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Joan Claybrook, President

MEMORANDUM

TO: **State Legislators, Attorneys General and other Constitutional Officers**
FR: **Public Citizen's Global Trade Watch**
DT: **March 7, 2005**
RE: **Dismissing State Legislators' Concerns, U.S. Trade Representative Sends New 2005 Letter to Governors Requesting State Sign-on for *Additional* Trade Pacts' Procurement Constraints and Threatens States That Choose Not to Do So**

In the spring of 2004, seven governors removed their states from the list of states to be bound by the government procurement rules contained in a proposed Central American Free Trade Agreement (CAFTA) and other new trade deals. Governors acted after state legislators and others raised concerns about how these CAFTA provisions would undermine many common state purchasing laws and preferences – handcuffing state governments with restrictive "trade" rules that limit legislators' policy options to promote good jobs and a healthy environment. Currently, a minority of 21 U.S. states remain bound to CAFTA's procurement constraints,[1] although the agreement remains unimplemented due to the lack of congressional support.

In January 2005, the National Conference of State Legislatures (NCSL) and the Intergovernmental Policy Advisory Committee (IGPAC) again raised concerns in a series of oral and written communications about the exclusion of state legislatures from the process used by federal trade officials to determine whether states would agree to be bound by trade agreement provisions. Among the reasonable requests made was for state legislatures to be copied on communications to governors from federal officials requesting a state's agreement to be bound.

Rather than seeking solutions, the United States Trade Representative (USTR) has continued to negotiate additional trade pacts that contain CAFTA-style procurement rules, and to ask governors for approval on behalf of their states, cutting state legislators out of the process. On January 27, 2005, USTR sent letters to governors requesting sign on proposed free trade agreements (FTAs) with Panama and the Andean nations of Columbia, Ecuador, and Peru. USTR explicitly rejected even providing state legislatures with notice of such requests.

Additionally, in its January 2005 letter to Governors, USTR unveiled a new policy designed to punish states unwilling to be bound by trade pacts' procurement constrains. USTR's proposal would establish "reciprocity" rules that are designed to remove procurement opportunities now available to businesses in all states from businesses in states refusing to be bound to future agreements' constraints. This proposal, which may violate constitutional Interstate Commerce Clause rules, and under any circumstances seems almost impossible to implement, would create an unequal playing field between states by attempting to allow only firms from states that sign on to trade pact procurement constraints to have access to the *subfederal* procurement markets of the nations involved in the agreement. Businesses in all states would maintain equal access to *federal* procurement opportunities in these nations. Of course, this is just a unilateral USTR proposal, as these agreements are not yet signed and Congress may not yet be aware of the issue and its ramifications for states.

Remarkably, USTR is attempting to spin this policy as a benefit to states. In fact, it would be a troubling shift that underscores an unwillingness to address state officials' legitimate concerns:

<u>USTR's subfederal procurement "reciprocity" plan ignores state officials' concerns, recommendations.</u>

USTR's new policy fails absolutely to address state legislators' concerns about lack of notification and consultation regarding binding states to trade agreements' procurement constraints. Instead, it contains an additional snub by attempting to "punish" those who have raised legitimate concerns. The USTR subfederal reciprocity proposal is intended to increase the "costs" of a decision not to submit a state to be bound to procurement constraints. Although, as discussed below, it is not clear how much real economic loss would be experienced by most state companies because of exclusion from subfederal procurement opportunities now available, the proposal is designed to meddle in the political dynamic in states seeking to avoid trade pacts' procurement constraints.

State officials have rescinded their commitments to trade agreements' procurement rules because of legitimate concerns regarding these provisions' affect on states' ability to use government procurement as a policy tool to pursue economic development, environmental sustainability and social justice. Seeking to punish states for such decisions sends a clear message that USTR is simply unwilling to address states' concerns. Moreover, states' decisions to withdraw from trade pact procurement constraints – and many other procurement policy decisions, including regarding anti-offshoring procurement policies – are made in the context of a major pushback by business associations, such as the national Chamber of Commerce, which represent companies that seek impunity from their decisions to offshore U.S. jobs or that seek freedom from state labor and environmental requirements. This new USTR proposal represents a crass attempt by USTR to meddle in states' local political affairs.

<u>USTR's proposed new policy would deny businesses existing procurement opportunities, not provide new or additional "benefits</u>."

USTR claims that "the approach offers a state a direct incentive and benefit for agreeing to cover its state procurement in the new FTAs, by ensuring that the benefits of open sub-federal procurement markets overseas flow to companies and workers in states that offer reciprocal opportunities."[2] In fact, the effect of USTR's proposal would be to *eliminate* existing opportunities now available to businesses from all states to seek federal and subfederal procurement contracts in countries signing trade agreements. The "direct incentive and benefit" that USTR is "offering" states is the same benefit that businesses in *all* states obtained under the previous trade agreements, whether or not a particular state choses to subject its procurement policies to agreements' restrictive procurement rules. In other words, the USTR is purposefully denying market access for U.S. suppliers by blocking a "benefit" for businesses located in a state that decides that signing on is not in the public interest. That USTR would seek to *limit* U.S. companies' international business opportunities post facto if states do not cede their regulatory authority to trade pacts' procurement terms reveals that this USTR proposal is rooted in ideological, not commercial goals. USTR often argues that obtaining state sign-on to trade agreement procurement terms is vital to negotiating better procurement opportunities for all U.S. companies. Yet, the new USTR proposal to cut off certain companies' potential business opportunities only operates *after* an agreement is negotiated. Whatever truth underlies USTR's contention about negotiating benefits based on the number of states signing on, this proposed policy would only kick in *after* a trade deal is signed when businesses from some states would be denied access to whatever terms were agreed. Unfortunately, USTR's ideological commitment to imposing one-size-fits-all economic and social policies in trade agreements through a form of international preemption that implicates federal, state and local policy options is leading the agency to seek to limit U.S. companies' international business opportunities.

USTR's proposed new policy would create an uneven playing field among U.S. states.

Some state officials have raised concerns that the new subfederal reciprocity proposal could be a violation of the constitutional Interstate Commerce Clause. For instance, in a February 3, 2005 letter from Maine Governor John Baldacci's office to USTR, Senior Policy Advisor Alan Stearns writes, "The new incentive described immediately above could be viewed as creating an uneven playing field for businesses from different US states. By definition, if not all 50 states grant access, then businesses from some states will be disadvantaged due to actions of the federal government. Could you discuss generally how this incentive should be viewed in the context of due process and interstate commerce provisions that would seem to argue for a level playing field?"[3] While more legal analysis of this constitutional issue is needed, it is certainly troubling that USTR is trying to create disparities among states to punish those unwilling to be bound rather than acting to address the substantive reasons leading states to choose not to participate in the procurement provisions of new trade agreements.

USTR has not honored states' past requests to list specific procurement laws as exceptions when states have signed-on to trade agreement procurement pacts.

USTR continues to claim that "state commitments to cover government procurement in trade agreements are voluntary; a state decides whether, and the extent to which, it will cover its procurement under the new agreements; a state decides the manner in which it will make a commitment to cover its procurement; a state may exclude sensitive goods and services…" However, USTR has failed to include specific state requests to list some state laws as exceptions (i.e. listing state laws that would not be required to comply with the agreements' constraints) when states have signed on to past trade pact procurement rules. For example, the state of Maryland, in agreeing to be bound by the World Trade Organization Agreement on Government Procurement (WTO AGP), requested that laws giving preferences for recycled products and selective purchasing laws targeting South Africa and Namibia, among other policies, be listed as exceptions to the state's commitment. No such exceptions were listed in the WTO AGP text. Giving the benefit of the doubt, one might argue that Maryland's situation was an oversight. Yet, just last year, USTR Robert Zoellick explicitly refused to take such reservations for a list of sensitive procurement policies requested by Governor Gary Locke of Washington in June 2004 as a condition for signing on to CAFTA,[4] putting in perspective the lack of real commitment to the oft-repeated promises that states can define participation on their own terms.

That some states are considering new policies that would clarify that they are not bound to trade agreement procurement rules unless their legislatures so vote is well justified given several recent revelations. Documents obtained through a recent Freedom of Information Act request show that Montana was listed as a state that is bound to meeting World Trade Organization (WTO) procurement constraints after its Governor sent a letter in 1993 noting that the state's laws did *not* conform to the WTO rules. Apparently, any letter from a Governor – even one saying that the state did not agree to commit – sufficed to get a state bound. Further, it appears that in 2003 the USTR simply copied the list of states bound to the WTO AGP and pasted them into the annex to the procurement chapter of the U.S.-Chile Free Trade Agreement – binding some 37 U.S. states to these additional agreements' procurement constraints without any consultation with states whatsoever. While the examples listed above are far from comprehensive, it is evident that the USTR is not making a good faith effort to solicit the prior informed consent of states before binding them to procurement agreements, and has bound states to various agreements in a slipshod manner.

USTR continues to downplay trade pact procurement rules' threats to many common state procurement policies and diminishment of state authority over taxpayer dollars.

USTR claims that "Most states already apply open and transparent procurement procedures and would not have to change their practices in order to participate in the FTAs."[5] However, recently-negotiated free trade agreements (FTAs) contain requirements that go far beyond transparency and 'national treatment' (the requirement that all foreign suppliers must be treated the same as domestic suppliers). CAFTA and the other recent FTAs impose subjective constraints on the types of technical specifications states may require for goods and services, and on the qualifications for potential suppliers that states can require. CAFTA requires that "procuring entities not prepare, adopt or apply any technical specification describing a good or service with the purpose *or the effect* of creating unnecessary obstacles to trade… and that technical specifications are limited to performance requirements rather than design or descriptive characteristics." These constraints mean that specifications based on *how* a good is made or *how* a service is provided are forbidden.[6] So, for example, preferences for recycled content, renewable energy or fuel-efficient vehicles could be subject to challenge under trade agreements' procurement rules. CAFTA also limits what sorts of qualifications may be required of companies seeking to supply a good or service. Conditions for participation in bidding are limited to "those that are essential to ensure that the supplier has the legal, technical and financial abilities to fulfill the requirements and technical specifications of the procurement."[7] Under this provision, policies that target companies' human rights, labor rights, or environmental track records – as well as prevailing wage requirements and project labor agreements – could also be subject to challenge under CAFTA.

Furthermore, while trade agreement procurement provisions do not operate automatically to overturn conflicting state laws, recently-negotiated agreements require that "Each Party [i.e. the U.S. Federal Government] shall ensure that its procuring entities [i.e. states listed in the agreement] comply with the provisions of this Chapter in conducting any covered procurement."[8] This clause has been interpreted to mean that the federal government must take all constitutionally available actions to force compliance – for instance enacting preempting federal legislation, suing or cutting off federal funding to states. USTR's downplaying of the risks of binding state laws to trade agreements' procurement rules is a disservice to state officials who are trying to evaluate the most prudent choice for their state.

Staying free of trade agreement procurement obligations gives states maximum flexibility.

USTR's claim that state taxpayers will benefit from "more competitive" government procurement if states sign on to trade pact procurement obligations. Yet, staying free of trade pact procurement rules in no way limits the number or kind of suppliers that may bid on states' contracts. Rather, staying out simply allows states to maintain maximum flexibility in deciding what criteria it will employ in choosing from among bidders. States not bound by trade agreements' restrictive rules are free to decide their priorities: some states may prioritize obtaining the lowest price at all costs, and others may use additional criteria that take into consideration bidders' past labor, environmental or criminal records (so-called debarment rules) or whether a supplier pays a living wage or provides healthcare for its workers, or performs the contract at home or overseas. The actual decisions states make regarding criteria for procurement are what influence the "costs of government," not the decision about whether to be bound by trade pacts' procurement rules.

What are "gains" from subfederal procurement market access in Panamanian, Andean pacts?

The USTR subfederal procurement reciprocity proposal is intended to pressure more states into agreeing to be bound by these pacts' procurement rules. While this policy would create a new lobbying point for those interested in limited state sovereignty over procurement policy, the actual economic implications of eliminating subfederal procurement opportunities to businesses in states not agreeing to be bound are unclear at best. First, U.S. companies from any state, regardless of whether or not a particular state has

signed on, would still be free to bid on contracts at the central or federal level in countries with which the United States has a FTA. Second, the notion that most state businesses could take advantage of whatever marginal, additional subfederal overseas procurement opportunities (i.e. contracts with a Panamanian municipality) might exist is in itself questionable, as mainly large and/or multinational firms have the capacity to undertake major international projects. However, more broadly in evaluating the costs and benefits of being bound, states must consider that what might be in the interest of a particular supplier – marginally more opportunities to bid overseas – is not likely to benefit a broad swath of a state's population, which is the constituency that stands to lose from seeing their tax dollars spent in a manner that will not recycle wealth in the community or satisfy environmental, labor or other principles typically reflected in a state's purchasing law. Most simply, theoretical, undocumented "gains" must be balanced with the loss to state sovereignty that is ceded by signing on to trade agreements' procurement rules.

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In sum, while the USTR's new policy is troublesome in its attempt to bully states rather than respond to state officials' legitimate concerns, it does little to change the ultimate decision that states must make. At stake remains how state tax revenues are spent, and what values and goals such policies promote. Opting out of coverage under proposed FTAs such as the U.S.-Panama and Andean agreements is still the best option for states looking to maintain maximum flexibility and control over state taxpayer dollars.

For leaked procurement documents from the U.S.-Panama Free Trade Agreement, correspondence between USTR and your state's governor, or additional information, please contact Sara Johnson at 202-454-5193 or sjohnson@citizen.org or visit www.tradewatch.org/subfederal/procurement.

[1] For an analysis of the policy implications of the government procurement rules in CAFTA and other free trade agreements, see www.tradewatch.org/subfederal/procurement.
[2] USTR Trade Facts, "State Government Procurement and Free Trade Agreements: A New Sub-Federal Reciprocity Approach That Preserves State Sovereignty and Provides Direct Benefits to States," Feb. 24, 2005.
[3] See Correspondence, Alan Stearns, Senior Policy Advisor to Governor John Baldacci, to Jean Grier, USTR, February 3, 2005, on file at Public Citizen.
[4] See Letters, Governor Gary Locke to Ambassador Robert Zoellick, Jun. 17, 2004 and Ambassador Robert Zoellick to Governor Gary Locke, Aug. 13, 2004, on file at Public Citizen.
[5] Ibid.
[6] Article 9.7
[7] Article 9.8
[8] CAFTA Chapter 9, Article 9.1(4).