
Government Procurement

Indonesia has not yet signed the plurilateral WTO Government Procurement Agreement (GPA). Accordingly, a US-Indonesia FTA would create procurement opportunities in both directions. Buy-national procurement rules and kindred restrictions exist at the national and subnational levels in both Indonesia and the United States, and less fettered competition for government purchases could deliver considerable benefits.

This chapter has three sections. The first two sections review the regulatory environment and recent developments in the United States and Indonesia. The third section recommends ways to liberalize government procurement in the context of a prospective US-Indonesia FTA.

Government Procurement: The United States

In 1996 the United States signed the WTO GPA along with 28 other nations. US procurement rules at the federal level and in most states are generally applied in light of GPA obligations. The GPA agreement, however, does not cover all US federal or state government procurement but only scheduled entities, and even then only for purchase contracts above certain threshold values. Exceptions listed in general notes to the schedules further restrict coverage under the agreement.

Regulatory Environment

At the federal level, US public procurement takes place through various departments supervised by the Office of Management and Budget (OMB)

and two acquisition regulatory councils, the Defense Acquisition Regulations Council and the Civilian Agency Acquisition Council (WTO 2006b). The Federal Acquisition Regulation (FAR) establishes umbrella regulation for all federal entities but permits them to follow their own internal guidelines (WTO 2006b).¹ Under FAR, federal entities must publish their procurement requirements on a website known as FedBizOpps when the procurement exceeds \$25,000.² The proposed contract must be published at least 15 days before bids begin; thereafter, prospective bidders must be given at least 30 days to place their bids (WTO 2006b).

State and local governments regulate procurement contracts at the sub-federal level. Contracts are subject to threshold values and other provisions specific to each state. Some states grant preferences to local suppliers and impose local-content requirements. However, 37 states have adopted the GPA provisions³ and are obligated to publish tender invitations on the Fed-BizOpps Web site for GPA-covered sectors.

The Buy America Act

The Buy America Act (BAA) of 1933 (as amended) is the core document governing US procurement of goods at the federal level. The act establishes discriminatory measures, also known as Buy America restrictions, for government-funded purchases, including supply and construction contracts (European Commission 2004). Restrictive measures can take several forms: prohibiting government entities from purchasing foreign goods and services, requiring a certain amount of local content, and preferring domestic suppliers when evaluating bid prices.

The United States maintains a number of Buy America restrictions for procurement that are not covered by the GPA, the North American Free Trade Agreement (NAFTA), the WTO plurilateral Agreement on Trade in Civil Aircraft, or bilateral procurement agreements with Chile, Singapore, Australia, and Israel (WTO 2006b). Where in force, BAA requirements apply to goods, not services, requiring federal entities to procure only US-mined or US-produced unprocessed goods. In addition, only manufactured articles with at least 50 percent local content can be procured (European Commission 2004).

Executive Order 10582 of 1954 goes beyond the scope of the BAA by carving out special status for procurement contracts with small businesses

1. FAR was amended in 2001 to change aspects of electronic procurement and preferential access for small businesses, make procedures more transparent, and alter the bidding process and thresholds. Part 25 of FAR deals with policies and procedures to acquire foreign supplies, services, and construction materials (WTO 2004a).

2. Exceptions are made for purchases of perishable supplies when delayed publication could be damaging (WTO 2004a).

3. The 37 states are listed in Annex 2 of the US GPA schedule (WTO 2002).

and firms in places with labor surpluses. The order also allows government entities to reject bids from foreign firms for reasons of national security or interest (European Commission 2004).

The Berry Amendment

The Berry Amendment imposes strict guidelines that require the Department of Defense (DOD) to prefer US producers when making procurement decisions. It is more stringent than the BAA: It requires 100 percent domestic origin for goods and services rather than the BAA's 50 percent, and it is not limited to contracts within the United States. Some interest groups have lobbied to extend the Berry Amendment to other US government agencies, such as the Department of Homeland Security, but its provisions currently govern procurement only by the DOD.⁴

The Balance of Payments Program

The balance of payment program is a nonstatutory program that potentially restricts the purchase of supplies by government entities as well as contracts for construction, alteration, or repair of any public building outside the United States (WTO 2004a). Since 2001 this program no longer applies to civilian-agency acquisitions, but it affects the DOD for purchases of end products that are used abroad and cost more than \$100,000 (WTO 2004a).

The Trade Agreements Act of 1979

The Trade Agreements Act of 1979 implemented the General Agreement on Tariffs and Trade (GATT) Government Procurement Code signed in the Tokyo Round. Essentially, it overrides the BAA and kindred legislation by ensuring national treatment to signatories of the code with respect to scheduled entities and above-threshold contracts (USITC 2004a). Thus, the act gives up BAA preferences regarding civil aircraft and related articles,⁵ as well as other end products for designated parties to the GPA.⁶

4. The Berry Amendment has been the subject of debate in recent years. Critics point to the supposed gap between the legislative requirements of the Berry Amendment and US productive capacity, particularly in the textile and clothing (T&C) sector. However, representatives of US T&C firms consistently support the amendment as written.

5. Related articles are articles that "meet the substantial transformation test of the Act and originate in countries that are parties to the WTO Agreement on Trade in Civil Aircraft" (WTO 2004a).

6. Similar preferences are extended unilaterally to eligible countries through the GPA, NAFTA, other bilateral procurement agreements, and to least-developed countries (WTO 2004a). End products that are granted duty-free entry under the Caribbean Basin Economic Recovery Act (CBERA), for example, are eligible for government contracts.

Exemptions and Waivers

Exemptions and waivers to the BAA and balance of payments program are granted if it can be shown that domestic preferences are inconsistent with national interests and if the supply of a particular material is either unavailable or too expensive in the United States (WTO 2004a).⁷ BAA restrictions have been waived in acquiring defense equipment originating from countries with which the United States has a reciprocal procurement agreement.⁸

The goods listed in subchapters VIII and X of Chapter 98 of the BAA are not subject to custom duties when they are purchased for use in government contracts. Other supplies may also be eligible for duty free entry if the contract price is reduced by the amount of duty that would prevail if the supplies did not enter duty free. Finally, excepting equipment, supplies aimed at government-operated vessels or aircraft are eligible to enter the United States duty free (WTO 2004a).

The WTO GPA and US Bilateral Agreements

As of 2004 the threshold values of procurement contracts covered under the GPA have been maintained at their 1996 levels (WTO 2004a). Table 5.1 shows the threshold values set by the United States in the WTO GPA schedule, NAFTA, and in its FTAs with Singapore and Chile. Table 5.2 shows the list of services that the United States has chosen to exclude from the GPA and selected FTAs.

The US-Chile and US-Singapore FTAs opened additional state and federal agencies to foreign bids (Schott 2004). However, under the US-Singapore FTA, state obligations do not expand beyond the sector obligations already committed under the GPA. Local procurement is not covered under either the GPA or the two FTAs. Under the US-Chile FTA, the 37 US states that have agreed to GPA provisions will treat Chilean suppliers in essentially the same manner (USTR 2003a). Finally, the US-Chile and US-Singapore FTAs specify high threshold values and exclude state set-aside programs for small and minority businesses (Salazar-Xirinachs and Granados 2004).⁹

7. A domestic offer is judged too expensive if the foreign product is priced “below the lowest domestic offer when this offer is from a large business concern.” The price includes any import duties and a 6 percent added margin (WTO 2004a). If the offer is from a small business, the margin added is 12 percent, and for defense-related purchases, the foreign price has to be at least 50 percent below the domestic price.

8. However, the secretary of defense retains the right to restrict or reject an offer from a qualifying country for national defense reasons.

9. Government procurement was a source of concern in the debate over Central American Free Trade Agreement–Dominican Republic (CAFTA-DR). Congressman Benjamin Cardin

Table 5.1 Threshold values set in the WTO General Procurement Agreement schedule and selected US bilateral free trade agreements (US dollars)

Agreement	Goods and services	Construction
World Trade Organization	193,000	7,407,000
Canada	56,190	7,304,733
Mexico	56,190	7,304,733
Chile	56,190	6,481,000
Singapore	56,190	6,481,000

Source: WTO (2006b).

Effect of Restrictions

In 2005 US government expenditures amounted to \$2.36 trillion, or 18.9 percent of GDP (EIU 2006b). Defense-related expenditures were the largest component, some \$420 billion. Most federal expenditures, however, represent salaries and transfer payments. In 1999 the US federal government reported 56,598 procurement contracts totaling \$205 billion (WTO 2006b).

The EU Commission has estimated that Buy America restrictions each year affect approximately \$25 billion of public contracts, most noticeably in mass transport and airport improvements (European Commission 2004).¹⁰ Current restrictions under the BAA and Berry Amendment would discourage Indonesian firms from participating in US procurement of T&C goods, among others.¹¹

US public procurement restrictions appear as federal restrictions on procurement by federal entities, state restrictions on state and local procurement contracts, and federal restrictions on how state and local govern-

(D-MD) attempted to withdraw Maryland from the list of states subject to government procurement rules in the FTA package. However, Deputy USTR Peter Allgeier informed Cardin that Maryland “will have to remain on the list of states subject to government procurement rules” in CAFTA-DR. See “Maryland to Remain on Government Procurement Annex for CAFTA,” *Inside US Trade*, July 1, 2005.

10. This figure is expected to increase to \$35 billion in 2005 (European Commission 2004).

11. According to the latest US notification of government procurement statistics to the WTO, total US federal government procurement of textiles and clothing in 1999, subject to GPA provisions, was around \$70 million. That same source reported expenditures on medical appliances, precision and optical instruments, subject to GPA provisions, of about \$1 billion (WTO document GPA/40/Add.4 Committee on Government Procurement, Statistics for 1999 Reported under Article XIX: 5 of the Agreement, Report by the United States, Addendum, January 30, 2002).

Table 5.2 Services excluded or included by the United States in the WTO General Procurement Agreement and US bilateral free trade agreements

Service	WTO	NAFTA/Chile	Singapore	Australia/Morocco
Purchase of military services overseas	Excluded	Excluded	Excluded	Excluded
Automatic data processing, telecommunication, transmission	Excluded	Excluded	Included	Included
Telecommunication network, automated news services, data services	Excluded	Excluded	Included	Included
Basic telecommunications network services	Included	Included	Excluded	Excluded
Dredging	Excluded	Excluded	Excluded	Excluded
Federally funded research and development centers	Excluded	Included	Excluded	Included
Defense, energy, aeronautics/space facilities	Included	Excluded	Included	Excluded
Research and development	Excluded	Excluded	Excluded	Excluded
Transportation services	Excluded	Excluded	Excluded	Excluded
Utility services	Excluded	Excluded	Excluded	Excluded
Maintenance, repair, rebuilding, installation of equipment related to ships, including nonnuclear ship repair	Included	Excluded	Included	Excluded

NAFTA = North American Free Trade Agreement

Source: Acquisition Central, Subpart 25.4—Trade Agreements, www.arnet.gov.

ments can use federal grant money (USITC 2004a). The major restrictions at the federal level relate to defense procurement contracts and small and minority-owned business contracts. At the state level, federal regulations—mostly Buy America restrictions—prohibit using federal grant money for transportation and food assistance projects (USITC 2004a).

Public Transportation

Federal aid to state and local governments is distributed by the Department of Transportation under the Highway Administration Act, the Urban Mass Transit Act, and the Airports Improvements Act. The federal government may fund 40 to 80 percent of a project, while the state funds the rest. All of the projects are subject to local content requirements of 60 percent, or face a penalty of up to 25 percent of the price (European Commission 2004).

Highway Construction

Federally assisted highway projects amounted to \$46 billion in 2002, while federal grants to state and local governments totaled \$26 billion (USITC 2004a). Under the BAA, highways must be constructed with domestically produced iron and steel. A waiver is possible but rarely granted.

Airport Construction

The Federal Aviation Administration (FAA) monitors Buy America restrictions on state and local public procurement for airport construction projects. Some 80 to 90 percent of airport construction spending comes from the federal government. Airport construction projects are obligated to use domestically produced steel and manufactured goods unless a waiver is invoked.

Food Assistance

The US Department of Agriculture and other federal entities, such as the Department of Health and Human Services, monitor many food assistance procurement programs. These programs, the National School Lunch Program and the Child and Adult Care Food Program among them, prefer local food suppliers. Even donated commodities must be of domestic origin. Some programs require that school food authorities buy domestic commodities to the maximum extent. Under NAFTA and the Uruguay Round agreement, the United States retained the right to exempt from its national treatment obligations the “procurement of agricultural goods made in furtherance of agricultural support programs or human feeding programs” (USITC 2004a).

Small Business Set-Asides

Federal grants and subcontracts for goods and services awarded to small business firms are governed by the Small Business Act (SBA) of 1958 (as

amended). Under the act, 23 percent of prime contracts must be awarded to small businesses, 5 percent of prime and subcontracts to minority-owned businesses, 5 percent to women-owned businesses, and 3 percent to service-disabled veteran-owned businesses. Prime contracts for Historically Underutilized Business Zone firms (HUBZone) are phased in from 1 percent in fiscal year 1999 to 2.5 percent in fiscal year 2002 and 3 percent in fiscal year 2003 (USITC 2004a). The SBA requires that all owners of small businesses must be US citizens to qualify for preferential procurement. Because SBA regulations require that receipts from all domestic and foreign affiliates of the business be counted in scoring whether the firm qualifies as a small-size business, US affiliates of foreign-owned corporations usually cannot obtain small-business status. Most federal purchases under the SBA programs face Buy America restrictions, although a general waiver may be granted to federal purchases of less than \$2,500 (USITC 2004a).

Defense Procurement

The BAA governs domestic sourcing requirements for defense procurement. In addition, the Defense Federal Acquisition Regulations System (DFARS) regulates defense-related procurement of specific products such as food, clothing and fibers, vessel acquisition, and anchor chain. The DFARS regulations are intended to ensure that government procurement contracts comply with the memorandum of understanding (MoU) between the DOD and the SBA with respect to the small-business goals mentioned above. North Atlantic Treaty Organization (NATO) countries that have ratified the MoU can obtain a waiver from the DOD's domestic preferences (USITC 2004a).

State and Local Government Procurement

The states impose procurement restrictions over and above federal restrictions. So far, all negotiated US trade agreements have allowed states to choose between retaining their state procurement rules or acceding to the agreement. In response, 37 of the 50 states have chosen to accept the GPA provisions in the WTO, and the same states have generally accepted similar FTA provisions. As of 2005, Ohio, Indiana, Virginia, Georgia, and New Jersey were the most important holdout states. Among the states that do not participate, Alabama restricts foreign participation in biddings, New Mexico and Alaska offer preferences to in-state suppliers, and Indiana and South Carolina apply domestic purchase requirements.

The US Trade Representative (USTR) has adopted a new reciprocity approach to subfederal procurement in the US-Peru and US-Colombia FTAs, negotiated in 2006. In this approach, states are invited to cover procurement voluntarily under the FTA. Only firms based in states that accept the invitation can bid on scheduled procurement contracts in the partner country. The new approach will not modify the commitments that states made previously under the GPA and other FTAs (WTO 2006b).

According to the most recent data reported by the United States to the WTO, in 1999 total procurement by all states that have acceded to GPA provisions reached \$306 billion.¹² For the US FTA partner, the benefits of state accession are enhanced by the large number and diverse nature of state programs (USITC 2004a).

Subfederal Selective Purchasing Laws

Selective purchasing laws at the subfederal level often impede foreign firms that have links to “offensive” third countries, such as Burma; Massachusetts and 20 cities and other local authorities have adopted penalty laws (European Commission 2004). The Supreme Court ruled that one Massachusetts law was preempted by federal legislation, but the holding in that case had a narrow legal focus.¹³ Hence, selective subfederal purchases that are tailored to foreign policy objectives can still be a problem. In 2001 New York attempted to enact selective purchasing legislation based on the so-called MacBride principles (European Commission 2004). The proposal was dropped, but it flagged a continuing concern.

Services

The BAA is not supposed to apply to procurement of services, but the offshore outsourcing debate has inspired new legislative forays, mainly at the state level. In 2002 New Jersey—followed by Michigan in 2004—enacted legislation stating that “only citizens of the United States and persons authorized to work in the United States pursuant to federal law may be employed in the performance of services [funded by the state]” (European Commission 2004, 45). Connecticut, Florida, Maryland, Missouri, and Wisconsin have announced similar provisions. The legislation seeks to discourage call centers and data processing abroad (European Commission 2004).

Recent Developments

Recent initiatives have attempted to improve the efficiency of federal government procurement. The E-Government Act of 2002 led to the creation of an Internet portal for government procurement known as the Integrated Acquisition Environment (IAE) initiative. The General Services Administration (GSA) has promoted two new programs. The first program, the GSA Global Supply (GGS), identifies an array of goods and services that conform

12. WTO document GPA/40/Add.4 Committee on Government Procurement, Statistics for 1999 Reported under Article XIX: 5 of the Agreement, Report by the United States, Addendum, January 30, 2002.

13. *Crosby et al. v. National Foreign Trade Council*, U.S. Sup. Ct., No. 99-474, June 19, 2000.

to government acquisition policies and socioeconomic regulations (WTO 2004a). GSA Advantage is an Internet program that allows interested parties to communicate with authorized contractors online. Under this program, 5,298 contracting foreign firms registered online in 2004 (WTO 2004a).

Government Procurement: Indonesia

In 2004 Indonesia's total government procurement market for goods and services was estimated at 18.8 trillion rupiah—approximately \$20.1 billion—or 8.2 percent of GDP (ADB 2005). Indonesia has not signed the GPA or made a commitment to begin accession negotiations. Procurement practices are on the front line of the battle to reduce corruption in the civil service, particularly at the provincial and local level.¹⁴ Political influence on procurement decisions, charges of official corruption, and long delays in bureaucratic decision making have been noted.

Regulatory Environment

Since late 1999 the Indonesian authorities have audited the state-owned electricity company (Perusahaan Listrik Negara), the state oil and gas company (Pertamina), the State Logistics Agency (Bulog), and the General Elections Commission.¹⁵ The audits identified serious irregularities in procurement, and a few state officials have been detained for corruption, while many others face investigation. However, significant difficulties face the Indonesian government's anticorruption campaign, and according to several observers, its results so far are mixed.¹⁶

Indonesia's government procurement regime is governed by a number of overlapping laws, regulations, and presidential decrees. In November 2004 the government issued a presidential decree on government procurement aimed at simplifying procedures and increasing efficiency and transparency in the procurement process.¹⁷ However, the new rules also grant special preferences to encourage domestic sourcing and call for the maximum use of local content in government projects, regardless of their source of funding (USTR 2006b). Government departments, institutes,

14. Indonesia ranks 137 out of 159 nations in the Transparency International 2005 Corruption Perceptions Index.

15. The Corruption Eradication Commission has played a particularly important role in President Yudhoyono's anticorruption campaign.

16. S. Reiner, "Mixed Results in Govt's Anticorruption Campaign," *Jakarta Post*, June 1, 2006, available at www.thejakartapost.com (accessed on August 18, 2006).

17. Presidential Decree No. 61/2004.

and corporations are expected to utilize domestic goods and services to the maximum extent feasible. Thus even projects funded by foreign donors are potentially subject to the domestic rules, but international procurement rules often take precedence, as discussed below. State-owned enterprises that publicly offer shares through the Indonesian stock exchange are exempt from the government procurement regulations. However, the new oil and gas upstream authority, BP Migas, regulates the import of all materials used by the oil and gas sector (USTR 2006b).

According to the presidential decree, foreign companies can bid for government contracts as part of a joint partnership or as a subcontractor to a domestic firm. The permissible level of foreign participation in a given contract was recently increased from \$1 million to \$5 million. Nevertheless, regional decentralization may introduce new barriers if municipal and provincial governments adopt their own buy-local procurement rules.

Bilateral and multilateral donors finance many large government contracts and often impose their own special procurement requirements. The Indonesian government seeks concessional foreign financing for most procurement projects. Large government-funded projects must follow international competitive bidding practices, allowing for procurement from foreign sources. However, the Indonesian government sometimes has asked foreign firms bidding on high-value government-sponsored projects to purchase and export the equivalent value in Indonesian products (USTR 2006b).

Recommendations

Practices that impede competition in public procurement cannot be abolished overnight. Nevertheless, a US-Indonesia FTA should be ambitious and forward-looking, and we offer the following recommendations.

For the United States

- The FTA should grant Indonesian firms the best terms enjoyed under the GPA as well as by NAFTA partners, Chile, Singapore, Australia, and future US bilateral FTAs: an unconditional most favored nation (MFN) provision. The MFN provision should apply to both federal and state procurement.
- Without undercutting the thrust of the BAA or Berry Amendment, the United States should extend its procurement coverage for products that Indonesia exports, such as T&C products. Negotiators of a US-Indonesia FTA should explore the possibility of relaxing origin requirements to

facilitate procurement in Indonesia for US firms supplying to the DOD, particularly in overseas contracts.¹⁸

- A US-Indonesia FTA should emulate the new reciprocity model inaugurated with the US-Peru FTA. The USTR should also seek to convince two or three holdout states, as well as states that have previously agreed, to sign up for GPA and FTA procurement provisions.¹⁹

For Indonesia

- Indonesia should accede to the GPA in the context of the Doha Round. Accession will help Indonesia rationalize its own public procurement system and ensure the continued progress of domestic reform.²⁰
- In the FTA, Indonesia should schedule the same type of procurement obligations, allowing for similar reservations, as the United States has scheduled in the GPA and in its FTAs. Indonesia's commitments should mirror those stipulated by the GPA for developing countries and those of CAFTA-DR for US partners.
- As above, the FTA should grant US firms the best terms enjoyed under the GPA as well as by current and future Indonesia bilateral FTA partners: an unconditional MFN provision applying to both federal and provincial procurement.

Indonesia should welcome the salutary impact of open procurement rules in its anticorruption campaign. But for budget reasons alone, public authorities in both countries should welcome the greater competition that liberalizing government procurement rules allows.

18. US T&C manufacturers that currently supply the DOD will strongly oppose this change.

19. Obtaining states' agreement will be difficult because state authorities increasingly question the benefits derived from opening their own procurement markets to US FTA partners. Instincts to buy local are strong in many US states.

20. The recommendation's greatest difficulty and perhaps most positive implication is that it would lead to greater transparency and less corruption. Powerful local groups that benefit from the status quo will strongly lobby against Indonesia signing the GPA.