

Navigating the Recovery Act's Buy American Rule in State and Local Government Construction

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The American Recovery and Reinvestment Act, Pub. Law No. 111-5 (the Recovery Act), contains a “Buy American” requirement limiting the use of certain foreign materials on projects paid for with Recovery Act funds.¹ The application of the Buy American provision is very complicated, because the rules to be applied will

vary depending upon the agency that is doing the procuring, the materials that are being used, and the country of origin of the materials. As a result, the application of this provision may differ for the same type of project procured by two different public agencies. Procurement officials and contractors should carefully examine the Buy American provision to ensure that they fully understand its applicability to a given project, and to determine whether they can comply or whether a waiver is needed.

Section 1605(a) of the Recovery Act provides:

None of the funds appropriated or otherwise made available by this Act may be used for a project for the construction, alteration, maintenance, or repair of a public building or public work unless all of the iron, steel, and manufactured goods used in the project are produced in the United States.

Section 1605 can be broken down into three key elements which must be understood to apply the rule: (1) (*Project Scope*) Recovery Act funds may only be used “for the construction, alteration, maintenance or repair of a public building or public work” if (2) (*Product Scope*) “all of the iron, steel and manufactured goods used in the project” (3) (*Country of Origin Rule*) “are produced in the United States.”

The Recovery Act itself does not define these three key elements, but the Office of Management and Budget

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* “Top Sheet” is used in construction and other fields to denote a condensed overview of essential information about a bid or project. The Construction Division’s Top Sheet articles are similarly crafted to be succinct examinations of key aspects of a case, law, or other issue.

(OMB), as well as the combined Defense Acquisition Regulations Council and the Civilian Agency Acquisition Council (the FAR Councils), which jointly are responsible for maintaining the Federal Acquisition Regulation (FAR),² have issued interim guidance for the Buy American requirement.³ This article analyzes the application of section 1605 to state and local government construction projects. The OMB guidance applies most directly to spending at the state and local levels, and thus is the focus of this article, but the FAR Councils’ rules are also a helpful source of guidance for issues as to which OMB has not provided definitive rules.

Determining Whether the Recovery Act's “Buy American” Rule Applies

To determine whether the Buy American rules apply to a given project, several questions need to be asked. As a threshold matter, the Buy American provisions of the Recovery Act apply only if Recovery Act funds are being used. (Note, however, that if Recovery Act funds are not being used, Buy American restrictions in other laws may still apply.)

Projects Covered: “Public Buildings and Public Works.” The Recovery Act’s Buy American rule only applies to “a project for the construction, alteration, maintenance, or repair of a public building or public work.” OMB’s definitions of “public building” and “public work” are set forth at Title 2 of the Code of Federal Regulations, section 176.140(a):

... a public building of, and a public work of, a governmental entity (the United States; the District of Columbia; commonwealths, territories, and minor outlying islands of the United States; State and local governments; and multi-State, regional, or interstate entities which have governmental functions). These buildings and works may include, without limitation, bridges, dams, plants, highways, parkways, streets, subways, tunnels, sewers, mains, power lines, pumping stations, heavy generators, railways, airports, terminals, docks, piers, wharves, ways, lighthouses, buoys, jetties, breakwaters, levees, and canals, and the construction, alteration, maintenance, or repair of such buildings and works.⁴

There are two important considerations to take from this definition. First, the limitation to buildings and public works “of a governmental entity” means that it should

apply only to improvements owned by a government. As a result, the Buy American provision would not apply to a privately owned project that received Recovery Act funds. Outside of this limitation, however, the scope of the Buy American provision is very broad. It applies to improvements owned at all levels of state and local government, including regional entities such as water districts or transportation districts, and even multistate entities.

Second, the definition of buildings and works is very broad, and includes any “construction, alteration, maintenance or repair of such buildings or works.” In other words, the Buy American rule will very rarely *not* be applicable to a construction project conducted by a state or local government using Recovery Act funds.

Products Covered: “Iron, Steel, and Manufactured Goods.” Once it has been determined that the project uses Recovery Act funds for a public building or public works project, the next issue is the determination of which goods the Buy American restriction applies to. Section 1605 applies to only two types of goods: iron/steel, and manufactured goods, both of which are defined by OMB.

OMB’s definition of iron/steel is “an alloy that includes at least 50 percent iron, between .02 and 2 percent carbon.”⁵ That definition is broad enough to cover virtually all construction-grade steel.

OMB’s definition of a “manufactured good” is:

(1) *Manufactured good* means a good brought to the construction site for incorporation into the building or work that has been—

- (i) Processed into a specific form and shape; or
- (ii) Combined with other raw material to create a material that has different properties than the properties of the individual raw materials.⁶

The threshold question for “manufactured goods” is thus whether the good is for “incorporation into the building or work.” For example, a manufactured item that is brought to a construction site solely to facilitate construction would not fall within the scope of the Buy American rule. The definition does include, however, any good that is processed into a specific form and shape (e.g., any machinery or equipment), or that is combined with other raw materials to create a material with new properties (e.g., cement and asphalt), so long as the good is incorporated into the public building or public work.

With that understanding of which products are covered by the Recovery Act’s Buy American provision, one can turn to the really difficult issue: applying the country-of-origin rules to determine whether the iron, steel, or manufactured good is to be treated as a U.S.-produced item or as a foreign-produced item.

The Country-of-Origin Rule: “Produced in the United States.” A tricky part of applying any Buy American rule is to determine which “country of origin” test to use. In a world where many products go through a series of production or manufacturing steps in different countries, it is often

very difficult to determine the “origin” of a given product. Section 1605 of the Recovery Act merely provides that the iron, steel, and manufactured goods must be “produced in the United States,” but otherwise provides no insight into how the country of origin is to be determined.

There are a variety of possible origin tests, including: (1) the traditional “substantial transformation” test used by U.S. Customs and Border Protection; (2) a “cost of domestic components” test used in FAR Part 25; (3) a “wholly obtained or produced/all manufacturing process” test like that used by the Department of Transportation; (4) the “tariff shift” test being used in recent trade agreements; or even (5) the “Made in the USA” test used by the Federal Trade Commission.

In its interim regulation, OMB gave less than complete guidance on determining country of origin. For iron and steel, OMB adopted the origin test that the Department of Transportation has used for many years. Specifically, the interim regulation provides:

- (2) All of the iron, steel, and manufactured goods used in the project are produced or manufactured in the United States.
 - (i) Production in the United States of the iron or steel used in the project requires that *all manufacturing processes must take place in the United States, except metallurgical processes involving refinement of steel additives*. These requirements do not apply to iron or steel used as components or subcomponents of manufactured goods used in the project.⁷

Thus, for iron/steel to qualify as United States produced, “all of the manufacturing processes must take place in the United States, except metallurgical processes involving refinement of steel additives.” This is an extremely strict country-of-origin test. It effectively treats as foreign much of the steel “produced” by the U.S. steel industry, particularly steel “produced” west of the Rocky Mountains. For example, the rule means that contractors cannot use steel products that are made in the United States from unfinished or semi-finished foreign steel products such as steel slab or plate. This is the case even though the federal government has recognized for many years that these products undergo a “substantial transformation” when processed in the United States.⁸

Unfortunately, OMB’s interim regulation does not really explain what country-of-origin test applies to “manufactured goods.” On this topic OMB says:

- There is no requirement with regard to the origin of components or subcomponents in manufactured goods used in the project, as long as the manufacturing occurs in the United States.⁹

A test that requires that the “manufacturing occurs in the United States” is not significantly more precise than section 1605’s requirement that the manufactured goods be “produced in the United States.” While it does indicate that mere assembly in the United States is insufficient, it does not specify which country-of-origin test should be applied

for the more difficult situations. The OMB rule is enlightening, however, because it clearly states that the requirement applies only to the final product and not to any components or subcomponents. In the absence of specific guidance from OMB, a reasonable and defensible approach for a procurement official or contractor is to utilize the “substantial transformation” test that the FAR Councils have adopted for application of section 1605 at the federal level.

The “substantial transformation” test is intended to identify the country of origin of a product when the product either is manufactured in more than one country, or it incorporates materials, parts, or components from more than one country, or both. It is a fact-intensive analysis directed at determining the country where the most significant manufacturing or processing operation took place; that is, the country in which the imported product was given its essential character. The origin of such a product is that country in which it was last “substantially transformed” into a new and different article of commerce with a name, character, or use different from all foreign materials, parts, and components used in its manufacture. Not surprisingly, whether a product has been substantially transformed is often not clear, and is subject to a variety of interpretations.

Determining the Impact of International Agreements

Applying the Recovery Act’s Buy American provision would be relatively straightforward if the rules described above were all that need be considered. Unfortunately, they are not. The Recovery Act provides that the Buy American provision is to be applied “in a manner consistent with United States obligations under international agreements.”¹⁰ These international agreements include the World Trade Organization Government Procurement Agreement (GPA) and many other bilateral and multilateral free trade agreements (FTAs). Generally speaking, the United States’ obligation under these agreements is to give end-products of the signatory countries the same treatment afforded to products produced in the United States in a “covered” procurement. If applicable, an international agreement could result in iron, steel, or manufactured goods of a signatory country (e.g., goods that are substantially transformed in that country) being treated the same as U.S.-produced iron, steel, or manufactured goods. Treating the foreign product the same as the domestic product means not only that the foreign product is to be deemed a U.S. product for purposes of applying the Buy American rule, but also that the foreign product should be given the Buy American preference over a foreign product from a nonsignatory country.

The first step in understanding the impact of an international agreement is to determine whether the procurement is subject to such an agreement. Applying the international agreements is very complex, but Appendix B to OMB’s interim guidance provides a list of “U.S. States, Other Sub-Federal Entities, and Other Entities Subject to U.S. Obligations Under International Agreements.”¹¹

This list allows one to determine:

- Whether the procuring agency is a “covered entity” subject to the GPA or another FTA;
- Whether there is a product exclusion that would exempt iron, steel, or manufactured goods from the impact of the GPA or FTAs; and
- What international agreements must be considered.

The accompanying table (page 6) is an excerpt from the appendix published by the OMB on March 25, 2010.

To understand whether an international agreement applies, the first step is to determine whether the procuring agency’s state is contained in the appendix. If the state is not listed, then neither the GPA nor any FTA impacts the application of the Recovery Act’s Buy American rules. Approximately 10 states, along with the District of Columbia, are not identified in the appendix.

If the state is listed in the appendix, the next step is to determine whether the procuring agency falls under the “Entities Covered” list for that state. Not all state agencies are covered. For example, in California all “executive branch agencies” are covered, but other divisions of the

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State, such as the University of California and California State University systems, are not covered. Moreover, local governments are never covered. If the procuring agency is not a covered entity, then application of the Recovery Act’s Buy American rule is not impacted by any international agreements.

If, however, the procuring agency is a covered entity, the third step is to determine whether the iron, steel, or manufactured good is subject to an exclusion. Product exclusions are listed in the third column in Appendix B. Many states have exclusions for construction services, construction grade steel, or even “goods.” If a product exclusion applies, then the Buy American rule is unaffected by an international agreement; if no exclusion applies, one must consider the impact of the international agreement.

As noted previously, these international agreements generally require that end products from a signatory country receive the same treatment in a covered procurement as a domestic product. The final step is to consider the impact of the GPA and each FTA identified by OMB. These international agreements may or may not have monetary thresholds that limit their applicability. For example, the

GPA covers projects valued at \$7.443 million or above. Thus, even if the procuring agency is subject to the GPA and no product exclusion applies, if the project is for less than \$7.443 million, then application of the Recovery Act's Buy American rules is unaffected by the GPA, and the foreign iron, steel, and manufactured goods will not be considered comparable to their domestic counterparts.

In summary, if a potential international agreement is identified that may impact the Recovery Act's Buy American requirement, one must follow the four steps outlined

above to ensure that one is applying section 1605 in a manner consistent with the international obligations of the United States. Once the applicable country-of-origin rule is identified, it will be possible to determine what iron, steel, or manufactured goods are deemed to be products of a relevant signatory country, and, consequently, the products that must be treated the same as domestically produced products.

A review of all of the international agreements is beyond the scope of this article, but a review of how the GPA would apply is informative. The GPA uses the "substantial trans-

Appendix to Subpart B of 2 C.F.R. part 176—U.S. States, Other Sub-Federal Entities, and Other Entities Subject to U.S. Obligations Under International Agreements (as of February 16, 2010)

States	Entities Covered	Exclusions	Relevant International Agreements
Arizona	Executive branch agencies		<ul style="list-style-type: none"> – WTO GPA. – U.S.-Chile FTA. – U.S.-Singapore FTA.
Arkansas	Executive branch agencies, including universities but excluding the Office of Fish and Game	Construction services	<ul style="list-style-type: none"> – WTO GPA. – DR-CAFTA. – U.S.-Australia FTA. – U.S.-Chile FTA. – U.S.-Morocco FTA. – U.S.-Peru TPA. – U.S.-Singapore FTA.
California	Executive branch agencies		<ul style="list-style-type: none"> – WTO GPA. – U.S.-Australia FTA. – U.S.-Chile FTA. – U.S.-Singapore FTA.
Colorado	Executive branch agencies		<ul style="list-style-type: none"> – WTO GPA. – DR-CAFTA. – U.S.-Australia FTA. – U.S.-Chile FTA. – U.S.-Morocco FTA. – U.S.-Peru TPA. – U.S.-Singapore FTA.
Connecticut	<ul style="list-style-type: none"> • Department of Administrative Services • Department of Transportation • Department of Public Works • Constituent Units of Higher Education 		<ul style="list-style-type: none"> – WTO GPA. – DR-CAFTA. – U.S.-Australia FTA. – U.S.-Chile FTA. – U.S.-Morocco FTA. – U.S.-Singapore FTA.
Delaware	<ul style="list-style-type: none"> • Administrative Services (Central Procurement Agency) • State Universities • State Colleges. 	Construction-grade steel (including requirements on subcontracts); motor vehicles; coal	<ul style="list-style-type: none"> – WTO GPA. – DR-CAFTA (except Honduras). – U.S.-Australia FTA – U.S.-Chile FTA. – U.S.-Morocco FTA – U.S.-Singapore FTA

Slab Produced In...	Final Processing In...	Country of Origin Test	Foreign Steel Product Treated The Same As U.S. Produced?
GPA Country	GPA Country	Substantial Transformation	Yes
Non-GPA Country	GPA Country	Substantial Transformation	Yes
GPA Country	United States	Substantial Transformation	Yes
Non-GPA Country	United States	"All manufacturing in U.S...."	No

formation” test to determine a product’s country of origin. The FAR defines a “WTO GPA country end product” as an article that—

(2) In the case of an article that consists in whole or in part of materials from another country, has been substantially transformed in a WTO GPA country into a new and different article of commerce with a name, character, or use distinct from that of the article or articles from which it was transformed.¹²

An example of the impact this rule has on the Buy American provision is to consider the foreign-produced steel slab mentioned earlier. Recall that the steel slab was produced in a foreign country and brought to the United States for processing into a finished steel product. Under the Recovery Act’s Buy American provision, the processing in the United States did not render the product “produced in the United States.” But if the GPA applies to the procurement, the country-of-origin analysis changes significantly. The chart (above) shows how the GPA’s substantial transformation test changes the result.

In the first three scenarios, the applicability of the GPA changed the status of the end-product steel from foreign to a product that must be treated the same as U.S.-produced steel. In other words, the results can change on a product-by-product basis depending on the applicability of the GPA or another FTA.

Some states have misinterpreted the impact that compliance with an international agreement has on section 1605. For example, a common misperception is that if the GPA applies to a project, then the Recovery Act’s Buy American rule does not apply. That is not a proper interpretation of section 1605(d) or OMB’s guidance. The applicability of the GPA means that section 1605 cannot be applied in a manner that is inconsistent with the United States’ obligations under the GPA.¹³ That is to say, section 1605 continues to apply, but it cannot be applied to discriminate against products from the GPA signatory country. The continued applicability of section 1605 is evidenced by OMB’s providing a contract clause for inclusion in solicitations on projects that are subject to international agreements.¹⁴

Waivers of the Buy American Rule

There are three instances in which the head of the relevant federal agency may grant a waiver of the Buy American provision. Specifically, the agency head may do so where:

- application of the Buy American provision would be inconsistent with the public interest;
- the iron/steel or manufactured good is not available in sufficient quantities or sufficient quality from domestic suppliers; or
- the cost of the domestic iron/steel or manufactured good would increase the overall cost of the project by at least 25 percent.¹⁵


OMB’s interim guidance details the process for obtaining a waiver. The head of the federal agency awarding the Recovery Act funds may make a project-specific waiver or a waiver applying to a broader category of projects, including a nationwide waiver.¹⁶ Waivers may be granted before or after funds are obligated based on the facts that support

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the need for a waiver. The awarding official will consider any reasonable available information, which should include information provided by the state or local government procuring agency, the contractor(s), and potential domestic and foreign suppliers. Waivers require public notice, including publication in the *Federal Register*.

A survey of the *Federal Register* notices describing the waivers that have been granted demonstrates a few clear trends. First, the agency that has granted the most waivers is the Environmental Protection Agency (EPA). EPA has granted more waivers than those granted by all other federal agencies combined. Second, far and away the most common basis for a waiver is the nonavailability of the product from domestic suppliers. Third, only a few waivers have been granted under the “public interest” exception. Finally, no waivers were granted because the use of domestic iron, steel, or manufactured goods increased the cost of the project by more than 25 percent. This may be because a 25 percent cost increase for the *project* (not the item or the contract) is a very tough standard to satisfy.

Conclusion

The Recovery Act's Buy American restrictions have broad applicability and likely apply to almost any state or local public construction project that uses Recovery Act funds. Procurement officials and contractors should carefully review the rules applicable to a given procurement; they should not simply assume the restriction is not applicable because the World Trade Organization Government Procurement Agreement or another free trade agreement may apply. Whenever possible, it is advisable to get country-of-origin certifications from suppliers, so long as such certifications are based on the proper country-of-origin analysis. 

Endnotes

1. Recovery Act, § 1605.
2. See FAR Subpart 1.2.
3. Buy American Requirements, 74 Fed. Reg. 14623 (Mar. 31, 2009) (to be codified at 48 C.F.R. pts. 1, 5, 25 and 52); Requirements for Implementing Sections 1512, 1605 and 1606 for Financial Assistance Awards, 74 Fed. Reg. 18449 (Apr. 23, 2009) (to be codified at 2 C.F.R. pt. 176).; Requirements for Implementing Sections 1512, 1605 and 1606 for Financial Assistance Awards, 75 Fed. Reg. 14323 (Mar. 25, 2010) (to be codified at 2 C.F.R. pt. 176).
4. The FAR Councils adopted a broader definition that does not require public ownership of the building/work: "Public building or

public work means a building or work, the construction, prosecution, completion, or repair of which, as defined in this section, is carried on directly by authority of, or with funds of, a Federal agency to serve the interest of the general public regardless of whether title thereof is in a Federal agency." FAR 22.401.

5. 2 C.F.R. § 176.140(a)(3).
6. 2 C.F.R. § 170.140(a)(1).
7. 2 C.F.R. § 176.70 (emphasis added).
8. See, e.g., U.S. Customs Rulings HQ 079628 (Aug. 25, 1987) and 081659 (Mar. 3, 1989) (holding that reheating and hot-rolling steel slab substantially transforms it into a new product).
9. 2 C.F.R. § 176.70.
10. Recovery Act, § 1605(d).
11. 75 Fed. Reg. 14323 (Mar. 25, 2010).
12. FAR 25.003.
13. It is also important to realize that state or local projects that involve federal funds for "mass transit and highway projects" are exempt from trade agreements such as the GPA. In such circumstances, the state or local government entity and the contractor must comply with the Recovery Act's Buy American rule.
14. OMB provided different contract clauses for procuring agencies to use in Recovery Act solicitations. The first clause, 2 C.F.R. § 176.140, is used if the project is not subject to an international agreement. The second clause, 2 C.F.R. § 176.160, is used if the project is subject to an international agreement.
15. Recovery Act, § 1605(b).
16. 2 C.F.R. § 176.100(a).