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What You Need to Know About

# States' Rights and International Trade

- **What do international trade agreements have to do with states? Isn't this a federal issue?**

Trade is no longer simply a federal matter. Today's international trade agreements delve deeply into matters of state law. Pacts like the North American Free Trade Agreement (NAFTA) and various World Trade Organization (WTO) agreements contain numerous policy obligations and constraints to which U.S. federal, state and local governments are bound to conform their domestic policies. These types of "trade" agreements, which were passed in the United States using an extremely outdated trade negotiating process called Fast Track Trade Authority, undermine state regulatory authority in three major areas: government procurement, service-sector regulation and investment.

- **Does the federal government ever consult with states on international trade?**

While the federal government generally works cooperatively with states and state international trade offices in the area of export promotion, in other extremely important areas, consultation has been extremely limited or nonexistent. The Office of the U.S. Trade Representative (USTR), which is the cabinet-level, executive branch agency that negotiates U.S. trade agreements, relies on a severely flawed, outdated system for consulting states on trade-related matters. The current consultation system includes rare direct consultation only with governors on procurement issues; indirect consultation on services and other matters through a state Single Point of Contact (SPOC); and limited suggestions through the government-appointed Intergovernmental Policy Advisory Committee (IGPAC), who are required to have security clearances and are forbidden to share the information they receive with anyone else in the state government.

- **What are some specific examples of state laws that could be threatened by these agreements?**

Many common state policies could be threatened under the procurement, investment and service sector rules of various trade agreements. Under procurement rules, jeopardized policies include measures to prevent offshoring of state jobs; "Buy Local" or "Buy America" policies; preferences for recycled content or renewable energy; and policies targeting companies' human rights, environmental and labor conduct. Under service sector rules, jeopardized policies include a variety of state gambling restrictions, health care policies, higher education subsidies, transportation policies, energy policies and many more. Under investment rules, an incalculable number of state regulations that might negatively impact a foreign investor's profitability could be challenged, including environmental and public health measures such as toxics bans and tobacco controls, adverse court judgments and more.

- **What happens if a state law is found as a "barrier to trade" under one of these agreements?**

If another WTO nation challenges a state policy as a violation of one of the many WTO agreements, the case goes to a powerful, binding dispute resolution system built into the WTO. State and local officials have no standing before the WTO tribunals and must rely on the federal government to defend a challenged state or local policy. Tribunals are staffed by a rotating roster of trade lawyers who are not subject to conflict-of-interest rules and who may have no expertise in the matter at hand, yet are empowered to judge whether a local policy has resulted in a violation of a particular trade agreement – without reference to any U.S. law and jurisprudence on the matter. If a state law is ruled against in one of these trade tribunals, the policy must be eliminated or amended, or the federal government is subject to punitive trade sanctions until the violation is remedied.

In the case of NAFTA, in addition to the tribunals that can authorize trade sanctions, there is an additional enforcement system with tribunals empowered to order that cash damages be paid to corporations that are permitted to directly challenge state laws as a violation of their NAFTA-granted foreign investor rights. Though it is the federal government that is technically liable for these cash damages, state governments could be held hostage for the funds. Simply defending one such corporate attack on a California law banning the gasoline additive and water pollutant MTBE has cost over $3 million in legal fees alone.

- **Have any state laws ever been challenged as a barrier to trade?**

One notable case occurred in 1997, when the European Union (EU) and Japan challenged a Massachusetts law banning purchases from companies that did business with the dictatorship in Burma (Myanmar). The EU argued that the state's procurement policy had to conform to WTO rules and that the Burma law contravened the WTO procurement agreement by imposing conditions that were not "essential to fulfill the contract." While this WTO suit was withdrawn because the same business interests were pursuing a parallel suit in the domestic court system (that eventually succeeded in undermining the state law on narrow grounds that federal policy already existed on the Burma trade issue), this EU-Japan formal WTO attack on Massachusetts' law was then used by the U.S. State Department as Exhibit #1 when Maryland sought to pass similar legislation regarding the Nigerian dictatorship's brutal human rights violations. Federal government officials descended on the state capital lobbying to kill the proposal, which had been expected to pass easily. In the end, the bill was defeated by one vote.

After an initial wave of WTO cases and NAFTA foreign investor challenges, the enforcement of the NAFTA and WTO policy constraints has gotten more subtle − with challenges being threatened as a way to chill innovation or trigger federal government pressure against state initiatives. Although there is not a long list of formal WTO or NAFTA cases against U.S. state policies, the cases that have been launched are illustrative of the threats posed to normal governmental activity and legislative prerogatives by the NAFTA-WTO model.

- **What actions have states taken to safeguard their sovereignty from trade agreement incursion?**

Many states have taken action in various ways to fight for fairer trade policies. Alarmed at the role the WTO's service-sector agreement has already had in accelerating the offshoring of service-sector jobs and worried about the problems the agreement could pose for quality health care and higher education, in 2006 four state governors took decisive action to safeguard their states from the worst aspects of the General Agreement on Trade in Services (GATS). Governors Baldacci of Maine, Kulongoski of Oregon, Granholm of Michigan and Vilsack of Iowa wrote to the USTR demanding that their states be carved out of prior and future U.S. GATS commitments.

Due to the growing awareness that states have much to lose and little to gain by signing up to the restrictive procurement rules of trade agreements, 31 states declined to sign onto the Central America Free Trade Agreement (CAFTA) procurement provisions in 2005. Also in 2005, two state legislatures took the extra step of clarifying the legal procedure at the state level regarding trade agreements' procurement provisions. Maryland and Rhode Island both passed laws that ensured the power to sign up to the procurement terms of any trade agreement rest exclusively with the state legislature.

- **Does a state lose business opportunities overseas if it doesn't sign on to the procurement terms of a trade agreement? If a retroactive bill is passed, will these procurement contracts be invalidated?**

Whether a state has signed on to the procurement chapter of a trade agreement or not, it still is qualified to bid for federal contracts in other countries in a trade agreement regardless of the state's signatory status. Thus, the only potential gain if a state signs on is the right to bid for *subfederal* contracts in other countries. Yet, the marginal benefit of additional business opportunities overseas depends on how many subfederal entities in other countries are bound to the procurement terms and how that other country deals with procurement vis-à-vis the portion of procurement conducted nationally versus locally. Second, the notion that most state businesses could take advantage of whatever marginal, additional subfederal overseas procurement opportunities might exist is in itself questionable, as mainly large and/or multinational firms, not smaller state businesses, have the capacity to undertake major international projects. If a state passes a law retroactively invalidating that state's participation in a procurement agreement with country X, this should not affect current state contracts made with overseas providers from country X. Whether or not a company was granted a contract probably has nothing to do with a state's participation in a specific trade agreement.

- **How can a state be a part of the fight to replace Fast Track?**

States can take two actions as part of a nationwide effort to encourage the federal government to replace the failed Fast Track model. First, states can pass binding legislation like Maryland and Rhode Island did that formally clarifies and clearly provides that only an act of the state legislature − not just a governor's signature − can bind a state to the non-tariff terms included in any trade agreement that affects state regulatory authority. Second, to play a role in federal level reforms, states can pass nonbinding resolutions urging the replacement of the failed Fast Track model with a new mechanism that requires checks and balances, including by requiring federal trade negotiators to seek the formal consent from state legislatures prior to binding states to conform their laws to the terms of international trade pacts. If a large number of states were to pass such resolutions, it would send a powerful message to Congress that states expect their concerns about Fast Track running roughshod over state sovereignty to be addressed when Congress replaces Fast Track.

***To learn more about state sovereignty and trade, please contact:***
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