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The Impact of International Trade on State and Local Government Authority

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Since the 1990's, the United States has vigorously pursued and become a party to international trade agreements such as the World Trade Organization (WTO) and the North American Free Trade Agreement (NAFTA). Traditional trade treaties are intended to open new commercial opportunities and technology sharing avenues which promote economic development by leveling the playing field .

The new trade agreements have the potential to open unprecedented service and goods markets bringing economic growth to U.S. investors. However, this new generation of trade agreements reaches beyond the traditional agreements that limit excessive tariffs, import limitations, or customs practices and may change substantively domestic governance at all levels. Benefits to state and local government will depend in large part on the interpretation of the agreement regarding state and local government authority.

The WTO, NAFTA, the General Agreement on Trade in Services (GATS) and the upcoming Free Trade Area of the Americas (FTAA) have been formulated to limit government participation in a number of ways in the name of free market competition. Government measures such as subsidies, taxes, health and environmental regulations, administrative rules, and government provision of goods and services are viewed as potentially interfering with the free market disciplines of competition based on price and quality.

New Generation Trade Agreements

Name	Signatories	Highlighted Impacts on Government
North American Free Trade Agreement (NAFTA) 1994	United States Canada Mexico	▪ Individual foreign investors can sue nations ▪ Dispute resolution in secret tribunals ▪ Removes state court jurisdiction over cases ▪ Property redefined for foreign investors
The World Trade Organization (WTO) 1995	144 countries	▪ Trade-legal test for all government action ▪ Binding obligations ▪ Financial penalties for government actions
The General Agreement on Trade in Services (GATS) 1995	The 144 WTO Countries	▪ Liberalizes services listed in the agreement ▪ Government provision exception limited to those services not offered privately ▪ Water delivery and treatment, schools, and prisons may be open to competition
The Free Trade Area of the Americas (FTAA) In draft form Expected 2003	34 North, Central and South American countries and the Caribbean but not Cuba.	▪ Liberalizes all service sectors not specifically excluded ▪ Draft includes NAFTA investor rights chapter ▪ May extend foreign investor protection from performance requirements to domestic investors

Under NAFTA claims are
- decided in closed arbitration;
- defended by the federal government;
- the state does not have access to the hearings; and
- state law is irrelevant.

The foreign investor is on par with the nation and chooses the court, the law, and level of transparency.

State and local laws may be affected because the trade agreements extend to all levels of government including administrative agencies or businesses contracted to implement programs legitimized by government authority. The United States is a federalist government in which the federal government shares powers with the states. Federal law preempts state law where they conflict.[i] Trade agreements become federal law when congress ratifies them and, therefore, trump state and local law. There is a shift in power from the state to the federal government whenever the federal government agrees to international obligations that bind the states. States are duty bound to govern for the benefit of the people of that state, which is a discriminatory standard by its nature. The federal government, through the commerce clause of the U.S. Constitution prohibits the states from inhibiting interstate commerce in pursuit of local advantage. Federal district courts hear disputes between foreign parties and the states. The federal courts interpret state law in this process and are used to avoid state bias, not to supplant federal law. Under NAFTA, foreign investors can bring these claims to binding international arbitration panels. This avoids both the state and federal domestic court systems, and any obligation to use U.S. laws. This process lacks the predictability of the U.S. court system and the framework in which local and state governments function.

Proponents of free trade consider the loss of sovereignty, and growth of international influence to be a step in the right direction for international cooperation. By extending U.S. investor protections to other countries the agreements help safeguard investments abroad. Some state and local government associations believe that the benefits can be attained without limiting the dynamic, flexible and community-based leadership role of local and state government actors.

Other analysts believe that the trade agreements shift powers away from the state toward the federal government, international arbitration panels, and individual foreign investors. NAFTA Article 105 and the NAFTA implementation language specifically assert that the federal government must take measures to ensure that sub-national government agents, quasi-governmental organizations or authorized contractors comply with the agreement obligations. Thus the agreements increase pressure on state and local governments to defer to international standards rather than community standards or custom.

New Rights Bring Investors on Par with Nations

Property is defined to include future profits, market share, and market access which by their nature would allow compensation for partial takings, in conflict with the U.S. takings clause.

An "investor" is any person, company or lender with a financial venture that sells goods or services in a participating country where the investor is considered foreign[ii]. These investors have a right to bring nations into international arbitration to defend government measures that affect their investments (property) negatively. These agreements expand foreign investor rights by granting:

- ✓ property rights greater than domestic citizens and

- ✓ access to an international court that can award damages for government actions that impact investor profits.

The expanded view of "property" is defined to include future profits, market share, and market access. Partial losses of profit or use of land may require government compensation. This is a greater right than U.S. citizens have under the takings clause. Partial regulatory takings are considered non-compensable, reasonable losses for the privilege of citizenship in the domestic context[iii].

Foreign investors have also been granted the right to comment on draft legislation that might affect investments. If displeased with the final legislation, foreign investors can circumvent the legislation and challenge the law by asking a secretive international arbitration tribunal to declare the law invalid under NAFTA on a number of grounds. These changes are the basis of much of the concern voiced by state and local governments. The concern is not unfounded, and has been reinforced by the actions of some investors.

Several California communities noticed a terrible smell and taste from their water taps. A study of Santa Barbara revealed that MTBE (methyl tributyl ethanol), an additive used to make gasoline burn cleaner, had leached into the wells. Separate scientific studies found MTBE to be carcinogenic and very difficult to remove from water. Aesthetically, a few drops of MTBE can make an Olympic pool-sized reservoir of water taste and smell like turpentine. Freshwater resources are critical to California, so to protect public health and the environment, the Governor of California called for a ban of the chemical.

Methanex, a Canadian firm that provides one component of MTBE, is currently challenging California's right to ban MTBE on the grounds that it violates NAFTA Chapter 11 obligations. The company has interpreted the ban as an expropriation of their market though it accounts for only 6% of their product sales. Methanex further claims that the state should have pushed for strict compliance with existing environmental inspection regulations of underground tanks rather than eliminating the chemical. To choose the more expeditious route of eliminating the chemical from the stream of commerce conflicts with Methanex's right to be governed by the least trade restrictive methods available. Methanex is claiming nearly a billion dollars in damages including good will, reputation and future profits. The challenge is being entertained by a tribunal at the time of writing though no arguments have been made public .

Methanex v. U.S.

The Methanex case is resting on whether the U.S. must enforce environmental laws that require better underground storage tanks, or can choose to eliminate MTBE and only use chemical additives that don't leak from the tanks that are now in use.

Methanex claims that under the agreement the nation should have to pay them for their loss of business, or repeal the ban and pay for containers impermeable by MTBE to prevent the pollution.

California chose to ban MTBE rather than spend large sums of money to replace tanks or increasing inspections.

The U.S. court system has awarded California cities millions in damages from refineries for the environmental damage cause by MTBE. In either case, the financial burden is placed on the government, not manufacturers or users.

"“Sovereignty” is the power to govern without external limits”
Schweke, 1999

Domestically, the U.S. court system has been supporting cities affected by this chemical and making gasoline refiners pay. California cities have sued refiners for MTBE ground water well pollution. Courts have awarded cities close to $40 million for remediation.

IMPLICATIONS FOR STATE AND LOCAL GOVERNANCE

The manner in which state and local governments protect public health, encourage sensible growth, economic development and interpret their laws is in question under trade agreements. These traditional powers are not protected, and may be targets for elimination as "non-tariff barriers to trade" in some instances. The WTO and NAFTA change the way that laws are made, the interpretation of those laws in the court system, and the scientific standards on which they are based. Taxes on foreign businesses operating in the U.S. may be limited by NAFTA as will the ability of states to require state licenses, certifications, or the residency of key personnel under GATS. Performance requirements, bonds to ensure a fund for liability in case of dispute, and any preferences for local goods or labor may conflict with NAFTA. State and local governments are bound to the international trade agreement obligations and must comply with all of the restrictions on government market intervention.

State Sovereignty Challenged

Some state members of Congress, such as California Senator Sheila Kuehl and Massachusetts Representative Byron Rushing are concerned that the obligations may go so far as to encroach on state sovereignty. Both states and state legislators support free trade and understand the importance of foreign markets to US growth. California boasted $1.7 billion of exports in 1999 and supported those exports with $13.5 million of subsidies annually.[iv] Kuehl and Rushing are concerned, however, that the trade agreements lack procedures that promote meaningful public input and may undermine domestic legislation.

States currently pass laws that affect health, property rights, taxation, development, and environmental regulations. These laws are generally upheld if they are rationally related to a legitimate government purpose and do not conflict with or are not less stringent than federal law. NAFTA further burdens all U.S. "government measures" that may impact trade to be consistent with international standards.

Laws that may have an impact on foreign investments must pass a test called the "trade-legal " requirement. Laws must pass a three-part test that proves that:

1. the objective is considered legitimate under the treaty;
2. it is the least trade restrictive alternative available; and
3. the measure does not constitute a disguised restriction on trade.

The analysis does not take into account the public policies, customs or goals of the government body making the law. The treaties require laws to be the least burdensome necessary to achieve the legitimate government objective. The highest priority in the treaties is to encourage, support and protect foreign investment. All other priorities are secondary.

Who Makes These Agreements?

The federal government has the exclusive power to make agreements with foreign governments. The "treaties" discussed in this paper are actually presidential agreements. They carry the same weight as treaties, but the ratification process is significantly different.

For both, the executive branch formulates the U.S. goals by consulting with 30 industry specific advisory boards and negotiates with foreign nations through the United States Trade Representative (USTR).

For a *treaty*, the president must be advised by the Senate and receive the consent of 2/3rds of the Senate. A *presidential agreement* is approved by both houses, but requires only 51% in each house to carry. NAFTA was presented as a presidential agreement and the FTAA is also in that format.

Fast-track further limits the role of the Congress in affecting international agreements. Congress has 60 days to review the proposed agreement and then is limited to a yes or no vote. It is limited to 20 hours of debate. Congress cannot modify the agreement, but must reject it entirely to have it revised. The only opportunity for state and local governments to safeguard critical programs and get exceptions for specific laws is to participate in the negotiations before ratification .

Government measures defined loosely are rules or regulations from any government actor or authorized contractor. Under the trade agreements, government measures may be challenged if they affect foreign investment profits, market share, or give preference to domestic investors. To be upheld, the laws have to be legitimate under international rules rather than rationally related to standards used in the U.S. The penalties for non-compliance involve huge and unpredictable financial awards. Previous treaties and agreements were voluntary and were enforced only by tariffs or boycotts. These new agreements extend the interpretation of "non-tariff barriers to trade" to include many state and local government laws and procedures.

The Legislative Process

Trade agreements have broad implications for the legislative process including changes in the formulation of laws, the public participation and representation of citizens and foreign investors, and the interpretation in the courts. Laws must be in compliance with the trade agreement obligations, and may be interpreted in international tribunals rather than the traditional courts. This circumstance limits citizen input, judicial interpretation, and the state's role as the democratic representative of citizen voice.

Public Participation Must Include the International Community

Foreign investors will have an opportunity to ensure that the laws passed in the US will not negatively affect their investments. Regulators and rule makers have to provide a comment period open to all foreign investors who may be impacted by the resulting government measure. All rulemaking bodies must invest in communication procedures that announce pending and new rules to all potentially concerned parties including current and future investors. Investors may take this opportunity to explain to the state or locality why the proposed legislation or rule might conflict with a trade agreement, and outline how that might translate into an international arbitration and a substantial financial reward to the investor. These concerns may take precedence over the will of the citizens and the goals of the state.

Health Laws and Harmonization

Existing laws must also be harmonized with the participating countries. Either all countries have one set of regulations, or each party may simply accept each others' different laws as comparable or acceptable. *Harmonization* results in one law that is a compromise of the other laws. The point is to lower the uncertainty and transaction costs of investors by having similar laws in all countries whenever possible. The Western Governor's Association believes state standards may be compromised through this process. State laws regarding environmental protection, natural resource management and consumer safety are generally more stringent than the standards used by U.S. trading partners.[v] U.S. federal and state safety standards would have to be lowered to comply with the required harmonization preempting the states' role in setting the acceptable risk.

> ***Harmonization***
> U.S. safety standards are likely to be compromised in the negotiation for a single legal standard.

Once laws are harmonized, challenges may still be brought to tribunals under NAFTA. The controversy over Lindane is a good example. Lindane was targeted as a persistent organic pollutant (POP). Lindane has been used to kill head lice and to stop fungal damage in agricultural seeds. In these applications, Lindane has caused death, seizures and rashes in children and adults who have come into contact with the chemical. Equally troubling, the chemical breaks down very slowly once in the environment. It was considered for the POPs Treaty but was not included.[vi] Since it was not listed, but remained controversial, the U.S. and Canada harmonized their laws regarding its use. Lindane was to be sold freely until July 1, 2001, and the governments would fund a new study to assess the health risk. The compromise was that all U.S. and Canadian companies would stop manufacturing in December 2000 and sell the stock over the next six months. When the voluntary agreement was published, the Canadian announcement said that Lindane could not be used after July 1, 2001, and violators could be subject to a $200,000 fine. Lindane dropped in value precipitously.

Crompton is a United States manufacturer of Lindane. The manufacturer is now bringing a NAFTA challenge. Crompton says that it only agreed to take Lindane off the market if the study proved it was harmful, and that the government is acting in bad faith.[vii] The risk assessment by the governments was never completed, so Crompton is challenging the scientific basis for the ban. The governments had included the manufacturers in the initial decision, and Crompton is treating the government like a contractual partner that is in default rather than a regulatory authority obligated to protect human health. Crompton questions the need for Lindane to be banned, and is demanding $100 million from Canada for the premature loss of market share, the retraction of the ban, and return of their license to manufacture the chemical. If the tribunal allows Crompton to move forward, this challenge threatens the finality of negotiations between parties to harmonize laws. Financial compensation for affected profits would be valued above the ability of government to stand by a compromise or otherwise legitimate legislation.

The Precautionary Principle Could Be Challenged

The Lindane case begs the question, “who decides?” Does a manufacturer have a burden to prove a chemical is safe, or must the government prove certain harm before acting to protect the public? The burden seems to be placed on the governments in the NAFTA and WTO cases at this time.

Crompton Corporation v. Canada

Lindane was nearly listed as a persistent organic pollutant (POP), which would have banned its use under the POPs Treaty. It has been used to stop spoilage of seeds as well as an ingredient in lice-removing shampoo. Canada was permitted to use Lindane on canola seeds, while US farmers treated 13 other crops. According to some US and European studies, Lindane is carcinogenic and acute exposure symptoms include seizures, skin rashes, and neuromuscular complaints.. Crompton asserts that the ban is to benefit Canadian replacement products. This would violate the national treatment requirement that bans domestic preference over foreign goods. The next round of POPs negotiations may eliminate all use of Lindane, but Canada may have to pay the manufacturer damages under NAFTA before that is resolved.

U.S. governing agencies are generally allowed to use the precautionary principle to avoid damage to the public from a substance that is potentially harmful. The precautionary principal is a risk averse policy that favors erring on the side of safety when scientific evidence suggests that something may be harmful, but harm is not certain. The trade agreements require a scientific basis for government measures which suggests that the results of any study be reproducible and statistically significantly different from control groups. Less information tends to settle questions in favor of using the product until it is proven harmful rather. A government exercising caution where evidence is forthcoming or scant may be inviting a challenge. The same government entity may face some liability domestically for not acting quickly enough to protect the affected public. An imminent NAFTA challenge may make the decisions more economically driven because public policy and local conditions are irrelevant to international tribunals.

Foreign investors may try to impose international standards to challenge the scientific basis of the state or local government for restricting the use or release of what is considered a pollutant in the US. For example, the California legislature was convinced that there was enough scientific evidence that MTBE should not be introduced to the environment. Other researchers in Germany concluded that it was not dangerous, and the Canadian manufacturer is claiming that the U.S. should accept those scientific studies. The challenges may be resolved in the state or local government's favor, but at a significant cost to both the state and the federal government defender.

Professional Licensing

Harmonization is not limited to health or environmental legislation. NAFTA and GATS require that all laws affecting investment be as similar as possible in the participating countries.[1] One of the first topics being considered by special GATS subcommittees is the issue of licenses for professionals. At this time, without the appropriate license with the credentials required by a state, lawyers, accountants, doctors and other professionals cannot operate. The trade proponents are striving to come up with universal criteria for licenses that will allow these services to be traded freely. This is a huge detour from the state character of licenses in the past that require specific knowledge of local customs and practices.

[1] "Affecting investment" is a broad category that encompasses anything that could inadvertently change the property rights or future expectations of the foreign investor including higher expenses of raw materials which might result in a loss of profit.

Protections for Current Laws Weak

There are some general exceptions that exempt open-ended categories of laws. These exceptions provide a false sense of security because in some cases these exceptions have sunset clauses, and in others they are available as candidates for compromises in future rounds of liberalization. The continued obligation to liberalize is called a "rollback" requirement. The grandfathered laws are restricted by a "standstill" requirement that means that the law can not be strengthened. This freezes future lawmaking powers at the point the agreement is negotiated.[viii]

> State and local governments protect public health, encourage sensible growth, economic development and interpret their laws…These traditional powers are not protected, and may be targets for elimination as "*non-tariff barriers to trade*"...

Exceptions may not protect natural resources

There is no guarantee that exceptions will be interpreted consistently over time. The General Agreement on Tariffs and Trade (GATT) has a general exception for protecting animals, plants, and exhaustible natural resources. It is not clear what those natural resources are. It is fairly certain that water is not among them since the USTR and the Supreme Court of the United States both consider water to be a commodity, and the GATT defines water as all water other than sea water. Although NAFTA defers to the GATT, NAFTA preempts the GATT where the two are in conflict, so GATT protections may be overruled by interpretations of NAFTA. There is a potential conflict between the reserved right to protect natural resources (GATT Article XX) and the obligation to continue exports of products at the average level of the previous 36 months (NAFTA Article 15). The implication is that a country would be obligated to continue natural resource exports regardless of changed local conditions or serious risk of unsustainable depletions.

A U.S. company is challenging a Canadian ban on the export of fresh water on this basis as well as other national treatment claims. Sun Belt, Inc. claims that British Columbia, a province of Canada, expropriated their profits by putting a temporary moratorium on freshwater export. Sun Belt had contracted with a local firm to export water to California. Sun Belt is asking for $1.5 billion in lost profits and the reinstatement of the license to export. A company spokesperson has claimed that NAFTA has made them an active participant in Canadian political process, and a rightholder of Canadian water. NAFTA is controlling because, in Sun Belt's view, water is a commodity like any other, and therefore must be traded under NAFTA rules. The case has not been approved for arbitration by the tribunal at this point, but is evidence of the types of issues that may be raised under the agreements. It may inform future decisions of planners, conservationists and manufacturers alike.

> ***U.S. Court System Avoided***
>
> Foreign investors can avoid U.S. state and federal courts. The claims are heard by an international tribunal.
>
> The investor and country:
>
> - Each select a judge, and jointly agree on a third.
> - Jointly select laws to use (the law of either country or some international standard)
>
> The tribunal:
>
> - is closed to the public
> - can ignore domestic law
> - has limited appeals
>
> can award financial penalties

It is important to note that British Columbia's moratorium was in effect before NAFTA was signed. Sun Belt is gong back retroactively to say that it was owed the NAFTA treatment before the trade agreement was in existence. Legislators may be concerned that implications of having issues as critical as access to the freshwater supply can be decided by an international tribunal with no direct accountability to local citizens. The tribunals emphasis may be given to economic criteria over local public health and environmental quality concerns.

The Courts Lose Jurisdiction at the State and Federal Levels

The agreements invite foreign investors not only into the legislative process, but also to interpret laws once applied. This is a significant shift in influence that limits the ability of the state to act in an autonomous, independent, self-interested manner. If the resulting measure is perceived as discriminating against foreign investors, or gives domestic competitors an inadvertent advantage, the foreign investor can challenge the law. This challenge would be heard in international arbitration. Tribunals are selected by the two parties to the challenge (an investor and a party country) and they choose the standard of law that will be used to decide the controversy.

Both the venue and the finality of the courts are modified under NAFTA. The arbitration panels and international law replace the state courts as the venue for hearing complaints against a state action and the standards applied. Under NAFTA, the federal government defends the claim in an international setting according to whichever law the parties choose, which has generally been the international standard. The state does not directly participate, and state law is not considered unless the parties both agree that it will be the standard. If a domestic court decision is made, an unfavorable outcome for the foreign investor might encourage the investor to go into arbitration by claiming discrimination and avoid the state law.

The *Loewen Group, Inc. v. United States* challenge is an example of this threat.[ix] Loewen, a Canadian funeral home, has been granted standing by a NAFTA tribunal to sue the United States for requiring a bond before the appeals process. Loewen was found guilty of illegal competitive tactics and was fined $100 million compensation and $400 million punitive damages award in the Mississippi Supreme Court. Mississippi requires that appellants post a bond (equal to 125% of the award) which would be due if the appeal fails. Loewen settled the case for $175 million. Still dissatisfied with the outcome, in 1998 Loewen turned to the NAFTA process for relief. Loewen is claiming that the actions of the awarding jury and the court have been influenced by its status as a foreign company, and therefore are challenging the damages award. If Loewen is successful, there will be broad implications for all U.S. courts. If the NAFTA tribunal protects Loewen by declaring the Mississippi law invalid, then the impact of NAFTA will be that

- investors will not be required to exhaust remedies before going to arbitration,
- investors can go through the court system and then challenge it if not satisfied,
- court decisions will not be given weight by the tribunal or considered in their deliberations,
- no civil dispute with a foreign investor can be considered settled until a tribunal has also considered it.

> ***Democratic Deficit***
> "Civil society is based above all on the free generation and exchange of information, with openness and participation as prerequisites. It is the recognition that decentralized, flexible, locally rooted responses are indispensable…"
> Bruce Rich
> Mortgaging the Earth

If Loewen is successful, the U.S. court system could be circumvented entirely. While this would not be a lenient interpretation, it illustrates the restrictions on government action integral to the trade agreement. The way the NAFTA is written the arbitration panels are under no requirement to give the court or the state laws deference. A single foreign shareholder, without the consent of the company or country of origin, could claim an investment loss and challenge the legitimacy of the American court system. The courts would lose their ability to interpret the law for foreign cases. There would be two standards for disputes, one for foreigners set by NAFTA, and the traditional U.S. law for domestic companies and investors.

The Structure of the Agreements Creates a Democratic Deficit

As outlined above, foreign investors have the right to participate in domestic lawmaking, and if they are not satisfied with that process, can take their complaints to an international arbitration tribunal that is not available to similarly situated domestic investors. These arbitration hearings are not open to the public, and though the U.S. federal government would be a participant in any claim against a U.S. governmental entity, the proceedings remain behind closed doors unless both parties agree to make a public disclosure.

The success of the U.S. system is based on the transparency of the process, and the ability of citizens to participate in debates regarding laws, policies and actions. Public hearings are an opportunity for all stakeholders to be heard, and ideally come to a balance of interests. The U.S. system is built on the notion of checks and balances. If a lawmaking body exceeds its authority, the court or the executive can keep the legislature in check. International trade agreements lack such checks and balances. These trade agreements give foreign private investors the right to arbitration tribunals to second-guess the legislature and the courts. International law may be used as proof that a U.S. law is too stringent. Neither U.S. citizens nor state and local governments are allowed access to these tribunal proceedings.

> ***Loewen Group, Inc. v. United States***
> Loewen Group is a Canadian funeral home that was sued in Mississippi by a local business for unfair competition. Loewen was found guilty of fraudulent business practices in their expansion effort. The jury awarded $100 in compensatory damages, and an unprecedented award of $400 million in punitive damages including emotional distress. Loewen chose to settle for $175 million rather than put up the required bond for $625 million to appeal the decision. Then the Canadian company decided to take the case to a NAFTA tribunal. Loewen asserts that the bond for appeals is not reasonable and forced them to settle and requests $725 million compensation. The law is of general application, not just for foreign companies. If successful, Loewen will circumvent the U.S. court system. The facts of the case are not in question, but the ability of the state of Mississippi to require a bond from domestic and foreign citizens alike before the appeals process begins. This is a significant threat to the finality of the court system, and could give foreign enterprises a way to avoid civil penalties for misconduct.

On a procedural level, domestic and foreign businesses have better access to the negotiators because corporations fill the 30 industry-specific advisory committees that have direct access to the President and the United States Trade Representative (USTR). The public can submit written comments to the Committee for the Participation of Civil Society, or to each negotiating group. No committee is obligated to respond to citizen inquiries. State representatives can try to influence Congress and the members of the committees, but are not privy to the negotiations within the advisory committees. After the trade agreements are passed, administrative staff often modify the text without public input. Under GATS, ongoing administrative harmonization is required to continue the process of liberalizing markets and removing trade barriers. As a government action, however, foreign investors can demand to be notified of these changes or seek damages later if profits are negatively impacted.

> The strategic advisory role of the corporate interests may raise concerns. "The literature on regulation … is almost universal in its conclusion that it is difficult, if not impossible to prevent the "capture" of [regulatory] systems by the interests they are supposed to regulate."
>
> Luberoff, 2000

Enhanced Property Rights Conflict with Land Use Planning

Of all of the roles of local government, land use is the most specific to place. Many localities post signs at the edge of town announcing that local zoning is in place, and permits for building and businesses will be required. Zoning affects a broad range of on site land uses and allowed impacts on neighboring lands and waterways. The placement of businesses, residences, and the allowed uses of land are local decisions. Environmental regulations and emissions standards can be set by state governments and sometimes regional or local governments. The latitude to set restrictive land use regulations or environmental regulations to protect human health might be challenged under NAFTA and later trade agreements.

Environmental Regulations

The use of zoning balances the benefits of being a citizen with the rights of a landowner to profit from the use of the property. Commercial enterprises have always been heavily regulated and the courts consider it foreseeable that the status quo will change. Therefore, domestic investors have no reasonable expectation that profits from the property will be secured in perpetuity. Foreign investments may use a different standard for deciding appropriate compensation for losses of market share or profits. Governments may have to pay for environmentally based restrictions (air, water pollutant restrictions) if the regulations are strengthened due to a change in circumstance and inadvertently limit the return on investment

> ***Land Ownership***
>
> NAFTA investor rights would consider restrictions on foreign land ownership or leasing to be discriminatory. Residency requirements for land ownership, use, or access to resources exist in some form in Nebraska, Oklahoma, Indiana, Kentucky, Mississippi, Wisconsin, Arizona, Colorado, North Dakota, Montana, Pennsylvania, Iowa, Minnesota, Oregon, Nevada, Alaska, Hawaii, Georgia, California, Maryland, Massachusetts, and Washington state.
>
> **Western Governor's Association**

Ownership or Access to Natural Resources

Lack of access to natural resources may be considered discrimination in violation of the national treatment requirement. States that limit foreign access to minerals or water include Alaska, Montana, Arizona, Utah, Wyoming, Idaho, and Oregon.

Western Governor's Association 1997

expected by the foreign investor. The national government, as the party to the agreement, may be expected to satisfy that lost expectation of profit.

Government compensation for property loss or the act of *expropriation* or *takings* is not new. The concept of takings in the domestic context awards compensation to citizens whose property is used or burdened for the public good. In the US, only the loss of use of the property *in its entirety* gets compensation unless the government physically occupies all or a portion of the land. (The citizen would be compensated only for the occupied portion). The courts have long held that the diminution of the value of property is insufficient to be considered a takings. The trade agreements suggest that *partial takings* may be granted to foreign investors. This would mean that counties that wanted to place restrictions on land use that required setbacks, buffer zones or denied dredge and fill permits might have to pay foreign investors for their compliance.

The *Metalclad v. Mexico* challenge illustrates this expanded definition of takings as well as the potential for private investors to overrule public health and environmental concerns. Metalclad is a US company that purchased land in Mexico with the intent of building a processing plant for toxic wastes. The Mexican regional and federal governments approved the venture. The building commenced and was completed based on representations of approval from the federal government. The local government never issued a building permit and refused to on the basis on the environmental impact report. The local government would not allow the plant to operate because it would have exacerbated the ground water pollution problem. In a desperate attempt to stop the plant, the community zoned the site as a preserve.

Metalclad took the claim to a NAFTA tribunal and was awarded $16.8 million, (the cost of the building). The tribunal also could have awarded the lost profits estimated in the business plan or loss of reputation. Judge Tysoe, one of the judges who sat on the tribunal, voiced concern that this broad interpretation of the trade agreement could interfere with customary and legitimate zoning laws.[x] The potential for environmental damage or the health effects of ground water contamination were not considered to be critical to the determination of the case. The impact on the investor was the main concern of the tribunal.

Note that the community would not allow the property to be used as a toxic waste facility, but did not say that the property could not be used for other purposes. A U.S. court would not award takings if there were still economic uses of the property available. The ability to use the property is protected, but not a particular use. Particular uses must be consistent with local zoning, and broader public policies. The trade agreement does not incorporate any of these criteria in the deliberations. If foreign investors receive similar awards against the U.S., domestic investors may lobby for equal rights to partial takings in the future. In

"[T]his broad interpretation of the [agreement] could interfere with customary and legitimate zoning laws."

Judge Tysoe, British Columbia

fact, this has been proposed in Congress and defeated. Compensation for partial takings would undermine the basis for land use law in the U.S.

Economic Development Restricted

Local and state governments use many mechanisms to enhance economic development. Many of the most successful programs include subsidies or preferences available only to resident businesses, or businesses that meet a certain criteria for a disadvantaged class. NAFTA and the WTO specifically target subsidies that in any way give preference to domestic business or discriminate against foreign investors.

Performance bonds, performance requirements, local input and labor requirements and local business preferences are among the activities that may be interpreted as non-compliant with NAFTA and the WTO. Programs that may be at risk include:[xi]

- Community reinvestment acts
- Living wage ordinances
- Use of public pension funds for redevelopment
- Purchasing criteria other than price and quality
- Minority business support
- Buy local or buy American policies
- Recycled or local content preferences

These programs are common programs used by local governments to support local businesses or draw investors to the community. The use of economic development to nurture local business is against the free market principles that guide international trade agreements. The goal of the agreement is to encourage foreign investment by leveling the playing field through harmonization or freezing regulation so that investments are more predictable. State and local governments lose flexibility and predictability within that process.

States use subsidies and tax breaks to encourage economic development, fund services for the poor, and reward initiatives that fulfill public purposes. These practices may be considered illegitimate if the result gives the government or domestic investors an edge over foreign investors. Any subsidies available to U.S. companies must also be made available to foreign concerns. Tax breaks must be available equally and without residency requirements.

Traditional Government Services May Be Challenged

As a provider of goods and services, governments receive special interest rates to save the public interest on large capital projects. If a government activity is also provided by private industry, any subsidy or better lending rates enjoyed by the government may be considered illegal subsidies that favor government providers over foreign private enterprise. For example, United Parcel Service (UPS) is challenging Canada's right to use their letter delivery routes to also deliver parcels. UPS claims that access to the Royal Post infrastructure is unavailable to UPS, and therefore puts the Canadian Post at an unfair competitive advantage. Under the NAFTA, any subsidies available to domestic market competitors must be available to foreign concerns as well. Tax breaks must be available equally. UPS, therefore, is demanding either access to this infrastructure, which would allow their packages to be carried by the Canadian

UPS v Canada

UPS is claiming substantively that this is a failure to provide national treatment (preferring Canadian competitors to U.S. counterparts) and an abuse of government monopoly power. Procedurally, UPS is bringing the challenge under Chapter 11 claiming a breach of a Chapter 15 requirement for Parties to properly control their government monopolies. UPS contends that any breach of the other chapters in the agreement are failures to comply with the minimum international standard of treatment required in Chapter 11. If this argument is accepted, then every violation of any part of the treaty would open a Party to a Chapter 11 dispute resolution. It is arguable that the dispute resolution section was intended to prevent discrimination or nationalization of property and was not expected to include other articles of the agreement.

letter carriers at no extra charge, or financial compensation equal to that value. There is no reason that this challenge could not be posed to the United States Postal Service if UPS is successful since the U.S. uses the same government-owned corporation arrangement and delivers the same services. The challenger could be a Canadian investor in Federal Express, or a sole proprietor with a license to deliver packages in Canada.

Privatization Process Altered

Professor John Roberts defines the role of the state as an umpire between private interests, and an advocate for the public problem of market failure (Appleton 1994 at 206).[xiii] Privatization has the potential to offer alternative provision of public goods and services. State and local governments fulfill this role when they carefully construct contracts for private industry to provide goods and services traditionally provided by the state (solid waste disposal, water distribution and treatment, etc.). However, the government has to play a market-structuring role to promote competitive efficiency while serving broader public values in the public service.[xiv]

In the NAFTA, GATS and FTAA regime, privatization is a matter of course, not a decision to be made by individual localities or public utilities. The trade agreements, to varying degrees, liberalize markets to provide goods and services that have been supplied by the government. Recall that governments provide public goods in the first place because of market failures such as externalities and free riders. From the GATS each party specifically lists the services that the government will open to private competition with public providers[2]. There is an exception for services that are provided by government agencies, but the caveat is that the service must not be available in the marketplace. Thus, the existence of private hospitals, schools and water treatment plants could open the door for private industry to compete with the government to provide these services.

Government latitude in a number of areas may be significantly reduced under the agreements. According to Barry Appleton, a Canadian plaintiff's attorney in NAFTA challenges, the trade agreement was drafted specifically to restrain the traditional role of the state. Quality and access to public services may be undermined if governmental control over the contracting process is weakened. Government subsidies currently used to lower costs and expand citizen access may be claimed by foreign investors as compensation for lost profit and market share due to the lower cost of government provision.

[2] GATS is a "bottom-up" approach that includes only what is listed. NAFTA and FTAA are “top-down” treaties, which means that all services that are not specifically excluded are liberalized.

Costs May be Significant

There may be significant costs incurred by local and state governments in trying to satisfy these international obligations. Many localities would have to enhance administrative and legal departments to gain the expertise necessary to communicate the legislative agenda with potential investors in all participating countries.

It is unclear whether the localities and states that are challenged will be financially liable for the damages awarded to investors. The known challenges against the United States at this time include claims for $1.8 billion. There may be other claims that have not been reported since, there is no obligation for either party of the arbitration or the tribunal to make it public. (The Loewen claim was admitted only after a Freedom of Information Act request). A group at the Fletcher School of Law and Diplomacy at Tufts University undertook a study to assess the potential financial liability posed by international trade agreements. They estimated the liability at $32 billion in the first four years that all agreements are in effect. Over the following four years the estimate climbs to $159 billion.[xv] Legal fees, staff time, and lost productivity of government employees who will respond to these cases are not included in the estimates.

A Balance Between Economic and Governance Goals

The focus of these agreements is on increased trade and economic growth. These goals are not balanced by concerns with other public policies and governance goals. The historical legal framework of the U.S. may be altered dramatically by the property rights expansion for foreign investors. For example, the Clean Water Act relies on land use management techniques and zoning. The technology-forcing advances required by the Clean Air Act were costs absorbed by the private industries benefiting from the production of wastes. Both of these major federal initiatives rely on state and local cooperation and the takings law as interpreted by the Supreme Court. Government regulatory approaches such as these could be stymied by expropriation awards under the free trade agreement. Domestically, some litigators stress that rampant takings liability would bankrupt many local governments or divert financial resources from critical public works.[xvi]

There needs to be a balance between the free trade agenda and the need for domestic governance. The restrictions and obligations of the trade agreements are substantial and may impact significantly state and local governments' ability to protect their residents, resources, and economic viability of local industry.

State and local governments are concerned that decision-making based on local conditions might be severely restrained and burdened by international interests entirely unfamiliar with the needs of the residents.

> Zoning that restricts development in order to protect drinking water sources, wetlands, or steep coastal areas from mudslides may have to pay foreign claims for partial takings if the tribunals interpret the actions as expropriations of land investment profits.

REACTION BY STATE AND LOCAL GOVERNMENTS

Governments are trying to understand the best way to enjoy the benefits from markets and free trade provided by the agreements while retaining state and local governmental authority.

The Western Governors Association (WGA), the National Council of State Legislators (NCSL), and the National League of Cities (NLC) are a few entities that have made public requests to the US negotiating body, the United States Trade Representative (USTR) for clarification of or protection from the trade agreement obligations. These entities are not against free trade. The National Conference of State Legislatures, for example, supports free trade, but recognizes that reservations can be made to avoid unnecessary preemption and preserve traditional state authority.[xvii] Similarly, the National Association of Counties (NACo) supports free trade, but not to the exclusion of federalism. NACo supports accountability including federal identification and communication of all impacts federal legislation may have on state and local operations.[xviii] Over a dozen counties and municipalities have passed resolutions requesting protection from the agreements or declaring that they will not participate in the agreement and do not consider themselves bound. Canadian public unions and some municipalities have been very critical of the agreement and have requested major revisions or repeal. Some of these groups have requested that the NAFTA not be used as a template for other agreements without revisions to Chapter 11.

Despite the public controversy over international trade and the clearly communicated concern expressed to the USTR and members of Congress, the FTAA draft made public in 2000 contained a virtually verbatim replica of Chapter 11. The ability of state and local governments to eliminate the burdens of the legislative restrictions and the threat of Chapter 11 liabilities is hindered by the singular focus on the economic benefits of the agreement. Giving up the state right to immunity provides the corresponding right for U.S. companies to opt out of the court systems in other signatory countries. Allowing foreign input into our legislative process opens the door for U.S. business interests to shape foreign laws on subjects that may constrain profits abroad.

State and local governments could benefit from early participation in the negotiation process and by educating both their constituencies and representatives in Congress. State and local representatives should seek to understand the impacts of free trade on their constituents.

- Will investor rights may be in conflict with community values?
- Will takings legislation, if expanded, could make environmental and health regulations too expensive to enforce?
- Will subsidies and revenues be considered discriminatory?

State and local government representatives are the frontline of democracy and have an obligation to preserve the democratic, federalist character of the U.S. government. Democracy requires participation, representation, and debate. Federalism requires a clear delineation of powers shared between the state and federal governments. International trade agreements blur these distinctions, and grant foreign investors rights, participation, and representation superior to that of U.S. citizens.

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