a foreign firm, while large business bids can be 6 percent higher. The next step in estimating the cost is determining how much money was spent on contracts awarded to small and large businesses. The Federal Procurement Report of 2007 states that 22 percent of federal contract dollars went to small businesses, leaving 78 percent of contract dollars to large businesses. The data does not say how many of the excluded contracts, those above \$100,000, went to small or large companies. This means that the percentages of contract dollars for small and large businesses may not be 22 percent and 78 percent after excluding contracts above the NAFTA threshold. It is reasonable to believe that large businesses would have received a greater share of large dollar contracts than 78 percent. This is because as the FAR states small business are "unsuitable" for larger "bundled" contracts based on the following factors "diversity, size, or specialized nature of the elements of the performance specified; (ii) The aggregate dollar value of the anticipated award; (iii) The geographical dispersion of the contract performance sites"¹⁴⁷ Small businesses are more suited to "separate smaller contracts", meaning they potentially make up more than 22 percent of the

¹⁴⁷ The Federal Acquisitions Regulation Section 2.101

contracts submitted to BAA regulations.¹⁴⁸ Unfortunately data are not available to determine the percentages of money awarded to small and large businesses. This biases the cost estimate downwards.

Once the total value of lowest foreign firm bids values was estimated, this number was subtracted from the contract value awarded to small and large businesses respectively. This provides the cost due to BAA regulation on small and large businesses. These numbers were then added together to create the BAA cost estimate for FY 2007 of \$2 billion.

¹⁴⁸ The Federal Acquisitions Regulation Section 2.101

Estimated Cost of Buy American Legislation FY2007

Estimated Amount of Federal Spending Applicable to Buy American Regulation

Total Federal Contracts	459,998,278,356.00
Contracts above 100k	- 430,451,976,796.00
Contracts Applicable to Buy America Regulations	29,546,301,560.00

Estimated Value of Contracts awarded to Large & Small Businesses

% of Contracts Awarded to Large Business	78%
Contracts Applicable to Buy America Regulations	X 29,546,301,560.00
Value of Contracts Awarded to Large Businesses	23,046,115,216.80

% of Contracts Awarded to Small Business	22%
Contracts Applicable to Buy America Regulations	X 29,546,301,560.00
Value of Contracts Awarded to Small Businesses	6,500,186,343.20

Estimated Cost of Buy American Regulations on Large and Small Business Contracts

Value of Contracts Awarded to Large Businesses	23,046,115,216.80
Max increase over Foreign Firm	6%
Value without 6% Increase	21,741,618,129.06

Value of Contracts	23,046,115,216.80
Value without Regulation	- 21,741,618,129.06

Estimated Large Business Contract Cost due to regulation	1,304,497,087.74
---	------------------

- Available data includes contracts above NAFTA thresholds that are excluded from Buy America regulation. This biases the estimate upwards.
- Assumes all contracts were awarded to a domestic firm over a foreign firm that would have otherwise won the contract, biasing the final cost estimate upwards.
- Competition between domestic firms would probably not allow a domestic firm to capture the full 6 percent or 12 percent over a foreign firm allowed by the reasonableness of cost test. This biases the estimate upwards.
- The data are not available to tell how many of the excluded contracts were awarded to large and small businesses. It is likely most of them went to large businesses, making the percentages used to divide the contracts inaccurate. This biases the estimate downwards.