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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: July 2, 2004
RE: Urgent Action Needed to Prevent Preemption of State Procurement Policy by Trade Agreement Terms; Absent Action Now, Your State Could Be Bound without Your Prior Informed Consent to the Central American Free Trade Agreement (CAFTA) Rules

Today's international "trade" agreements, such as the North American Free Trade Agreement (NAFTA) and the World Trade Organization (WTO), contain many policy obligations and constraints to which U.S. federal, State and local governments are bound to conform their domestic policies. State laws that conflict with these rules can and have been challenged as illegal "barriers to trade" in the binding dispute resolution systems established by these agreements. The federal government has assumed authority to commit all levels of government to many of these trade agreement provisions, without specific consent by subfederal governments. A general exception has been procurement policy.

A leaked September 2003 letter from the Bush administration to Governors reveals that an attempt currently is underway to obtain Governors' "voluntary" commitment to bind their States to comply with procurement rules to be included in all new trade pacts now being negotiated. Governors were asked to commit States to comply with whatever procurement rules result from negotiations – effectively to deposit an open signature card for future pacts with unknown requirements. Among the pacts that would be covered are the recently-completed Central American Free Trade Agreement (CAFTA), which covers El Salvador, Guatemala, Nicaragua, Honduras, and Costa Rica, and the Free Trade Area of the Americas (FTAA), a proposed NAFTA expansion to 31 countries in the Western Hemisphere.

The notion of agreeing that all present and future State procurement policy must conform with international rules not yet written is in itself worrisome. However, the publication of the CAFTA text allows analysis of that pact's *actual* implications. We are writing to alert you that CAFTA contains constraints with regard to the development of procurement policy and the awarding of procurement contracts that conflict with an array of procurement policies common in many U.S. States. If a State signs up and agrees to comply with the procurement provisions of CAFTA, the following policies are forbidden, meaning existing policies that do not conform must be changed, and states are forbidden from establishing such policies in the future:

- Anti-offshoring policies. CAFTA requires "national treatment" for all goods and services a government purchases, meaning signatory governments cannot give preference to local firms or firms employing local workers, much less forbid the spending of State tax dollars on companies offshoring work. This means that the "anti-offshoring" legislation now proposed by 31 States, and an array of other local development policies aimed at keeping State dollars paying in-state wages and giving preference to locally-produced goods and services (so-called "Buy America" policies) are forbidden under CAFTA procurement rules.

- “Green” procurement policies. 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 – for instance requiring recycled content in paper or other goods to be procured – or *how* a service is provided – for instance requiring a portion of energy procurement be from renewable sources – is forbidden. As well, any qualification that might have the unintended *effect* of creating an obstacle to trade – such as environmental or consumer safety labels or certain packaging requirements – is subject to challenge before a trade tribunal. In the past, federal trade officials have lobbied in State capitols against laws which might have such effects – chilling State policy-making.
- Policies targeting companies’ human rights, environmental, labor conduct. CAFTA 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.” This means that suppliers cannot be disqualified because of the companies’ labor, human rights or environmental records or practices. Yet, many States condition contracts upon such track records or practices in a number of ways. Under the same provision, “sweat free” procurement rules that ban purchase of goods from companies using sweatshop labor or child labor are forbidden, as is the exclusion of companies based on their international human rights and environmental records.
- Prevailing and living wages and project-labor agreements. CAFTA’s limits on the requirements that can be imposed on contractors also forbid conditions such as prevailing wage and living wage requirements. Project labor agreements that require fair treatment of workers and their unions in order to avoid labor disputes in public works projects also cannot be required for a bidder to qualify for State business.
- Pro-union or pro-public bidding assistance. CAFTA rules forbid policies that provide aid to employees and unions in bidding for public contracts, and laws that require favorable consideration of such in-house bids. Also in conflict with CAFTA rules are costing requirements that require private bidders to provide substantial savings over public providers in order to get a public contract, but do not allow savings due to lower wages or benefits to be factored in.
- Policies targeting countries’ human rights, labor rights, other conduct. CAFTA requires “most favored nation” treatment in procurement, meaning that governments cannot treat foreign companies differently based on the human rights, labor rights or environmental records of the countries in which they are based or in which they operate. This removes tools used by States in the past to demand corporate responsibility in the face of human rights abuses – such as the policies disqualifying procurement from companies doing business in apartheid South Africa and those now in place in several States regarding procurement with companies doing business in Burma.

Under CAFTA Chapter 9, Article 9-2, the domestic procurement policies of the entities bound to the agreement must be consistent with the constraints set forth in the CAFTA procurement text – meaning committed States must change existing nonconforming procurement policies. Moreover, other nations that are party to the CAFTA are empowered to challenge a nonconforming State policy (no matter when it was established) as a violation of the agreement in a binding dispute resolution system established in the text. State government officials have no standing before these tribunals and thus must rely on the federal government to defend a challenged policy. The tribunals are staffed by trade officials who are empowered to judge if State policy has resulted in a CAFTA violation. Policies judged to violate the rules must be

changed, or trade sanctions can be imposed. As well, the federal government is obliged to use all constitutionally-available powers – for instance preemptive legislation, lawsuits and cutting off funding – to force subfederal government compliance with CAFTA tribunal rulings.

Since the release of the CAFTA text, Governors from seven States (Iowa, Kansas, Maine, Minnesota, Missouri, Oregon, and Pennsylvania) that were previously listed to be bound by the agreement's procurement rules each acted to withdraw their States from the agreement. Many other States (Tennessee, Wisconsin, and others) explicitly declined to be bound in the first place.

To date, only 21 States remain listed in the CAFTA text: Arkansas, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Kentucky, Louisiana, Maryland, Mississippi, Nebraska, New Hampshire, New York, Rhode Island, South Dakota, Texas, Utah, Vermont, Washington, and Wyoming. To avoid State procurement policy prerogatives and authority from being preempted, State Legislators and Attorneys General must act now, before Congress votes on CAFTA and other pacts, to remove their States from these agreements. Urgent action is needed now to protect your interests and to make sure that no further commitments are made to bind current and future State and local governments to trade agreements without their prior informed consent.

Some State officials have questioned whether a Governor has the authority to unilaterally commit a State to conform its legislation to trade pact requirements without obtaining State legislative approval because compliance with an agreement's terms could effectively rewrite policies set by the legislature. This is a critical question State officials must tackle so that proper procedures can be established for the future. However, at issue *immediately* for each State is a more urgent question: **has your Governor already authorized the State to be bound?** If so, and you do not believe it is in the public interest for your State to be bound, you must now take action to ensure that your State's commitment is withdrawn. In States not yet listed, action must be taken to ensure a future letter is not sent committing the State. Currently, Bush administration officials are lobbying Governors who have not responded to do so and to commit their States, so additional States not currently listed in the CAFTA text could be committed as well.

Moreover, CAFTA was signed by the Bush administration on May 28, 2004. Under special Fast Track rules, which bypass normal committee process and guarantee floor votes with no amendments and only 20 hours of debate, it can be sent to Congress for a vote at any time. When a trade agreement is approved by Congress, the entire agreement text is adopted as federal law. States that are listed when an agreement is approved would face additional federal preemption issues if they were to later seek to withdraw. However, getting a State off the list before an agreement is approved is key, because even if a State could convince the federal government to remove the State from the list, under CAFTA rules this can only be done after compensating all other signatories to the agreement for the removal of a "benefit."¹ This compensation requirement makes getting out of a trade agreement's procurement rules extremely costly at a minimum and in practice extremely unlikely. Thus, great care must be taken before agreeing to be committed in the first place.

Bush Administration Arguments to Persuade Governors to Sign On

The September 2003 letter from the Office of the United States Trade Representative (USTR) requesting Governors' consent on behalf of their States did not do justice to the wide-reaching implications of the decision they were being asked to make. Key omissions and misconceptions are addressed below:

¹ Article 9.16: Modifications and Rectifications to Coverage: "2. A Party may modify its coverage under this Chapter provided that it: (a) notifies the other Parties in writing and the other Parties does [*sic*] not object in writing within 30 calendar days of the notification; and (b) where necessary, offers within 30 calendar days acceptable compensatory adjustments to the other Parties to maintain a level of coverage comparable to that existing prior to the modification."

USTR Argument #1: *State procurement policy prerogatives would not be meaningfully limited if a State consents to be included. States are only agreeing to give foreign suppliers the same opportunity to bid on State contracts as domestic suppliers a.k.a. “non-discrimination.”*

First, agreeing to a binding non-discrimination standard is in itself a major policy change for the 24 States which have “Buy America” or “Buy- X State” procurement preferences for local goods, services and companies. As well, this commitment would forbid the many varieties of anti-offshoring legislation now being considered in States. But, second, as the text demonstrates, States signing on assume commitments that go far beyond “non-discrimination.” The CAFTA procurement terms contain numerous additional constraints limiting what types of technical specifications or qualifications of potential suppliers States can require for the goods and services they seek. The CAFTA terms would require States to eliminate many existing procurement policies and would forbid action now under consideration in many States.

USTR Argument #2: *Signing on to trade agreement procurement rules will promote State business opportunities overseas because doing so would qualify companies in the State to bid on projects in other countries.*

A fact the USTR letter to Governors fails to note is that U.S. companies in any State, whether that State has signed on or not, would be qualified to bid for federal contracts in other countries in a trade agreement regardless of the State’s status as a signatory or not. 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.

USTR Argument #3: *Thirty-seven States have already agreed to comply with the WTO’s Agreement on Government Procurement (AGP).² Thus, agreeing to commit to future agreements’ procurement terms is of little effect.*

What is not mentioned is that only the U.S. and 27 other primarily industrialized countries have signed the WTO AGP – while the other 120 WTO signatories have refused to do so. This means that currently the 37 States signed onto the WTO rules must only provide non-discriminatory treatment and meet the other WTO limits regarding bids from companies from those 27 countries.³ Given the dubious process used to sign States onto the WTO rules in the first place⁴ and that some States are considering the wisdom of these commitments, agreeing to follow procurement restrictions vis-à-vis more countries may not be

² States listed in the annex to the AGP procurement agreement are as follows: Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, New York, Nebraska, New Hampshire, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, Washington, Wisconsin, Wyoming.

³ There is some debate about whether the 37 counties may also owe this obligation to Chile, because it appears that the USTR listed the 37 AGP states as bound to the comply with the procurement rules in the 2003 U.S.-Chile Free Trade Agreement and the 2003 U.S.-Singapore Free Trade Agreement without any consultation or consent by States. Singapore is a party to the WTO AGP, but Chile is not.

⁴ Some States, such as Massachusetts, were signed up even though the Governor wrote a letter simply stating that the State conducts procurement policy in a manner generally consistent with the AGP. The State of Montana was signed up to the AGP even though the Governor wrote to the USTR to explicitly state that Montana’s procurement policies were not in accordance with the AGP.

the best approach. But, if a State sends in the requested permission to be bound to all future agreements' procurement rules, the privileges would have to be extended to the companies of 38 additional countries!⁵

USTR Argument #4: *The procurement provisions in CAFTA as well as the other agreements under negotiation contain exceptions which States can use to protect policies which otherwise violate the rules.*

While it is true that CAFTA contains exceptions, as with all legal instruments, the devil is in the details. There are two kinds of exceptions in CAFTA. First is a set of "Notes to United States - Section B, Annex 9.1" which carves out certain procurement activities. For instance, the broadest carve-out provision States: "This Chapter shall not apply to preferences or restrictions associated with programs promoting the development of distressed areas and businesses owned by minorities, disabled veterans, and women." This clause is effective in protecting set-asides and preferences for the types of businesses listed above which would otherwise be forbidden under CAFTA rules. However, this type of straightforward language is not used to carve-out many other kinds of policies that would be found in violation of the rules.

The Annex 9.1 includes circular language concerning environmental considerations regarding procurement which reads "3. Nothing in this Section shall be construed to prevent any State entity from applying restrictions that promote the general environmental quality in that State, as long as such restrictions are not disguised barriers to international trade." The last clause is associated with a long history of GATT-WTO jurisprudence interpreting policies based on how a good is made or harvested as being disguised barriers to trade. Thus, the second half of the sentence effectively eats the first half of the sentence. That is to say, this so-called exception does not protect the many procurement policies requiring product or producer environmental specifications which conflict with other CAFTA procurement rules.

Similarly useless is the language in Chapter 9, Article 9.7, which states "5. For greater certainty, this Article is not intended to preclude a procuring entity from preparing, adopting, or applying technical specifications to promote the conservation of natural resources." If this provision were meant to be binding – rather than greenwash – the operative verb would not be "is not intended." Rather, it would say "nothing in this article shall preclude" which is the language used in other provisions of this agreement and many other trade agreements. Further, even if this clause were written to be binding, it would conflict with other provisions' ban on consideration of *how* a product is produced. Given most natural resource conservation measures focus on such considerations (sustainably harvested wood, recycled paper), the mechanisms needed to deliver the policy goal of natural resource conservation would themselves be outlawed.

The other set of exceptions set out in the CAFTA procurement chapter, contained in Article 9.14⁶, are of very limited practical use. These exceptions can only be raised in defense of a law that is being challenged in a CAFTA tribunal as violating the procurement rules. That is to say that, unlike the General Notes, these exceptions do not carve out certain activity from coverage under the CAFTA rules, but only may be raised by the federal government defending a State law once a challenge has been lodged.

⁵ Including Argentina, Bahrain, Botswana, Brazil, Belize, Barbados, Bolivia, Columbia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Lesotho, Morocco, Namibia, Nicaragua, Panama, Paraguay, Peru, South Africa, Swaziland, Thailand, Trinidad and Tobago, Uruguay, Venezuela and an array of additional Caribbean nations.

⁶ "1. Provided that such measures are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between Parties where the same conditions prevail or a disguised restriction on trade between the Parties, nothing in this Chapter shall be construed to prevent a Party from adopting or maintaining measures: (a) necessary to protect public morals, order or safety; (b) necessary to protect human, animal or plant life or health; (c) necessary to protect intellectual property; or (d) relating to goods or services of handicapped persons, of philanthropic institutions or of prison labor. 2. The Parties understand that paragraph 1(b) includes environmental measures necessary to protect human, animal or plant life or health."

The Article 9.14 exceptions follow boilerplate language that is derived from decades of WTO-GATT jurisprudence. This history defines what they mean in the context of trade law – which is quite different than what they might appear to mean on their face. For instance, the *chapeau* language⁷ to Article 9.14 requires that to even qualify for an exception, “measures are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between Parties where the same conditions prevail or a disguised restriction on trade between the Parties...” These words have launched hundreds of pages of trade rulings, which boil down to a set of difficult-to-overcome tests that must be applied before the exceptions listed below can even be considered.⁸ Despite scores of attempts, GATT and WTO tribunals have very rarely permitted countries seeking to use these exceptions to proceed past the *chapeau*.

Assuming a challenged State procurement policy can get past the *chapeau* limitations, then it must be proved to be “necessary” to “protect public morals, order or safety; (b) necessary to protect human, animal or plant life or health.” The term “necessary” also has reams of GATT-WTO jurisprudence, which among other things, has been interpreted to require that the defending party must prove that another less-trade-restrictive means to obtaining its public safety or health goal does not exist. It is not surprising that countries seeking to use these “necessity” test exceptions have had a difficult time proving the negative – that another means does not exist – especially since tribunals have not been willing to consider financial, technical or other limits on the feasibility of hypothetical alternatives. The bottom line regarding the Article 9.14 exceptions is that they are of extremely limited use. Moreover, noticeably missing from the CAFTA’s procurement exceptions provision is one of the exceptions included in the GATT text on which this CAFTA clause is based that covers “exhaustible natural resources.”⁹

This absence of the natural resources exception only serves to highlight what is cynical rhetoric regarding environmental procurement issues sprinkled throughout the CAFTA text. For instance, Article 9.14 includes a clause stating that “2. The Parties understand that paragraph 1(b) includes environmental measures necessary to protect human, animal or plant life or health.” Yet, at issue is not what types of measures qualify for clause 1(b)’s exception for animal, plant and human life and health, but that there is no clause that provides any exception for policies aimed at natural resource *conservation* and *management*. There are several other places where such meaningless rhetoric purporting to safeguard environmental procurement policies from the agreement’s constraints is included.

USTR Argument #5: Challenge to State procurement policies is unlikely.

State procurement policies have already been challenged as “barriers to trade” at the WTO as not in compliance with the WTO’s Agreement on Government Procurement. In 1997, Japan and the European Union (EU) challenged a Massachusetts law barring purchases from companies doing business in Burma.

The serious human rights violations and the deliberate suppression of democracy perpetrated by the military junta ruling Burma (which the junta has renamed Myanmar) since it came to power in 1988 are well-known throughout the world. Burma’s pro-democracy movement, led by Nobel Peace Prize holder Aung San Suu Kyi, has called for South Africa-style foreign divestment from Burma to financially starve the military dictatorship. Some two dozen U.S. municipal and county governments, and the State government of Massachusetts,¹⁰ acted on this request and terminated purchasing contracts with companies doing business in Burma, including European and Japanese corporations.

⁷ *Chapeau* is the technical term for a preceding clause that sets the parameters for the underlying provisions.

⁸ The GATT-WTO jurisprudence on these terms is outside the scope of this memo, but each element of the *chapeau* has been interpreted to strictly limit which domestic laws might obtain protection from the underlying exceptions.

⁹ GATT Article XX(g).

¹⁰ Act of June 25th, 1996, Chapter 130, 1, 1996, Mass. Acts. 210, codified at Mass. Gen. L. ch. 7. 22G-22M.

In its WTO complaint, the EU argued that not only was Massachusetts covered by the AGP, but that the Burma law contravened the Agreement by imposing conditions that were not essential to fulfill the contract, imposing qualifications based on political instead of economic considerations, and allowing contracts to be awarded based on political instead of economic considerations.¹¹

This WTO action was preempted by a domestic court challenge which resulted in a narrow U.S. Supreme Court ruling which held that a State or local selective purchasing law sanctioning a nation is preempted only if Congress has passed a corresponding law sanctioning that nation (which Congress had done), and the two laws differ. However, the precedent of foreign governments challenging State procurement policy was set. Later, the Clinton administration successfully pressured the State of Maryland to withdraw selective purchasing legislation targeting Nigeria to avoid another WTO complaint.¹²

State Legislators and Attorneys General Must Act Now!

State government officials must act now to protect State sovereignty and the principle of federalism before CAFTA and other agreements are signed or brought to Congress for consideration.

- Where a Governor has already given consent and a State is listed on a pending trade agreement to be covered by the procurement provisions of that pact, concerned State officials should contact both the Governor and the Office of the USTR to urgently request that the State's name be removed from the agreement. Because USTR has not been sufficiently careful in its response to States, please obtain confirmation in writing that your State has been removed from the list.
- Concerned officials in States not yet listed should contact their Governor's office to determine if the Governor has or is considering signing onto any trade agreement. Legislators should make clear that these pacts contain binding procurement policy, not just a commitment not to discriminate against foreign firms. Concerned officials should obtain a commitment from the Governor that the Governor's office will not bind the State.
- State Legislatures should consider creating a more democratic mechanism for information sharing about trade agreements. Given that setting procurement policy is constitutionally under the purview of the State Legislature, not the executive branch, legislators should demand public hearings, legislative action, and other mechanisms for ensuring the Legislature's prior informed consent before states are committed to complying with trade agreement's provisions. State legislation should be considered to give State Attorneys General a formal review role in determining what State laws could be conflicting under trade agreement provisions. Information sharing and consent requirements should also be extended to county and city governments whose purchasing policies may be compromised in the future by global trade pacts.
- In addition, legislators might consider the provisions of a bill debated in the Colorado Legislature, Senate Bill 04-170, which in addition to prohibiting the outsourcing of State contracts to overseas firms also contains a legislative declaration that "State officials, including the Governor, do not have the authority to agree to bind the State under the government procurement rules of an international trade agreement, nor to give consent to the federal government for the State to be bound by such an

¹¹ World Trade Organization, "United States – Measure Affecting Government Procurement, Request for Consultation by the European Communities," WT/DS**/1, GPA/DS2/1, Jun. 26, 1997.

¹² Lori Wallach and Patrick Woodall, *Whose Trade Organization: A Comprehensive Guide to the WTO*, (New York, NY: New Press, 2004).

agreement.” The bill goes further to declare that any prior consent by the State to any trade agreement is invalid and any future consent must be garnered by a specific, explicit act of the General Assembly authorizing such consent.

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