

# Congress Rejects Proposed New “Buy America” Requirements for the Defense Department

by David W. Burgett, Hogan & Hartson LLP

After months of controversy, Congress has finally approved and sent President Bush the 2004 Defense Authorization Bill for his signature. But the original bill proposed by Duncan Hunter (R-California), Chairman of the House Armed Services Committee, contained several unprecedented and far-reaching restrictions on Defense Department (DoD) purchasing of foreign-made products and components.

These provisions were roundly attacked by major US defense contractors, who would have found the restrictions costly, and difficult or impossible to comply with. Key Senators, the Defense Department, the State Department, the U.S. Trade Representative (USTR) and others within the Administration who recognize the value of open trade for defense items, also objected, as did the EU, Japan, and other allies. After weeks of attempted compromise and intense lobbying, the final bill that emerged from the House-Senate conference committee eliminated most of the proposed restrictions and greatly reduced the impact of the remaining provisions.

While the immediate danger to defense trade has been largely

averted, it is likely that further “Buy America” proposals for the Defense Department and other agencies will be proposed and debated in the coming months. Some of the provisions that have been proposed – such as those relating to machine tools – could be of immediate importance to Japanese industry.

## Principles Governing US Government Purchases of Foreign Products

In general, most US government procurements are open to products produced by most industrialized nations, including Japan. Some 62 nations, including the US and Japan, are signatories to the WTO’s Agreement on Government Procurement (AGP). Under the AGP, each member country gives equal treatment to products of the other countries when it purchases goods for public use. The AGP applies to any contract exceeding a monetary threshold (currently \$169,000) by almost all federal departments and agencies, as well as 37 of the 50 states. DoD is covered by the AGP for most commercial items, including computer equipment. But the AGP does not cover major military items, such as aircraft, tanks, naval vessels, weaponry, and the like.

The Department of Defense has entered Memoranda of Understanding (MOU) on reciprocal defense procurement with the defense ministries of the NATO countries and several other allies. These apply the equal treatment principle to defense items not covered by the AGP. Japan has no MOU because is not generally engaged in defense trade due to the “three principles.”

The “Buy American Act” (BAA) gives a price evaluation preference for items produced in the US whose American components make up more than 50 percent of the total cost of components. For purposes of bid evaluation, a percentage increment is added to the price of goods that do not qualify for the preference (50 percent for DoD purchases and 6 percent for other agencies). But the BAA has very little significance today because it only applies in procurements that are neither covered by the AGP nor by defense MOUs. Defense items are covered by the MOUs and all important purchases of non-defense items exceed the AGP threshold of \$169,000.

## The Hunter Bill

Congressman Hunter, the new chairman of the House Armed Services Committee, sought to

change the rules governing defense trade in the 2004 Defense Authorization bill. Hunter, convinced that the US defense industry is eroding and that steps should be taken to ensure that more US defense dollars flow to American business, inserted into the House bill several unprecedented restrictions on foreign items:

- A list of several specific items that could only be acquired from US manufacturers. These included some items that are explicitly covered by the AGP.
- A requirement for a detailed analysis of the value and country of origin of hundreds of thousands, if not millions, of components incorporated in defense equipment. Industry estimated that it would cost enormous sums to comply with this data-gathering exercise.
- A requirement that items and components deemed “essential” to a military system be produced in the US. This would entail massive cost and retooling, since there are numerous foreign components in most pieces of defense equipment.
- A rule that a trade agreement (such as the AGP) could not be a basis for waiving the Buy

American Act. This could have led to US violation of its obligations under the AGP.

- A requirement that defense contractors making major defense items use only US-made machine tools. Unlike typical “buy domestic” rules, this would extend beyond restricting the origin of goods that the *government* acquires, and dictate purchases of items that *private parties* acquire and retain for their own use.

The corresponding Defense Authorization bill passed by the Senate contained none of these provisions. So the stage was set for the differences between the two bills to be resolved by a House-Senate Conference Committee convened in July.

### **Controversy Over Buy American Provisions**

Hunter’s Buy American provisions generated immediate controversy. Senator John Warner (R-Virginia), chairman of the Senate Armed Services Committee and leader of the Senate conferees, stated that he would not support any Buy American restrictions not acceptable to the Administration. Secretary of Defense Rumsfeld said he would recommend a Presidential veto if the Hunter provisions

remained in the bill. American industry associations and large defense contractors voiced strong opposition, pointing out that compliance would be extremely costly and that the cost and effectiveness of defense systems would be adversely affected. Moreover, major programs funded by multiple nations, such as the Joint Strike Fighter, would be jeopardized if the US embarked on a protectionist approach to defense procurement. The EU and other countries also expressed objections.

Deputy Secretary of Defense Paul Wolfowitz attempted to resolve the controversy by negotiating directly with Chairman Hunter to eliminate some provisions and reach compromises on others. This effort failed dramatically. While Wolfowitz reportedly struck an agreement with the chairman, he failed to consult Senator Warner, the White House, the State Department, or USTR. While the compromise significantly scaled back the original egregious provisions, it still contained many sections that would interfere with defense trade and hamper relations with trading partners.

At a White House meeting chaired by Chief of Staff Andrew Card, Secretary of State Powell and USTR Zoellick voiced objections.

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Following the meeting, the Administration position on the bill was coordinated by the Office of Management and the Budget. Finally, on November 5, the Conference Committee approved a final bill.

As finally passed, the Defense Authorization bill omits most of the restrictions on foreign items that Chairman Hunter had proposed. The relatively few remaining provisions will not make major changes in DoD purchasing practices. Under the final bill:

- No specific items are reserved for US industry.
- While the bill calls for the analysis of existing data on the number and value of “essential” components that are manufactured abroad, there is no requirement that any components be manufactured in the US.
- Trade agreements remain a valid basis for waiving the Buy American Act’s domestic preference.
- There is no requirement that defense contractors exclusively use US machine tools.

Importantly, the bill now explicitly stipulates that none of its provisions may violate an interna-

tional agreement, such as the WTO Agreement.

### **Machine Tool Provisions Could Yet Affect Japanese Industry**

While the restriction on defense contractor purchases of foreign machine tools was dropped, three provisions remain that could have an impact on Japan and other machine-tool-producing countries. First, DoD is directed to make machine tools a priority for R&D funding. Second, a new government “industrial base” fund is established which could be used to subsidize defense contractors’ acquisition of US-made machine tools, to the detriment of foreign competitors. Potentially, such a subsidy might constitute a “state aid” in violation of the WTO Agreement. And third, when conducting major acquisition programs, DoD is for the first time directed to give “consideration” to a bidder’s use of US-made capital assets. It remains to be seen how this will be implemented, and whether it will have any significant impact on contract awards or on the defense industry’s purchases of machine tools.

### **Conclusion**

Free traders can breathe a sigh of relief at the outcome reflected in the final bill. But the controversy over this bill is likely to be only the first

of a series of debates over the coming months and years over domestic restrictions in government procurement. Chairman Hunter believes fervently in restrictions on DoD purchases and will almost certainly try again. The reports on foreign component purchasing mandated by the legislation are designed to add fuel to the debate in coming years. Forthcoming congressional and presidential elections also focus public attention on issues such as this that are perceived to have an impact on employment.

In the short term, Japanese industry could be affected by any restrictions in the realm of machine tools. In the longer term, Japan may become more involved in producing componentry used in defense items. Finally, there is some reason for concern that “Buy American” fervor in the defense arena may adversely affect trading relations with Europe, Japan, and other major trading partners in other areas. ■

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