University of Nebraska - Lincoln
DigitalCommons@University of Nebraska - Lincoln

College of Law, Faculty Publications | Law, College of

1997

SEARCHING FOR PARETO GAINS IN THE RELATIONSHIP BETWEEN FREE TRADE AND FEDERALISM: REVISITING THE NAFTA, EYEING THE FTAA

Matthew Schaefer
University of Nebraska College of Law, mschaefer1@unl.edu

Follow this and additional works at: https://digitalcommons.unl.edu/lawfacpub

 Part of the Legal Studies Commons

Schaefer, Matthew, "SEARCHING FOR PARETO GAINS IN THE RELATIONSHIP BETWEEN FREE TRADE AND FEDERALISM: REVISITING THE NAFTA, EYEING THE FTAA" (1997). *College of Law, Faculty Publications*. 53.
https://digitalcommons.unl.edu/lawfacpub/53

This Article is brought to you for free and open access by the Law, College of at DigitalCommons@University of Nebraska - Lincoln. It has been accepted for inclusion in College of Law, Faculty Publications by an authorized administrator of DigitalCommons@University of Nebraska - Lincoln.

23 CAN.-U.S. L.J. 441 (1997). Published by Case Western Reserve University School of Law.

SEARCHING FOR PARETO GAINS IN THE RELATIONSHIP BETWEEN FREE TRADE AND FEDERALISM: REVISITING THE NAFTA, EYEING THE FTAA

*Matthew Schaefer**

INTRODUCTION

Is devolution of power to sub-national governments by the constitution of federal states or by delegation in other nations a threat to maximizing the benefits of free trade within the Americas? Conversely, is the drive towards regional free trade a threat to the goals of federalism and decentralization? These are two of the many questions that arise in revisiting NAFTA and eyeing the successful creation of a Free Trade Agreement of the Americas (FTAA) by the year 2005, an initiative launched by thirty-four nations within the region in December 1994.[1]

The scope of the FTAA is likely to be quite broad as indicated by the initial working groups created by participating nations.[2] Like other recently concluded regional and multilateral trade agreements, including the North American Free Trade Agreement (NAFTA)[3] and World Trade Organization (WTO) Uruguay Round Agreements,[4] the FTAA will ad-

---

* Assistant Professor of Law, University of Nebraska College of Law. The author served as a consultant to the National Governor's Association during the development of U.S. implementing legislation for the NAFTA and Uruguay Round Agreements. The views expressed are those of the author alone. The author would like to thank Professor John Jackson, University of Michigan Law School, for his guidance during my LL.M and S.J.D. research.

[1] Summit of the Americas: Declaration of Principles, Miami, Dec. 11, 1994, *reprinted in* 34 I.L.M. 810, 811 (1995).

[2] The initial seven working groups that were established at a ministerial meeting in Denver, Colorado in July 1995 were the following: 1) market access; 2) customs procedures and rules of origin: 3) investment; 4) standards and technical barriers to trade; 5) sanitary and phytosanitary measures: 6) subsidies, anti-dumping, and countervailing duties; and 7) smaller economies. Four new working groups were created at the March 1996 ministerial meeting in Cartagena, Columbia. They are the following: 1) intellectual property rights; 2) competition policies; 3) services; and 4) government procurement. *See* 12 INT'L TRADE REP. 1120 (June 28, 1995); 12 INT'L TRADE REP. 2011 (Dec. 6, 1995).

[3] NAFTA, signed Dec. 17, 1992, *reprinted in* House Doc. 103-159(I), 103rd Cong., 1st Sess. 713 (Nov. 4, 1993).

[4] Signed April 15, 1994, *reprinted in* House Doc. 103-316(I), 103rd Cong., 2nd Sess. 1320 (Sept. 27, 1994).

dress non-tariff issues, such as government procurement policies, technical standards for products, sanitary and phytosanitary measures, and subsidies, and seek to cover "new" trade negotiation topics, including trade-in-services as well as investment-related matters. It is possible that the linkage between trade and competition policy,[5] trade and the environment, and trade and workers' rights will be raised during the course of the FTAA negotiations as well.[6] These so-called "link issues" were addressed to some extent in the NAFTA,[7] which may serve as a model for an FTAA, and currently receive varying degrees of attention within multilateral trade fora.[8]

The scope of topics covered by these trade agreements raises the issue of the relationship between international law and federalism (and sub-national governments more generally). Sub-national governmental measures, including measures of component units of federal states, will continue by necessity to receive the increased attention of trade negotiators. Sub-national governments are active regulators in matters addressed by agreements on non-tariff barriers and the so-called "new" and "link" trade issues.[9] Thus, the strong economic policy reasons that exist for binding sub-national governments to international trade agreement obligations become even stronger once the comprehensiveness of trade agreements expands to cover these "new" and "link" trade issues.

If the FTAA is to reach its maximum welfare-enhancing goal, the agreement will need to constrain sub-national government as well as national government discretion exercised for protectionist purposes. For this reason, federal states with potentially significant constitutional and political limitations on constraining sub-national governmental behavior could be viewed as "problematic" by the regional system in attaining the

---

[5] A working group on competition policies will be established at the March 1996 ministerial meeting.

[6] U.S. proposals to establish a "study group of senior officials" to make recommendations on environmental and worker rights processes within the FTAA have met "near-unanimous" opposition from other countries. *See Senior Officials Unable to Bridge Gap on Hemispheric Trade Statement*, INSIDE U.S. TRADE, Mar. 15, 1996 at 1, 23.

[7] *See* NAFTA, *supra* note 3, Chapter 15. *See also* North American Agreement on Environmental Cooperation (hereinafter NAAEC) and North American Agreement on Labor Cooperation (hereinafter NAALC), *reprinted in* THE NAFTA: SUPPLEMENTAL AGREEMENTS (1993).

[8] *See* Final WTO Singapore Declaration, *reprinted in* INSIDE U.S. TRADE, *Special Report*, S-2-S-6, Dec. 16, 1996.

[9] *See* Matthew Schaefer, *Are Private Remedies in Domestic Courts Essential for International Trade Agreements to perform Constitutional Functions with Respect to Sub-Federal Governments?*, 17 NW. J. INT'L L. & BUS. 609-10 (1997). *See generally* Matthew Schaefer & Thomas Singer, *Multilateral Trade Agreements and U.S. States-An Analysis of Potential GATT Uruguay Round Agreements*, 26 J. WORLD TRADE 31 (Dec. 1992).

goal of maximum welfare gains. Conversely, sub-national governments in the region may view the move towards regional free trade as a threat to their regulatory authority and the goals of federalism or decentralization in a variety of areas. Fortunately, both perspectives have recently confronted these potential concerns and developed solutions within the context of the NAFTA and the WTO Uruguay Round Agreements. However, these solutions did not constitute Pareto optimal solutions. Enhanced application and development of the substantive rules constraining sub-national governmental behavior to take protectionist actions can occur without sacrificing the goals of federalism or other decentralized forms of government.

Part I of this Article first defines federalism and distinguishes it from other decentralized forms of government. It proceeds to explore the goals of federalism and the goals of international trade agreements, with specific reference to regional agreements. Part II analyzes the broadened scope of modern trade agreements and the accompanying importance of constraining sub-central government actions. Part III discusses the particular "problems" raised by federal forms of government for regional free trade and economic integration. Part IV considers existing approaches of international trade agreements regarding the applicability of rules to sub-national governments. It will explore various techniques used to reduce the impact of trade agreement rules on sub-national governments and which of these techniques are justifiable in terms of obtaining the Pareto gains described above. Part V considers possibilities for sub-national governments to participate in the rule formation processes so as to overcome political and legal obstacles to achieving Pareto gains in the relationship between regional free trade and federalism. Part VI concludes that Pareto gains in the relationship between free trade and federalism can occur by strengthening the application of anti-protectionism obligations to sub-federal governments. However, the current method of seeking the individual consent of each state and province prior to strengthening the application of anti-protectionism obligations may need to be replaced in order to achieve these Pareto gains at a more rapid pace.

I. FEDERALISM, DECENTRALIZATION, AND REGIONAL FREE TRADE: THEIR RESPECTIVE GOALS

A. Federalism Defined and Its Existence in the Americas

In a federation, power is divided vertically between a central government and regional or local governments. As it divides power vertically, federalism is to be distinguished from the horizontal division of

powers between different branches of government (commonly referred to as the separation of powers). A feature of a federation that distinguishes it from other decentralized forms of government is that the autonomy of each level of government is in some way guaranteed.[10] In other decentralized systems, the central government may devolve certain powers to local governments for reasons of efficiency or politics, but local autonomy is not guaranteed. Indeed, some definitions of a federal state require that divided powers and/or the existence of the two levels of government are guaranteed by a supreme constitution which is not unilaterally amendable by either level of government and which is umpired by a supreme court.[11]

However, a distinction is often drawn between coordinate federalism and cooperative federalism. In coordinate federalism the central and regional governments must each have a guaranteed autonomous sphere of action in which the other can not interfere.[12] Other theories focus on cooperative federalism in which the central and regional authorities are linked in a mutually interdependent political relationship.[13] These theories are concerned with the bargaining that occurs between the two branches of government and the persuasive abilities of one over the other. While coordinate federalism focuses on structure, cooperative federalism focuses on process. Recent studies suggest that federalism is a matter of both structure and process, each element necessary for a viable federal system.[14]

The two countries within the Americas that have strong elements of federalism in both structure and process are the United States and Canada.[15] Therefore, these two nations provide the most fertile ground for examining the interaction between federalism and regional free trade and economic integration. However, other nations within the Americas with long-standing federal traditions include Mexico, Argentina, and Brazil,[16] all countries of major importance to the regional integration process. Mexico is a NAFTA member while Argentina and Brazil are founding members of MERCOSUR. NAFTA and MERCOSUR are both looked to as models for a possible FTAA.[17] However, these Latin American na-

---

[10] *See* DANIEL ELEZAR, EXPLORING FEDERALISM 23 (1987).

[11] *See* Task Force on Canadian Unity, *Coming to Terms: The Words of the Debate*, at 4 (Feb. 1979). *See also* Klux, SOVIET FEDERALISM: A COMPARATIVE PERSPECTIVE 7 (1990).

[12] *See* WILLIAM STEWART, CONCEPTS OF FEDERALISM 55, 65-68 (1984).

[13] *Id.* at 51-54.

[14] *See* ELEZAR, *supra* note 10, at 67-68, 85 (1987).

[15] *Id.* at 69.

[16] Keith S. Rosenn, *Federalism in the Americas in Comparative Perspective*, 26 U. MIAMI INTER-AM. L. REV. 1, 3 (1994).

[17] *See, e.g., MERCOSUR Trade Pacts to Expand More Quickly Than NAFTA, Katz Says,*

tions are considered federal in structure only.[18] They generally lack strong federal processes raising doubts as to the extent to which they are ultimately federal.[19] Nevertheless, these nations have undertaken movements of decentralization to varying degrees over the last decade.[20]

Moreover, the broad scope and flexible nature of the meaning of federalism across countries, and even within the evolution and development of particular countries, displays the complexity of the concept. As Professor Elezar concludes, "what is characteristic of a great political principle [such as federalism] is both the essential simplicity in its basic formulation and the richness of fabric woven around its base."[21] Professor Stein has perhaps presented the best pragmatic image by suggesting that one view various governments and international organizations along a continuum of divided power systems.[22] The governments and organizations slide along this continuum as they devolve or integrate. It is a constant task of both levels of government and the supreme constitutional court to find the appropriate federal balance.[23] Thus, while this Article focuses on the two strongest federal systems in the Americas, other nations in the Americas may strengthen their federal systems in the future. Moreover, regional free trade and economic integration may have implications for decentralization in non-federal states.

B. The Goals of Federalism and Decentralization

Federalism has two primary goals: enhancing and protecting democracy and fostering experimentation and innovation. Both goals can be considered elements of a larger goal which is to maximize the attain-

---

INSIDE NAFTA, Nov. 1, 1995, at 11-12.

[18] Indeed, Argentina and Brazil are less federal in important structural respects as well. In particular, the Argentine and Brazilian constitutions can be amended without the consent of a majority of the component units governments. *See* Rosenn, *supra* note 16, at 6, n. 12.

[19] *See* ELEZAR, *supra* note 10, at 68; Keith S. Rosenn, *The Success of Constitutionalism in the United States and Its Failure in Latin America: An Explanation*, 22 U. MIAMI INTER-AM. REV. 1 (1990).

[20] *See* ROSENN, *supra* note 16, at 8-9.

[21] ELEZAR, *supra* note 10, at 83.

[22] *See The Foreign Affairs Power of an International Organization: The Case of the European Community*, 81 PROC. AM. SOC. INT'L L. 354 (1987).

[23] *See* Koen Lenarts, *Constitutionalism and the Many Faces of Federalism*, 38 AM. J. COMP. L. 205, 263 (1990); Woodrow Wilson, CONSTITUTIONAL GOVERNMENT IN THE UNITED STATES 178 (1911) (stating, "The question of the relation of the states to the federal government is the cardinal question of our constitutional system . . . . It cannot, indeed, be settled by the opinion of any one generation, because it is a question of growth, and every successive stage of our political and economic development gives it a new aspect, makes it a new question.")

ment of different preference sets of different geographic constituencies.[24] Other forms of decentralized government or movements towards devolution of power to lower levels of government share these same purposes to a more limited extent.

Many political scientists and philosophers believe that democracy functions best in smaller governmental units. It is thought that people have better and more direct access to regional and local governmental units.[25] However, federations divide power between national and subnational governments realizing that some issues are best dealt with on a national level. The principle of subsidiarity, which has origins dating back to ancient times,[26] but has recently assumed prominence in discussions of European economic integration, is thought of as a useful principle to apply in deciding how to divide powers among various levels of government.[27] The subsidiarity principle can be applied in non-federal structures,[28] but does assume a government that is vertically divided into several levels. The principle works on the assumption that decisions should be made as close to the people affected by the decision as possible. It makes a presumption in favor of lower levels of government. However, if lower levels of government are unable to address a problem or if a higher level of government can regulate an activity more effectively, the decision-making authority is elevated to the higher level of government.[29]

Federalism fosters experimentation and innovation. In contrast, if a central government is given authority to regulate on a particular issue

---

[24] Regarding the notion of preference sets, see Joel P. Trachtman, *Reflections on the Nature of the State: Sovereignty, Power, and Responsibility*, 20 CAN.-U.S. L.J. 399, 413 (1994). *See also* Joel P. Trachtman, *International Regulatory Competition, Externalization, and Jurisdiction*, 34 HARVARD INT'L L.J. 47, 100-03 (1993).

[25] The information and technological developments of the past several decades have certainly increased access to central government institutions, however.

[26] *See* W. Gary Vause, *The Subsidiarity Principle in European Union Law-American Federalism Compared*, 27 CASE W. RES. J. INT'L L. 61, 63 (1995). Traces can be found as far back as the works of Aristotle and St. Thomas Aquinas. Note by the Directorate-General for Research, European Parliament, Committee on Legal Affairs and Citizens' Rights, Notice to Members No. 21/92, Sept. 11, 1992.

[27] On the subsidiarity principle, see George A. Bermann, *Subsidiarity and the European Community*, 17 HASTINGS INT'L & COMP. L. REV. 97 (1993); George A. Bermann, *Taking Subsidiarity Seriously: Federalism in the European Community and the United States*, 94 COLUMBIA L. REV. 332 (1992).

[28] Indeed, some have contrast subsidiarity which allows for flexibility with static allocations of power under federal constitutions.

[29] For more description, see Franziska Tschofen, *Article 235 of the Treaty Establishing the EEC: Potential Conflicts Between the Dynamics of Lawmaking in the Community and National Constitutional Principles*, 12 MICH. J. INT'L L. 471, 504 (1991); Comment, *The Subsidiarity Principle*, 27 COMMON MKT. L. REV. 181-84 (1990).

and it decides to regulate in the field so as to preempt conflicting component unit government legislation, a bar has been placed in the way of experimentation and innovation by the sub-national governments and regulatory competition between sub-national governments.[30] In some instances, specifically where policy issues transcend geographic boundaries, harmonization will clearly be preferred. For instance, certain environmentally dangerous activities that have cross-border effects should be regulated by the higher level of government because sub-units will have no incentive to take into account the cross-border externalities when regulating the activity and, thus, regulatory competition between sub-units would lead to an inefficient regulatory result. In the international context, efforts at harmonization are usually thought of in terms of their effect on regulatory diversity among nations, but such efforts can also affect regulatory diversity within nations.

C. The Goals of International Trade Agreements and the Importance of Constraining Sub-National Government Behavior

International law can be seen as a means or instrument to achieve various goals. International trade agreements seek to enhance world welfare by increasing predictability and reducing barriers in trade relations between nations thereby allowing the economic principle of comparative advantage to operate more fully.[31] If international trade law is to achieve its goal of maximizing welfare gains, then it must seek to have its barrier-reducing obligations become as universal as possible. For instance, traditional trade theory based on comparative advantage suggests that nations that liberalize trade increase their own welfare and the welfare of the world. The more nations that liberalize trading rules, the more world welfare increases. However, nations often will not unilaterally liberalize for political reasons[32] (or based on new trade theories such as strategic trade policy).[33] Thus, refusal by some to participate in liberalization typically means trading partners will not participate. Nonetheless, the multilateral trading system has long recognized that regional (less than universal) arrangements may be beneficial to world welfare

---

[30] In the E.C. context, see generally Hauser & Hosli, *Harmonization or Regulatory Competition in the European Community*, Auseen Wirtschaft 46 Jahrgang (1991) Heft III/IV 497-512.

[31] *See* JOHN H. JACKSON, THE WORLD TRADING SYSTEM: THE LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS, 10-14 (1989).

[32] *See* NATIONAL CONSTITUTIONS AND INTERNATIONAL ECONOMIC LAW, 404-05 (Meinhard Hilf & Ernst-Ulrich Petersmann eds., 1993).

[33] On strategic trade policy, see, e.g., Paul Krugman, *Is Free Trade Passe?* J. ECON. PERSP. 131-44 (Fall 1987).

provided such arrangements remove (nearly) all barriers to trade.[34] The trade creation effects of such regional arrangements are believed to outweigh any trade diversion effects of such arrangements.[35]

However, universality can be thought of in another context. The universality of both multilateral and regional trade arrangements must also be considered in the context of various levels of government. If a multilateral or regional arrangement is to maximize the attainment of its goals, it must apply to and be complied with by governmental actors at all levels. There is both a political and economic element behind the drive to bind sub-national governments to obligations within trade agreements from the "international" perspective. A long-standing controversy in international treaty-making between unitary and federal states has been the extent to which component unit governments in federal states should be bound. To the extent federal states sought to exclude application of an international agreement to their component unit governments, unitary states complained of an "imbalance" in obligations. As a result, unitary governments might be less likely to enter into certain agreements or seek to reduce the level of their obligations. Within the trade agreement context, such consequences hinder the attainment of maximum welfare gains.

On a purely economic level, it is clear that failure to address sub-national government measures in a trade agreement would diminish welfare gains. First, some sub-national governments within the Americas represent territories with economies larger than many nations. For instance, California and New York have economies larger than all but a handful or two of nations in the world.[36] Sixteen states and two provinces would rank among the top twenty-five national economies; thirty-three states and four provinces would rank among the top fifty national economies.[37] Therefore, discriminatory or protectionist measures taken by California and New York may have a greater impact on welfare gains than measures taken by many other nations. Similar claims could be made with respect to Mexican states and sub-national governments in large South American nations such as Brazil and Argentina.[38] Second,

---

[34] *See* GATT 1994, art. XXIV.

[35] *See* Ken Dam, *Regional Economic Arrangements and the GATT: The Legacy of a Misconception*, 30 U. CHI. L. REV. 615 (1963); For an economic perspective, see CHARLES P. KINDLEBERGER & PETER H. LINDERT, INTERNATIONAL ECONOMICS 174-88, (7th ed. 1982).

[36] *See* Earl H. Fry, *Sovereignty and Federalism: U.S. and Canadian Perspectives, Challenges to Sovereignty and Governance*, 20 CAN.-U.S. L.J. 303, 308 (1994).

[37] *Id.*

[38] The economies represented by the membership of MERCOSUR (Brazil, Argentina, Paraguay, and Uruguay) and NAFTA (Canada, United States, and Mexico) account for more than

failure to address sub-national governmental measures within international or regional trade agreements would give a false incentive for governments to decentralize certain areas of regulation. While no country would be likely to undergo constitutional change of government to form a federal state as a result, central governments might seek to delegate certain powers to sub-central governments for protectionist purposes.

The need to bind sub-national governments in order to maximize welfare gains becomes even larger when one considers another aspect of universality or comprehensiveness, namely the types of barriers and the scope of topics governed by modern international trade agreements. Sub-national governments are generally prohibited from establishing tariffs and other border measures,[39] but regulate in many areas addressed by non-tariff barrier agreements and agreements covering "new" and "link" issues. In short, universality with respect to all levels of government increases in importance as trade agreements become more comprehensive with respect to types of barriers and scope of topics covered.

II. THE INTERACTION BETWEEN FEDERALISM AND INTERNATIONAL TRADE LAW

A. Historical Perspective

The interaction between federalism and international law generally is best seen in historical perspective. At the beginning of this century, treaties dealt primarily with matters of peace and security, and other matters indisputably within the external as well as internal competence of central governments. Thus, federations did not typically face the internal political and constitutional issue of whether the central government could enter into treaties on matters within the internal legislative competence of component unit governments and whether the central government could implement these international obligations. Gradually, however, foreign affairs came to be linked with domestic affairs, and matters within the domestic legislative competence of component units

---

95% of the hemisphere's GDP and for more than 85% of intra-hemisphere trade. *See* Report to the Presidents of the Review of Brazil-United States Trade Relations, *reprinted in* INSIDE NAFTA, Nov. 1, 1995, at 16-18.

[39] *See, e.g.*, U.S. Constitution, art. I, sec. 10, cl. 2. *See also* Matthew Schaefer, *Are Private Remedies in Domestic Courts Essential for International Trade Agreements to Perform Constitutional Functions with Respect to Sub-Federal Governments?*, 17 NW. J. INT'L L. & BUS. 612-13 (1997).

of federations became the subject of international negotiation.[40] This began most notably with the establishment of the International Labor Organization in 1919 and conventions negotiated under its auspices increased in the 1950s with the negotiation of several major human rights covenants, and expanded further with the GATT Tokyo Round trade negotiations of the late 1970s. Today, the newly elevated agenda items of international law, prominently including trade and economic integration, typically involve negotiations on topics within the domestic legislative competence of component units of federations.[41]

B. The Scope of NAFTA and the Uruguay Round Agreements in Comparison to Previous United States and Canadian Trade Agreements

The General Agreement on Tariffs and Trade (GATT) of 1947 was the primary agreement governing world trade in goods for nearly fifty years.[42] Several subsequent negotiating rounds were held under the auspices of the GATT, which became de facto the institution governing world trade after the United States failed to approve the International Trade Organization (ITO) in the 1950s.[43] The early negotiating rounds under the auspices of GATT held in the 1950s and 1960s focused primarily on tariff cuts, an area exclusively within federal government jurisdiction.[44] The original GATT did require non-discriminatory application of internal taxes and regulations,[45] but very little else fell within the realm of U.S. states and Canadian provinces.

This began to change with the seventh GATT negotiating round, called the Tokyo Round, concluded in 1979. The Tokyo Round focused in an extensive manner on non-tariff barriers, such as subsidies, government procurement practices, and technical product standards for the first time within the GATT system. The Tokyo Round culminated with a

---

[40] For a history of this phenomenon in Canada, see IVAN BERNIER, INTERNATIONAL LEGAL ASPECTS OF FEDERALISM 152-59 (1973).

[41] *See* Schaefer, *supra* note 39, at 613-14.

[42] 55 U.N.T.S. 194 (1947). This was so even though GATT itself never entered into force. GATT was applied through a Protocol of Provisional Application which grandfathered existing legislation inconsistent with Part II of the GATT. 55 U.N.T.S. 308 (1950). *See also* John H. Jackson, *The General Agreement on Tariffs and Trade in United States Domestic Law*, 66 MICH. L. REV. 249, 294-297 (1967).

[43] *See* JOHN H. JACKSON, WORLD TRADE AND THE LAW OF GATT 42-53 (1969); JOHN H. JACKSON, RESTRUCTURING THE GATT SYSTEM 9-17 (1990); ROBERT E. HUDEC, GATT LEGAL SYSTEM AND WORLD TRADE DIPLOMACY 59-61 (2d ed. 1990).

[44] *See* JACKSON, WORLD TRADE AND THE LAW OF GATT, *supra* note 43, at 52-53.

[45] GATT 1947, art. III.

series of agreements or "codes" on non-tariff barriers.[46] However, the potential impact of these agreements on the U.S. states remained relatively slight. The United States refused to cover state entities under the GATT Government Procurement Code.[47] The Subsidies Code did apply to state governments, however, its only stringent obligations related to the use of export subsidies (which are rarely, if ever, granted by states).[48] Its obligations with respect to domestic or general subsidies were relatively weak. The Technical Standards Code applied to states, but only required the federal government to use its "best efforts" to achieve state compliance.[49] Moreover, most GATT Contracting Parties did not participate in the non-tariff barrier "codes" for they were allowed to pick and choose which of the codes they would join. Canadian provinces similarly were not bound to the Government Procurement Code and were largely unaffected by other non-tariff barrier codes. (Canadian provinces, however, were affected by U.S. countervailing duty law).

The Canada-United States Free Trade Agreement (CUSFTA), which entered into force January 1, 1989, included provisions requiring non-discriminatory treatment of services and service providers. This was the first time a U.S. trade agreement with a major trading partner included obligations regarding trade-in-services. The United States was already seeking to have obligations regarding trade in services negotiated within the GATT Uruguay Round talks at this time. For the U.S. states, this was important because they are active regulators in many services sectors, including financial services and professional services. Canadian provinces also actively regulate in the services area. However, the CUSFTA broke no new ground with respect to sub-national government procurement practices or subsidies.

The NAFTA, which entered into force January 1, 1994, built upon the CUSFTA. Again, trade-in-services and investment issues were addressed by the agreement. However, new obligations can be found in the NAFTA. NAFTA's investment and financial services chapters contain broader obligations than the CUSFTA. For example, the NAFTA places

---

[46] *See* JOHN H. JACKSON, IMPLEMENTING THE TOKYO ROUND 13-17 (1984).

[47] *See* Schaefer & Singer, *supra* note 9, at 56-57.

[48] Although this conclusion depends on the definition of subsidy. For a discussion of possible state export subsidies, see Schaefer & Singer, *supra* note 9, at 51-52.

[49] *See* Ernst-Ulrich Petersmann, *Strengthening the Domestic Legal Framework of the GATT Multilateral Trade System: Possibilities and Problems of Making GATT Rules Effective in Domestic Legal Systems, in* THE NEW GATT ROUND OF MULTILATERAL TRADE NEGOTIATIONS: LEGAL AND ECONOMIC PROBLEMS 96-97 (Petersmann & Hilf eds., 1988); JACKSON, IMPLEMENTING THE TOKYO ROUND, *supra* note 46, at 51.

limits on the ability of a government to restrict the nationality of senior management and boards of directors of NAFTA investors.[50] While states were not bound to any obligations in the area of government procurement, the agreement envisaged state and provincial governments undertaking commitments to be bound to such obligations in the future on a voluntary and reciprocal basis.[51] The NAFTA also did not directly address the issue of subsidies. However, for the first time in a U.S. international trade agreement, NAFTA spelled out detailed rules for sanitary and phytosanitary measures, such as food safety standards and those relating to pests or diseases on imported plants or animals.[52] States are active standard-setting bodies in the sanitary and phytosanitary area.

Additionally, "side" environmental and labor agreements that applied to the states (but to only two of the Canadian provinces as of yet) were negotiated among the three NAFTA countries. The agreements require governments to maintain laws providing a high level of environmental and labor rights protection and to effectively enforce such laws.[53] A persistent failure to effectively enforce an environmental or labor law can lead to a challenge by another NAFTA country.[54] In the United States, states are the primary enforcers of environmental laws and actively regulate in the labor area. In Canada, the provinces maintain nearly exclusive jurisdiction with respect to labor matters and significant constitutional jurisdiction over environmental matters.[55]

The Uruguay Round Agreements were signed by over 120 nations in April, 1994 and most entered into force January 1, 1995. The Uruguay Round Agreements constituted a package of agreements under which countries had to agree to abide by all agreements negotiated (with a few exceptions).[56] The "single package" of agreements included a new General Agreement on Trade in Services (GATS) requiring non-discriminatory treatment of services and service providers. The GATS

---

[50] NAFTA, *supra* note 3, arts. 1107, 1408.

[51] NAFTA, *supra* note 3, art. 1024(3).

[52] NAFTA, *supra* note 3, Chapter 7B.

[53] North American Agreement on Environmental Cooperation (NAAEC), arts. 3-5; North American Agreement on Labor Cooperation (NAALC), arts. 2-3.

[54] NAAEC, arts. 22-33; NAALC, arts. 27-37.

[55] *See* PETER W. HOGG, CONSTITUTIONAL LAW OF CANADA 461-66, 581-99 (2d ed., 1985); Debra Steger, *Canadian Implementation of the Agreement Establishing the World Trade Organization, forthcoming in* IMPLEMENTING THE URUGUAY ROUND (Jackson & Sykes eds., 1996), manuscript on file with author.

[56] The most notable of these exceptions is the renegotiated GATT Government Procurement Code which has only 23 signatories.

applies more broadly to direct taxation of services and service suppliers than the NAFTA services chapter.[57] The package of agreements also included an agreement on sanitary and phytosanitary measures and technical product standards. Thirty-seven states became bound to some degree to follow obligations within the renegotiated Government Procurement Code after the federal government obtained their voluntary commitments.[58] The renegotiated code also covers procurement of services for the first time.[59] The new Uruguay Round Subsidies Agreement continues to ban export subsidies, but also seeks to limit domestic (non-export contingent) subsidies to a greater extent than the Tokyo Round Subsidies Code.[60]

Thus, trade agreements increasingly address issues within the concurrent legislative, regulatory, and enforcement jurisdiction of the U.S. states. In some cases they may even seek to address matters within the exclusive jurisdiction of the Canadian provinces.[61] The NAFTA and GATT Uruguay Round Agreements are the culmination of a gradual development of trade agreements to address non-tariff barriers in a meaningful way and the successful pursuit to seek a greater openness in "new" areas such as trade-in-services. These non-tariff and new topics entered international trade discussions because of their importance to expanding world trade. Indeed, the United States was one of the key countries pushing for these issues to be addressed because of the competitive advantage of the United States in many service sectors and the detrimental effect of non-tariff barriers on U.S. exports. A significant number of policy-makers and regulators throughout U.S. state capitols are entirely supportive of new rules in these areas due to complaints they receive from their states' exporters regarding foreign practices. Indeed, U.S. state governors consistently supported negotiations in these

---

[57] *See* GATS, art. I. Note, however, a major exception to the national treatment obligation for measures "aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of another [WTO] Member." GATS, art. XIV(d)(governing general exceptions). *Cf.* NAFTA, art. 2103.

[58] U.S. Schedule Attached to the Agreement on Government Procurement, Annex 2, *reprinted in* House Doc. 103-316, 103d Cong., 2d Sess., Vol. 1, at 1989-95.

[59] Government Procurement Agreement, art. I(2), III(1).

[60] *See* Schaefer & Singer, *supra* note 9, at 47-48.

[61] An example from NAFTA would be health services. However, for this reason the Canadian government exempted current and future discriminatory measures related to health services provided for a public purpose. *See* NAFTA, *supra* note 3, Reservations and Exceptions for Chapters 11, 12, and 14, Annex II-Canada, *reprinted in* House Doc. 103-159, Vol. 1 at 1646 (reservation for social services including health). A controversy arose between the federal government and the provincial governments over the scope of this exemption during the "grandfathering" of existing non-conforming provincial measures under Annex I.

areas and their support was seen as particularly critical to the passage of NAFTA. These strong beliefs in the non-protectionist treatment of foreign goods and services exist in many state capitols, despite the fact that a new push has begun in these same state capitols for additional state flexibility and powers with regard to non-trade related matters.[62] However, such views are not universal.

Other state interests, particularly within regulatory agencies, focused on how recent trade agreements might impact state sovereignty. However, much of the analysis behind the U.S. state sovereignty rhetoric began and stopped at a comparison of areas addressed by the trade agreements and areas in which states exercised a degree of legislative, regulatory, or enforcement authority. "Laundry lists" of state measures falling within these areas were created and labelled as laws subject to preemption.[63] However, noting that NAFTA and the Uruguay Round Agreements address a particular issue is only the starting point in assessing their impact on states and provinces and whether the values of federalism are somehow endangered. Any assessment of the impact of these agreements upon the goals of federalism must include an examination of the primary obligations states and provinces must follow and the significant exceptions carved out of the agreements for state and provincial laws.[64]

III. "PROBLEMS" RAISED BY FEDERAL STATES FOR REGIONAL FREE TRADE AND ECONOMIC INTEGRATION

As noted above, Canada and the United States represent the strongest federal systems in the Americas. As the analysis below shows, "problems" can be raised in a variety of ways by different brands of federalism. Federalism "problems" of the United States are somewhat more veiled than those of Canada.

---

[62] As to the push for new flexibility in non-trade related matters, see, e.g., *Conference of the States: An Action Plan to Restore Balance in the Federal System*, concept paper adopted by the Council of State Governments, the National Governors' Association, and the National Conference of State Legislatures, Feb. 1, 1995.

[63] *See, e.g.*, Center for Policy Alternatives, *The New Supremacy of Trade: NAFTA Rewrites the Status of States*, Testimony Before the Florida House of Representatives, Nov. 3, 1993 at 21. Additionally, some of the listed laws did not even fall within areas addressed by the NAFTA such as occupational health and safety regulations.

[64] It must also include an analysis of the domestic law effect of trade agreements. *See* Schaefer, *supra* note 39, at 609-52.

A. *United States*

The United States Constitution enumerates several bases of power for the federal government including the grant to Congress of the power to regulate interstate and foreign commerce.[65] The Tenth Amendment reserves all powers not delegated to the federal government to the states. Under constitutional interpretation by the U.S. Supreme Court since the late 1930s, the U.S. Congress can exercise broad powers under the Commerce Clause of the U.S. Constitution. The test is whether the activity sought to be regulated by the Congress has a significant economic effect on interstate and foreign trade.[66] Such a test allows Congress to reach purely "local" activities provided that such activities have a substantial effect on interstate commerce.[67] Furthermore, Congress is allowed to cumulate the total incidence of a practice to determine whether it has a substantial effect on interstate commerce.[68] While the Supreme Court recently struck down a federal statute under the Commerce Clause for the first time in over forty years ("no guns in a school zone" legislation[69]), this decision does not in any way call into question the federal government's constitutional ability to legislate on matters addressed in trade agreements. Recent Tenth Amendment jurisprudence also does not change this conclusion.[70] Moreover, even if the Supreme Court revived some notion of reserved powers under the Tenth Amendment, it would unlikely affect legislation enacting trade agreements.[71] The Supreme Court earlier in this century established the principle that federal government has the power to implement any valid international agreement even

---

[65] U.S. Constitution, art. I, sec. 8, cl. 3.

[66] *See, e.g.*, Wickard v. Filburn, 317 U.S. 111 (1942). In the U.S. Supreme Court's most recent opinion dealing with Congressional power under the Commerce Clause, the Court at various times refers to economic or commercial activity having a substantial effect on interstate commerce, in essence, shifting the economic modifier away from the effect to the activity itself. U.S. v. Lopez, 115 S.Ct. 1633, 1634 ("[P]ossession of a gun in a local school zone is in no sense an economic activity that might, through repetition elsewhere substantially affect any sort of interstate commerce"). *See also id.* at 1640 (Kennedy concurring)("[U]nlike earlier cases to come before the Court, here neither the actors nor their conduct have a commercial character").

[67] *See, e.g.*, Wickard v Filburn, 317 U.S. 111 (1942); Perez v. U.S., 402 U.S. 146 (1971).

[68] *Id.*

[69] U.S. v. Lopez, 115 S.Ct. 1624 (1995).

[70] New York v. U.S., 505 U.S. 144 (1992). For additional discussion and analysis, see Matthew Schaefer, *The Impact (If Any) of Recent Supreme Court Federalism Jurisprudence on the Negotiation, Implementation, and Enforcement of Trade Agreements*, (unpublished manuscript on file with author).

[71] *See* National League of Cities v. Usery, 426 U.S. 833 (1976) (protecting certain attributes of state sovereignty, namely those representing "functions essential to separate and independent existence" or "integral government functions"), *overruled by* Garcia v. San Antonio Metropolitan Transit Authority, 469 U.S. 528 (1985).

if it would not have the power to legislate on the subject in the absence of the agreement.[72]

Nevertheless, the U.S. federal government faces many political obstacles in regulating foreign commerce as a result of its federal structure. Indeed, the Supreme Court has held that the Constitution's main protection of state rights is the political process established by the Constitution.[73] Thus, the United States has what many have termed federal "reluctance" rather than federal incapacity to implement treaty obligations affecting the states.[74] These political constraints can be formidable, particularly in the areas of government procurement and direct taxation as seen in the negotiation and implementation of the Uruguay Round Agreements.

This federal reluctance has caused chagrin on the part of foreign trading partners. For instance, federal government negotiators recognized as early as the Tokyo Round negotiations that they maintained the constitutional power to bind states to follow non-discriminatory procurement policies upon Congressional approval.[75] After the failure to bind subnational procurement in the Tokyo Round, foreign trading partners, particularly the European Community (E.C.), continued to complain about the in-state preferences within state procurement legislation. In the Uruguay Round, the E.C. refused to increase access of the U.S. suppliers to E.C. telecommunications and other utilities procurement until U.S. state procurement was bound to a certain extent to rules prohibiting discrimination.[76]

One factor that would seem likely to reduce federal reluctance in certain areas of trade negotiations is the dormant Commerce Clause doctrine. The grant of power to the Congress to regulate interstate and foreign commerce has been interpreted by the Supreme Court to imply limitations on state actions even in the absence of Congressional action preempting the state action.[77] Under the so-called dormant Commerce

---

[72] Missouri v. Holland, 252 U.S. 416 (1920). For additional discussion and analysis, see Matthew Schaefer, *supra* note 70.

[73] Garcia v. San Antonio, 469 U.S. 528 (1985). This is true even with judicially imposed "outer limits." *See supra* notes 69-70.

[74] Regarding the distinction between federal reluctance and federal incapacity, see Corey Oliver, *The Enforcement of Treaties by a Federal State*, 1974-I RECUEIL DES COURS 333, 359 (1974).

[75] *See* John H. Jackson, *United States*, in JACKSON, IMPLEMENTING THE TOKYO ROUND, *supra* note 46, 144.

[76] *See* Gerard De Graaf & Matthew King, *Towards a More Global Government Procurement Market: The Expansion of the GATT Government Procurement Agreement in the Context of the Uruguay Round*, 29 INT'L LAW. 435, 442-43 (1995).

[77] *See generally* Donald Regan, *The Supreme Court and State Protectionism: Making Sense*

Clause doctrine, state actions that have a protectionist purpose or that unreasonably burden interstate or foreign commerce will be held unconstitutional. Political constraints should theoretically subside in those areas in which restrictions imposed on the states via trade agreements are already imposed upon the states as a matter of constitutional law. Many areas addressed in trade agreements are subject to constraints under the dormant commerce clause.[78] However, due to the market participant exception elaborated by the U.S. Supreme Court, state actions in the areas of direct payment subsidies and government procurement are not covered by the dormant Commerce Clause.[79] Moreover, the federal government has removed dormant Commerce Clause restraints on the states in certain areas (such as insurance) through the enactment of federal legislation.[80] Therefore, the federal reluctance to binding the states to obligations in these areas can not be expected to diminish as a result of any existing constitutional restraints on the states.

For areas of state regulations and activities covered by both the dormant Commerce Clause and international trade agreements, the relevant question is whether the standards established by the Commerce Clause differ to any significant degree from those within the international trade agreements. In practical terms, the differences appear to be quite small. The general anti-protectionism obligation encompassed in the national treatment obligation of the NAFTA and GATT is to treat foreign products no less favorably than domestic "like products." Regulation of services is subject to a similar obligation.

For states, the national treatment obligation means that they must treat foreign goods and services as favorably as "in-state" goods and services. However, it does not require them to impose the same taxes or regulations as other states. This final point has been misunderstood by some reading the only previous GATT dispute settlement case concern-

---

of the Dormant Commerce Clause, 84 MICH. L. REV. 1091, 1125 (1986).

[78] The Privileges and Immunities Clause of Article IV and the Equal Protection Clause might also limit discriminatory state actions in some areas addressed by trade agreements. However, the Privileges and Immunities clause only applies to individual "citizens" while the Equal Protection Clause applies to "persons," both natural and legal.

[79] The Supreme Court first established the market participant doctrine in Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976). *See also* Reeves v. State, 447 U.S. 429 (1980); White v. Mass. Council of Construction Employers, Inc., 460 U.S. 204 (1983). For the line drawn with respect to direct subsidies and subsidies in the form of tax credits, see, e.g., New Energy Co. of Indiana v. Limbach, 486 U.S. 269 (1988). However, this line may have changed as a result of West Lynn Creamery, Inc. v. Healy, 512 U.S. 186 (1994).

[80] *See, e.g.*, McCarran-Furgeson Act. However, the Equal Protection Clause might still disallow certain protectionist actions in these areas. *See, e.g.*, Metropolitan Life Insurance Co. v. Ward, 470 U.S. 869 (1985).

ing state laws, the so-called *Beer II* case. In the *Beer II* case, the GATT panel held that five states' laws that required common carriers to be used for the importation of foreign-made beer violated the national treatment obligation since in-state beer was not subjected to a similar requirement.[81] It then proceeded to consider whether the measure could nonetheless be justified under GATT's general exception provision as a measure "necessary" to secure compliance with tax laws.[82] In its analysis, the panel noted that forty-five other states did not maintain similar requirements and thus such requirements could not be considered "necessary."[83] While the panel could be criticized for not examining whether other states measures were as effective for purposes of tax collection, it did not rule that the difference in measures between states violated the national treatment obligation. Rather, such measures could not be deemed "necessary."

One additional concern among some state officials was that local purpose would receive less consideration under GATT scrutiny than in dormant Commerce Clause analysis. However, one recent study undertaken by two distinguished scholars actually refutes such a proposition. Professor Daniel Farber and Robert Hudec found that state regulatory goals assumed at least as much and perhaps more importance in GATT national treatment cases as compared with dormant Commerce Clause cases.[84] Empirical evidence of actual cases brought before U.S. courts in the time between 1948-1994 appear to confirm this finding. A minuscule number of private parties choose to challenge state measures as violations of GATT (despite the fact GATT was part of federal law superseding state law during this time frame) as compared with the number of private parties challenging state measures under the dormant

---

[81] GATT, Panel Report-United States-Measures Affecting Alcoholic and Malt Beverages, Basic Instruments & Selected Documents, 39th Supp. at 206 (adopted by GATT Council June 19, 1992) (hereinafter *Beer II*).

[82] GATT, Art. XX(d).

[83] *Id.*

[84] With respect to facially discriminatory measures, see Daniel A. Farber & Robert E. Hudec, *Free Trade and the Regulatory State: A GATT's-Eye View of the Dormant Commerce Clause*, 47 VAND. L. REV. 1401, 1421 (1994) ("[P]erhaps, the national governments who are subjects of GATT law are in a relatively more powerful position than the U.S. state governments subject to the DCC doctrine, and so are able to exert stronger claims on behalf of their 'other' regulatory goals"). With respect to facially neutral measures, see *id.* at 1428 ("[T]he trick to making Article III:4 a sufficiently flexible and sensitive legal standard lies in finding some way to interpret the 'less favorable treatment' standard in a way that will permit tribunals to limit its application to more egregious measures that involve little or no genuine regulatory purpose. This has been done with the "like product" test of Article III . . . .) Recent "like product" jurisprudence within the WTO may possibly change this conclusion to a degree.

Commerce Clause. If state measures were to receive stricter review under the GATT, then private parties could have been expected to challenge state measures based on GATT standards.[85]

While it may be possible that a law valid under the dormant Commerce Clause will be held a violation of the national treatment obligation (and unjustified under the general exceptions clauses) under the dispute settlement processes of NAFTA or the WTO, such instances, if they occur, will be very rare. During the debate over the Uruguay Round implementing legislation, the state tax organizations frequently referred to the Minnesota law that gave an excise tax break to all beer brewed by microbreweries (regardless of where the microbrewery was located) as an example of a law that was held invalid under GATT's national treatment standard, but would be constitutional under the dormant Commerce Clause.[86] The GATT *Beer II* panel held that products do not become un-like merely because they are made by a different production process (small versus large breweries).[87] However, process distinctions will often not survive dormant Commerce Clause scrutiny either.[88] Moreover, in any comparison, one must remember that state actions that impact foreign commerce receive stricter scrutiny under the dormant Commerce Clause than state actions which merely affect interstate commerce.[89]

Nonetheless, the lingering uncertainty over the exact overlap of dormant Commerce Clause constraints and constraints within international trade agreements has lead certain state interests to oppose the application of international trade agreement constraints to the states. One clear difference between dormant Commerce Clause constraints and international trade agreement constraints is the bodies that review whether states have complied with the respective constraints. State critics of the trade agreements alleged that "faceless" tribunals are now allowed to review state actions instead of domestic courts.[90] However, it is readily

---

[85] Arguably this might also have been due to a lack of knowledge by private parties about the status of GATT. Additionally, GATT did not have as broad a coverage as the dormant Commerce Clause. For instance, GATT obligations do not address direct taxation measures.

[86] *See, e.g.*, Multistate Tax Commission, *News & Views*, July 11, 1994, at 7.

[87] *Beer II*, *supra* note 81, at ¶ 5.19.

[88] For instance, is there any doubt that a state law which prohibited the sale of a product made by a factory with pollution control technology of a lesser standard than that used by in-state factories would be unconstitutional? *See, e.g.*, Baldwin v. Seelig, 294 U.S. 511, 528 ("It is one thing for a state to exact adherence by an importer to fitting standards of sanitation before the products of the farm or factory may be sold in its markets. It is a very different thing to establish a wage scale . . . for use in other states, and to bar the sale of products . . . unless the scale has been observed").

[89] *See, e.g.*, Japan Line v. County of Los Angeles, 441 U.S. 434 (1979).

[90] For a response to this criticism, see Matthew Schaefer, *National Review of WTO Dispute*

apparent that a trade agreement allowing for neutral review of foreign actions would never be achieved unless the U.S. federal and state governments subject themselves to similar international scrutiny. Offers such as "your standard is the one contained in the agreement, our standard will be the one provided in our Constitution" are not accepted by foreign countries. The absence of an agreement would appear to leave U.S. states at a disadvantage in terms of reciprocal treatment because the states are already required to offer non-protectionist treatment in many areas as a result of domestic constitutional constraints unlike some other sub-national governments. Nevertheless, certain state interests would be willing to sacrifice the attainment of free trade unless such an offer was accepted.

B. Canada

The Canadian federal government has the power to enter into trade agreements within the domestic legislative jurisdiction of the provinces. However, the Canadian federal government faces potential constitutional constraints in implementing certain obligations which places political constraints on what it can in fact agree to in trade negotiations. While the exact limitations on the Canadian government are unclear (and neither the federal government nor the provinces seem anxious to press a court case that would address the jurisdictional issue), the federal government does not enjoy a broad commerce power or treaty implementing power similar to that of the U.S. federal government.[91]

In its renowned 1936 decision in the *Labor Conventions* case,[92] the Privy Council ruled that the Canadian federal government could not implement those provisions of three labor conventions that addressed matters within provincial legislative jurisdiction under the Constitution. The thrust of the reasoning of Lord Akin was that the treaty implementing power must be treated for constitutional purposes in the same manner as any other disputed power—one must look to the specific heads of power granted to the provinces and the federal government. In contrast to the U.S. Constitution, the Canadian Constitution allocates specific heads of power to both the federal and provincial governments and leaves residual powers to the federal government. Lord Akin stated that

---

Settlement Reports: In the Name of Sovereignty or Enhanced WTO Rule Compliance?, 11 ST. JOHN'S J. LEGAL COMM. 307, 333-34 (1996).

[91] HOGG, *supra* note 55, at 439 (noting this is a result of judicial interpretation); STEGER, *supra* note 55.

[92] A.G. for Canada v. A.G. for Ontario, 1937 A.C. 326.

"there is no such thing as treaty legislation as such. The distribution is based on classes of subjects; and as the treaty deals with a particular class of subjects so will the legislative power of performing it be ascertained."[93] Lord Akin summarized the impact of the decision on Canada's international abilities and capacities in a benign manner:

> It must not be thought that the result of this decision is that Canada is incompetent to legislate in performance of treaty obligations. In totality of legislative powers, Dominion and Provincial together, she is fully equipped. But the legislative powers remain distributed, and if in the exercise of her new functions derived from new international status Canada incurs obligations they must, so far as legislation is concerned, when they deal with Provincial classes of subjects, be dealt with by cooperation between the dominion and provinces. While the ship of state now sails on larger ventures and into foreign waters, she still retains the watertight compartments which are an essential part of her original structure.[94]

Dicta in several recent Supreme Court cases express dissatisfaction with the *Labor Conventions* case.[95] Indeed, hints at reconsideration of the *Labor Conventions* case have occurred at various times since the decision. Nonetheless, it is unlikely in view of the constitutional crisis facing the Canadian federation that the Supreme Court would brave overturning the *Labor Conventions* case. Of course, the expansion or contraction by the court of its interpretations of the various heads of power could also alter the balance in treaty implementation (at least with respect to trade agreements). Indeed, many would prefer the expansion of particular federal heads of power rather than an overturning of the *Labor Conventions* case to allow for federal treaty implementation over some previously provincial subjects.[96] For instance, a broadened interpretation of the federal trade and commerce power would allow Canada additional flexibility in implementing trade agreements without an overturning of the *Labor Conventions* case. For now, however, the trade and commerce power has not been interpreted in a manner that would allow for federal legislation over all matters having an economic effect on interprovincial or international trade.[97] Rather, Canadian constitutional interpretation focuses on the type of transaction and not the economic effect on trade. In addition no stream of commerce analysis is applied to transactions. The basic distinction drawn is between a regula-

---

[93] *Id.* at 351.

[94] *Id.* at 353-54.

[95] MacDonald v. Vapor Canada, Ltd., (1976) 66 D.L.R. 3d 1, (1977) 2 S.C.R. 134, 167; Schneider v. Queen, (1983) 139 D.L.R. 3d. 417, 437.

[96] *See* Gerard La Forest, *The Labor Conventions Case Revisited*, 1974 CAN. Y.B. INT'L L. at 151.

[97] *See* HOGG, *supra* note 55, at 439; STEGER, *supra* note 55.

tion affecting trade and a regulation in respect of trade.[98] In short, both the trade and commerce power and the "peace, order, and good government" (pogg) clause have been narrowly interpreted so as to protect provincial jurisdiction.[99] Therefore, unlike the United States, Canada has potential constitutional and not just political restrictions hindering its ability to implement trade agreements. In certain areas, Canada may suffer from federal incapacity to implement trade agreement obligations rather than mere federal reluctance.

Canada has no constitutional equivalent of the dormant Commerce Clause. This is no surprise in light of the fact that the constitutional ability of the federal government to act positively to prevent protectionism by and among the provinces under the Commerce Clause remains incomplete. Thus, trade agreement obligations generally do not overlap with existing domestic restrictions on the provinces. Instead, trade agreement obligations generally represent truly new restraints on Canadian provincial protectionism. The result of the conclusion of recent trade agreements was that foreign goods might enjoy better access to a province than goods from other provinces. This odd result lead to a new push for elimination of interprovincial trade barriers. An intergovernmental agreement among the provinces was signed in 1994 to eliminate numerous interprovincial barriers to trade,[100] but its implementation remains incomplete. Moreover, the interprovincial agreement was carefully negotiated so as to not increase access to foreign goods and services beyond that allowed by recent trade agreements.

IV. THE APPLICATION OF INTERNATIONAL TRADE AGREEMENT RULES TO SUB-NATIONAL GOVERNMENTS AND TECHNIQUES MINIMIZING CONSTRAINTS OF THE RULES

A. The Extent To Which NAFTA and Uruguay Round Obligations Apply to the U.S. States and Canadian Provinces As a Matter of International Law

The customary international law rule that acts or omissions of component units in violation of international obligations of the federal state

---

[98] *See* John Whythe, *Federal Powers Over the Economy: Finding New Jurisdictional Room*, 13 CAN. BUS. L. J. 257, 286, 296 (1987).

[99] *See* John Quinn, *Federalism and Foreign Economic Relations*, 10 CAN.-U.S. L.J. 197, 211 (1985).

[100] *See generally* GETTING THERE: AN ASSESSMENT OF THE AGREEMENT ON INTERNAL TRADE (M.J. Trebilcock & Daniel Schwanen, eds.) (C.D. Howe Institute Policy Study #26, 1995).

are attributed to the federal state, and give rise to the responsibility of the federal state, is well-settled.[101] This is true even in those cases in which the internal law of the federal state does not give the federal state the power to compel compliance by the component units with international obligations.[102] Rapporteur Ago's report on international responsibility for the International Law Commission notes a "consistent series of legal decisions" since the 1875 arbitral award in the Case of the "Montijo" in support of such a rule.[103] The rule is unanimously cited by commentators.[104] However, the rule regarding responsibility of a federal state for treaty violations by its sub-federal governments can be changed by the parties to a treaty. The customary international law rules on responsibility apply in the absence of a contrary intent expressed by the parties to a treaty.

Both the NAFTA and the GATT 1994 contain a general clause regarding the applicability of obligations within those agreements to sub-national governments. Those clauses are best understood by examining first the clause found within the original GATT of 1947. The original GATT contained a federal clause that was intended to deviate only slightly from the customary international law rules that nations are responsible for actions of their sub-national governments that violate a treaty. The original GATT's Article XXIV(12) stated:

> Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory.

The drafting history of the GATT 1947,[105] as well as an analysis of dispute settlement panel reports interpreting the provision,[106] indicate that to the extent a federal government had the constitutional authority to ensure observance of a GATT obligation, the obligation applied to sub-national government actions and the federal government was responsible for any violation of the obligation. In the United States, it is clear the federal government would have constitutional authority to ensure observance with the possible exception of regulation of the distribution

---

[101] IAN BROWNLIE, SYSTEM OF THE LAW OF NATIONS: STATE RESPONSIBILITY 141-42 (1983); BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 449 (4th ed. 1990); IVAN BERNIER, INTERNATIONAL LEGAL ASPECTS OF FEDERALISM 83 (1973).

[102] *See, e.g.*, Pellat Case, V. Reports of International Arbitral Awards 536.

[103] 1971 Y.B. INT'L L. COMM'N 257, § 175.

[104] *See supra* note 101.

[105] *See* JOHN H. JACKSON, WORLD TRADE AND THE LAW OF GATT 110-14 (1969).

[106] *See Beer II, supra* note 81; GATT Panel Report, Canada-Import, Distribution, and Sale of Alcoholic Drinks by Provincial Marketing Agencies, 35 BISD 37 (1987-88).

and marketing of alcoholic beverages due to the 21st Amendment. Unfortunately, the only GATT dispute settlement case regarding state laws examined laws implicating this possible exception. In the so-called GATT *Beer II* case, a GATT dispute settlement panel ruled that the U.S. President (by delegation from Congress) would have the authority to overturn state laws regulating the marketing and distribution of alcoholic beverages, therefore making the United States responsible for the state violations, despite the fact that the Supreme Court had not delineated the exact relationship between federal powers under the Commerce Clause and the 21st Amendment in all contexts.[107]

As noted above, the Canadian government's constitutional power to ensure observance of international trade agreement obligations by its provinces is subject to uncertainty in a wider range of areas. However, even under this original version of Article XXIV(12) if a sub-federal action were held not to violate a provision of the GATT because the federal government did not have the constitutional authority to ensure observance of the provision, the sub-federal action might still constitute "nullification or impairment" of a tariff concession and lead to compensation negotiations or a retaliatory suspension of concessions.

Nonetheless, the European Community sought a clarification within the Uruguay Round of the provision due to its concerns that the clause created an imbalance in obligations between federal and unitary states.[108] The European Community has the power to ensure observance of sub-national governments with Community law, including international trade agreements. As a result, the GATT 1994 adds the following understanding of Article XXIV(12):

> Each member is fully responsible under GATT 1994 for observance of all provisions of GATT 1994, and shall take such reasonable measures as may be available to it to ensure such observance by regional and local governments and authorities within its territory.

---

[107] Because of this factor, the United States tabled two "reservations" regarding portions of the report while allowing adoption of the report within the GATT Council. *See Statement of Ambassador Rufus Yerxa to the GATT, reprinted in* INSIDE U.S. TRADE, SPEC. REP., June 26, 1992. For a discussion of the relationship between tha Commerce Clause and the 21st Amendment, see Matthew Schaefer, *supra* note 70.

[108] The European Union claimed that "Article XXIV(12) should not operate as an escape clause exempting some Contracting Parties from certain of their GATT obligations. It should be made clear that Contracting Parties with a federal structure of government have the same obligations as those with a unitary structure." GATT Doc. MTN.GNG/NG7/20 (Aug. 21, 1990). *See also* JOHN CROOME, RESHAPING THE WORLD TRADING SYSTEM: A HISTORY OF THE URUGUAY ROUND 100 (1995) ("[The European] Community felt that GATT obligations were titled in favor of federal states").

Thus, GATT 1994 leaves no doubt that a federal government is fully responsible for all cases of non-observance by sub-national governments. The amended Article XXIV(12) thus distinguishes clearly between the separate issues of responsibility and remedial action. Unitary states and federal states have the same responsibility regarding sub-national government observance but might obviously have different abilities to actually enforce compliance by sub-national governments. The text also clarifies that consistent with existing GATT practice, dispute settlement cases may be brought regarding sub-national government laws and practices.[109] Additionally, provisions relating to compensation and suspension of concessions apply in such cases where it has not been possible to secure sub-national government observance.[110]

Other Uruguay Round Agreements annexed to the WTO, including the General Agreement on Trade in Services (GATS), the Agreement on Subsidies, the Agreement on Sanitary and Phytosanitary Measures, and the Agreement on Technical Barriers to Trade, although sometimes utilizing different language, contain similar clauses that clearly indicate that obligations within those agreements generally apply to sub-national measures.[111] Moreover, the Dispute Settlement Understanding (DSU), which applies to all of these "covered" agreements, explicitly states that "[t]he dispute settlement provisions of the covered agreements may be invoked in respect of measures affecting their observance taken by regional or local governments or authorities within the territory of a Member."[112]

The NAFTA (as well as the CUSFTA) also sought to remove any doubt over the general applicability of those agreements to state and provincial laws and the corresponding responsibility of the respective federal governments for sub-federal violations. Thus, the NAFTA, and previously the CUSFTA, did not utilize the language from the original GATT 1947. Rather, the NAFTA, in Article 105, states: "[t]he Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments." This provision is identical to that found in the CUSFTA.[113]

---

[109] Understanding on the Interpretation of Article XXIV of the GATT 1994, para. 14, *reprinted in* House Doc. 103-316, Vol. 1, 103d Cong., 2d Sess., at 1347.

[110] *Id.*

[111] *See, e.g.*, GATS, art. I(3); Agreement on Subsidies and Countervailing Measures, art. 1.1.

[112] Understanding on Rules and Procedures Governing the Settlement of Disputes, art. 22.9.

[113] U.S.-Canada FTA, art. 103.

B. Techniques Minimizing Constraints on Sub-National Governments

Therefore, obligations within both NAFTA and the Uruguay Round Agreements apply to state laws as a general matter and state laws are exposed to challenge under these trade agreements. However, various techniques are used to reduce the exposure of state and provincial laws (and sometimes federal laws) to challenge under both the NAFTA and the WTO Agreements. The most important of these techniques follow:

1) Encouraging but not mandating the use of international and harmonized standards;
2) Negotiating obligations with which existing laws comply and future laws will (likely) comply;
3) Allowing "grandfathering" or exemption of existing laws that do not conform to anti-protectionism and other central obligations;
4) Allowing states and provinces to voluntarily choose whether they will be bound to certain agreements and tailor the extent to which they will be bound.

The use of these various techniques and how they reduce the impact or constraints of the NAFTA and Uruguay Round Agreements on states and provinces will be illustrated below with an emphasis on examples from the NAFTA. The illustrations are not exhaustive, but seek to highlight some areas of potential concern to the U.S. states (and Canadian provinces) within international trade agreements.

Technique #1: Encouraging, But Not Mandating, the Use of International and Harmonized Standards

Illustration A: NAFTA Chapters on Sanitary & Phytosanitary Measures and Technical Barriers to Trade

The NAFTA Chapters on Sanitary and Phytosanitary (SPS) Measures and on Technical Barriers to Trade (TBT) seek to promote the use of international standards and the harmonization of those standards. However, the chapters do not compel the use of such standards. The rationale for seeking harmonization is clear. Harmonized standards can lower costs to both consumer and producers as producers are able to create longer production runs with less interventions. Additionally, harmonization eliminates the opportunity to create protectionist standards. However, harmonization also reduces the flexibility for variation among nations and among sub-national jurisdictions. Variation, both nationally and sub-

nationally, may be required due to different geographic conditions, different native flora and fauna, or simply because of different values reflected in different levels of protection of human health. Moreover, as a practical matter, international standards tend to achieve a relatively low level of protection of human health.

The NAFTA states that the obligation to base SPS measures on international standards "shall not be construed as preventing a party from applying an SPS measure that is more stringent than a relevant international standard."[114] However, if an SPS measure is not based on an international standard, then a Party whose exports are adversely affected or may be adversely affected may request reasons for the measure from the other Party and the other Party is required to provide their reasons in writing.[115] If an SPS measure conforms to a relevant international standard, it is presumed to be consistent with the NAFTA.[116] A measure that achieves a level of protection different from that which would be achieved by a measure based on an international standard is not presumed to be inconsistent with NAFTA "for that reason alone."[117] Additionally, the SPS Chapter explicitly recognizes the rights of Parties to set their own levels of protection of human, animal, and plant life, and health. It was intended by the negotiators from the three nations that these rights apply to all levels of government within a nation.

Further provisions of the SPS Chapter require the Parties to pursue "equivalence" (meaning anything between harmonization of standards or standards similar enough that they achieve equivalent levels of protection) "to the greatest extent practicable," but again "without reducing the level of protection of human, animal, and plant life or health [HAPLH]."[118] Under these provisions, a Party must accept as equivalent those SPS measures of another Party in which the other Party has provided scientific evidence to demonstrate objectively that the SPS measure will achieve the importing Party's appropriate level of protection. An importing Party is allowed to refuse to accept as equivalent those SPS measures which do not achieve the importing Party's appropriate level of protection provided it has a scientific basis and provided it gives the reasons in writing expressing this basis.[119] An exporting

---

[114] NAFTA, *supra* note 3, art. 713(3).
[115] NAFTA, *supra* note 3, art. 713(4).
[116] NAFTA, *supra* note 3, art. 713(2).
[117] *Id.*
[118] NAFTA, *supra* note 3, art. 714.
[119] NAFTA, *supra* note 3, art. 714(2).

Party, if it is seeking to have its SPS measure recognized as equivalent, must provide access in its territory to an importing Party for the purpose of testing and inspection.[120] Lastly, the SPS measures of other Parties "should" be considered in the development of a Party's own measures.[121]

The NAFTA Technical Barriers to Trade (TBT) Chapter (which applies to product standards not covered in the SPS Chapter) adopts a similar approach to that of the SPS Chapter. It only requires the Parties "to the greatest extent practicable" to make compatible their respective standard-related measures. Moreover, the TBT Chapter allows Parties to deviate from international standards in a variety of instances. Specifically, the TBT Chapter only requires Parties "to use as a basis for its standards-related measures relevant international standards or international standards whose completion is imminent, except where such standards would be an ineffective or inappropriate means to fulfill its legitimate objectives, for example because of fundamental climatic, geographical, technological or infrastructural factors, scientific justification or the level of protection that the party considers appropriate."[122] By adding this last factor of "appropriate level of protection," the TBT agreement recognizes that different jurisdictions may maintain different values even if such values are not based on "fundamental" objective factors.

The TBT Chapter also explicitly recognizes the rights of the Parties to set their appropriate levels of protection. Again, this right belongs to all levels of government within a NAFTA nation. The TBT Chapter gives a presumption of NAFTA legality to standards that conform to an international standard.[123] However, the chapter adds that the above obligation shall not be construed to prevent a Party from maintaining a standard-related measure that results in a higher level of protection than would be achieved if the measure were based on the relevant international standard.[124] Thus, if one has established a domestic standard different than an international standard, the domestic standard must achieve a higher level of protection and cannot simply be an arbitrary distinction that results in no higher protection.

---

[120] NAFTA, *supra* note 3, art. 714(3).
[121] NAFTA, *supra* note 3, art. 714(4).
[122] NAFTA, *supra* note 3, art. 905(1).
[123] NAFTA, *supra* note 3, art. 905(2).
[124] NAFTA, *supra* note 3, art. 905(3).

Technique #2: Negotiating Obligations With Which Existing Laws Comply and Future Laws Will (Likely) Comply

Illustration B: NAFTA Chapter on Sanitary & Phytosanitary Measures

Trade negotiations over the past two decades have increasingly focused on standards-related matters, including standards related to food products, animals, and plants. The outcome of these negotiations has been an increased emphasis on scientific justification or scientific basis for such measures. The rationale behind these developments is clear. It is felt that national treatment is no longer enough. A nation may treat foreign goods equal to its own, but nonetheless its regulations may be irrational and hinder beneficial trade unnecessarily. Thus, it is felt that science could bring some objectivity into deciding whether a regulation was rational. However, science cannot tell society how much risk to tolerate (i.e. there is a distinction between science and public policy). NAFTA recognizes the difference between science and public policy by requiring a scientific basis and a risk assessment for SPS measures, but allowing a government to choose its appropriate level of protection.

Under NAFTA, state SPS measures are required to have a scientific basis and are accompanied by a risk assessment. Existing state laws meet these two criteria. Moreover, states maintain processes that will ensure that future laws comply with these obligations. Article 715 enumerates the criteria which must be taken into account when conducting a risk assessment. Many states rely wholly or in part on federal risk assessments for some of their measures. Under NAFTA, states may continue this practice. The use of the terms "as appropriate to the circumstances"[125] and "take into account"[126] is language that eliminates any need to conduct a separate state risk assessment or make more formal or extensive risk assessment procedures. Discussions with negotiators and officials from the three countries indicate that there must only be some logical or rational connection of SPS measures to scientific findings.

Technique #3: Allowing "Grandfathering" or Exemption of Existing Laws That Do Not Conform to Anti-Protectionism and Other Central Obligations

---

[125] NAFTA, *supra* note 3, art. 712(3)(c).

[126] NAFTA, *supra* note 3, art. 715(1).

Illustration C: NAFTA Chapters on Services, Investment, and Financial Services

National treatment and most-favored-nation (MFN) treatment are required by the services, investment, and financial services chapters of NAFTA.[127] The national treatment obligation requires treatment of foreign service providers, investors, and their investments be as favorable as "in-state" services providers, investors, and their investments. However, the national treatment obligation in the financial services chapter is somewhat different than in the non-financial services and investment chapters. Although the wording is somewhat confusing, it is intended to incorporate the "home state" rule of U.S. banking law such that a state only need treat a foreign bank established in another state as favorable as U.S. banks established in that other state.

Each of these chapters contains several other major obligations. For instance, the services chapter states that "no Party may require a service provider of another Party to establish or maintain a representative office or any form of enterprise, or to be resident, in its territory as a condition for the cross-border provision of a service."[128] As another example, the investment chapter contains a prohibition on performance requirements.[129]

State laws existing as of January 1, 1994 were initially exempt from the national treatment and other central obligations of the investment and services chapters for an initial period of two years (or until January 1, 1996).[130] Those inconsistent with the major obligations of the financial services chapter were exempt for an initial period of one year (or until January 1, 1995).[131] During these initial exemption periods (which were extended to March 31, 1996 for the investment and services chapters[132]), the states and provinces worked together with their respective federal governments to identify specific measures that did not conform to these obligations. Specific measures identified as inconsistent with obligations were to be placed in Annex I of the NAFTA by the federal government. Measures placed in Annex I were to be in the form of a citation to a specific provision of state law, regulation, or judicial opin-

---

[127] NAFTA, *supra* note 3, arts. 1202, 1203.

[128] NAFTA, *supra* note 3, art. 1205.

[129] NAFTA, *supra* note 3, art. 1106.

[130] NAFTA, *supra* note 3, art. 1108(1)(a)(ii).

[131] A few states were required to have identified and list in an annex their non-conforming financial services measures by the date of entry into force of NAFTA (or January 1, 1994).

[132] *See NAFTA Nations Delay Listing of Sub-Federal Services Exemptions*, INSIDE NAFTA, Jan. 10, 1996, at 12-13.

ion. Placement in the annex was to have the effect of "grandfathering" or exempting these NAFTA-inconsistent measures from challenge for an indefinite period of time.[133] The process was completed as scheduled with respect to the financial services chapter. However, as the process continued, several states and provinces worried that the identification process failed to capture all measures that might be successfully challenged as inconsistent with the NAFTA chapters. Indeed, some states and provinces at certain points in the process sought to "grandfather" their entire state code.[134] Additionally, the United States found inconsistent reporting of measures among the fifty states. Thus, the NAFTA countries agreed that all state and provincial measures inconsistent with NAFTA Chapters on Investment and Services and existing as of January 1, 1994 would be "grandfathered" without requiring identification and specific listing in Annex I.[135] In essence, the NAFTA parties returned to the approach of the CUSFTA which also did not require identification of specific measures inconsistent with its services and investment obligations.[136]

The reason the NAFTA text was negotiated to initially require state and provincial measures to be identified was twofold: first, to provide greater transparency and, second, to provide a list for future liberalizing negotiations. Both of these goals have been undercut to a certain extent as a result of the NAFTA parties' agreement that specific measures would not require identification and listing in order to be "grandfathered." While the parties have apparently exchanged a list of state and provincial measures that have been developed, it is an incomplete listing and thus does not provide full transparency nor a complete list for any future liberalization negotiations.

Technique #4: Allowing States and Provinces to Voluntarily Choose Whether They Will Be Bound to Certain Agreements and Tailor the Extent to Which They Will Be Bound

---

[133] *Id.*

[134] *See Oregon Seeks Extension of NAFTA Deadline for Services Reservations*, INSIDE NAFTA, Dec. 27, 1995, at 3-5.

[135] *See NAFTA Parties to Protect Existing Sub-Federal Measures Indefinitely*, INSIDE NAFTA, Apr. 3, 1996, at 1.

[136] It is important to note that "grandfathered" laws are subject to a "one-way street" in that such laws only can be amended to increase their conformance with NAFTA obligations in order to maintain an exemption from NAFTA obligations and potential challenge.

Illustration D: Renegotiated GATT Government Procurement Code

The NAFTA explicitly states its intention to constrain sub-national government procurement practices in the future.[137] However, it notes that this will only be done on a "voluntary" and "reciprocal" basis.[138] Thus, it appears future NAFTA negotiations will follow the approach of obtaining state commitments to the GATT Government Procurement Code. Binding U.S. states to obligations within the renegotiated GATT government procurement code was handled on a voluntary basis. As noted before, thirty-seven states (through the political consent of their governors) voluntarily agreed to become bound to some extent to the renegotiated GATT Government Procurement Code.

Previous efforts by the federal government sought state commitments under an "all or nothing" approach. Under this approach, states would have to decide to bind all state entities or none at all. A more flexible approach was adopted in 1992 by which states could choose which state entities would be covered by Code obligations (although states were obviously encouraged to list as many as possible) and which products or services procured by these listed entities would be subject to Code obligations. Thus, states were able to tailor their commitments so as to account for existing procurement laws.

The Code requires non-discriminatory treatment of bidders from foreign countries which are signatories of the Code.[139] It also elaborates procedures to be followed for procurement, such as the amount of notice that must be given to bidders.[140] The federal government worked with the National Association of State Procurement Officers (NASPO) during negotiations to minimize the impact of administrative obligations. However, only entities listed in an annex to the agreement are bound to follow Code obligations.[141] States also received the opportunity to exclude the procurement of certain politically sensitive items from coverage under the Code. For instance, a note to the annex listing state entities excludes procurement of construction-grade steel, automobiles, and coal.[142] This exclusion applies to many of the thirty-seven states. Several states excluded additional products from coverage under

---

[137] NAFTA, *supra* note 3, art. 1024(3).

[138] *Id.*

[139] Government Procurement Agreement, art. III.

[140] Government Procurement Agreement, art. IX.

[141] Government Procurement Agreement, art. I(1).

[142] U.S. Schedule Attached to the Government Procurement Agreement, Notes to Annex 2, *reprinted in* House Doc. 103-316, Vol. 1 at 1995.

the Code. For instance, the state of Washington exempted procurement of "fuel, paper products, boats, ships and vessels" and the state of South Dakota exempted the procurement of "beef."[143] Procurements for mass transit and highway projects using federal funds and subject to restrictions (such as "prevailing wage" requirements) are also exempted.[144] An exemption from Code obligations for preferences for small and minority businesses is also included.[145] Lastly, the Code does not apply to contracts which do not reach a threshold level elaborated by the agreement.[146] The threshold is established higher for sub-national government purchasing than for central government procurements.

In short, the states tailored their commitments such that existing laws would not need to be changed in order to conform to Code obligations. Existing protectionist procurement laws were in essence "grandfathered." Thus, the potential impact of the renegotiated GATT Government Procurement Code on U.S. states appears rather meager. The only potential problem that could arise is if a state legislature in one of these thirty-seven states should enact a new preference that would need to be enforced by a covered procuring entity on a product or service not exempted from coverage and the procurement was above the threshold established by the Code. To be sure, the "bite" of the Code is already being felt by one state—Massachusetts—which recently enacted legislation that may conflict with the Government Procurement Code by prohibiting the state from transacting business with companies active in Burma. However, notwithstanding such state "foreign affairs" legislation, the trend in most states is away from preferences and processes that discriminate against foreign bidders and thus, this is unlikely to occur. In an era of limited budgets, state governments are seeking competitive bids to reduce taxpayer costs.

Canada has refused to make any offer regarding provincial procurement under the renegotiated GATT Government Procurement Code. Canada is demanding that the United States improve its offer regarding sub-national procurement prior to the making an offer.[147] As a result, the rules of the agreement with respect to U.S. state procurement will not apply vis à vis Canada.[148]

---

[143] *Id.* at 1993-94.

[144] *Id.* at 1995.

[145] *Id.*

[146] *Id.* at 1989.

[147] *See Canada, U.S. Deadlocked over Sub-Federal Procurement in WTO Talks*, INSIDE U.S. TRADE, Dec. 22, 1995, at 10.

[148] *Id.*

Illustration E: North American Agreement on Environmental Cooperation (NAAEC)

NAFTA's side environmental agreement requires that governments including state governments in the United States and Mexico, maintain environmental laws providing for a high degree of environmental protection and the effective enforcement of such laws.[149] A persistent failure to effectively enforce environmental laws can lead to a dispute settlement case by one nation against another. If a persistent failure to effectively enforce is found (an unlikely occurrence),[150] the first remedial step is the development of an action plan. The offending party can propose its own action plan or have one recommended by the dispute settlement panel established to hear the dispute.[151] If a party fails to follow an action plan, then a monetary penalty can be imposed.[152] If the party fails to pay a monetary penalty, then trade sanctions can be imposed to collect the monetary penalty.[153] In the case of Canada, trade sanctions are not possible because the Canadian government agreed to establish a mechanism by which the monetary penalty can be enforced in Canadian courts.[154]

The agreement currently applies to only two of the Canadian provinces for matters within their jurisdiction.[155] Canadian provinces maintain significant jurisdiction over environmental matters along with the federal government. The Canadian federal government did not want to risk paying a monetary enforcement penalty for lack of provincial enforcement when it could not necessarily compel the provincial government to enhance its enforcement.

Therefore, application of the agreement to a particular province with respect to matters within its jurisdiction is based on the consent of that province. Provinces that agree to be bound with respect to matters within their regulatory and enforcement jurisdiction will be included in a

---

[149] NAAEC, *supra* note 7, arts. 3,5.

[150] This is unlikely because a reasonable exercise of discretion and allocating resources to higher priorities does not constitute a failure to effectively enforce. *See* NAAEC, *supra* note 7, art. 45. Moreover, changing existing law to require less enforcement immunizes enforcement action from challenge. *See* Opinions on the Endangered Species Act and Logging Rider at <http://www.cec.org.html>.

[151] NAAEC, *supra* note 3, arts. 33-34.

[152] NAAEC, *supra* note 3, art. 34(5).

[153] NAAEC, *supra* note 3, art. 36.

[154] NAAEC, *supra* note 3, Annex 36A.

[155] *See Quebec Signs on to NAFTA Environmental Cooperation Pact*, 14 INT'L TRADE REP. 30 (Jan. 1, 1997).

Canadian declaration made under Article 41 of the agreement. To date, only Alberta and Quebec are included in the declaration. Alberta and Quebec have signed an intergovernmental agreement elaborating cooperation between the federal and provincial governments on the NAAEC. Under the intergovernmental agreement, signatory provincial governments agree to be bound to the NAAEC and in exchange receive certain rights to participate in the formation of Canadian positions within NAAEC and dispute settlement cases under the NAAEC.

The NAAEC attempts to balance the rights and obligations of the United States, Canada, and Mexico under the agreement by preventing Canadian access to the dispute settlement process in those cases in which the complaint is at the instance of a province not bound by the agreement or in which the matter would fall within provincial jurisdiction in Canada and provinces accounting for at least fifty-five percent of GDP have not become bound to the agreement. To date this fifty-five percent of GDP test has not been met.[156] Thus, enforcement in the United States and Mexico is subject to less possible scrutiny as a result of the need to balance rights and obligations.

There is no sense of urgency among other provinces to join the agreement. The agreement is a relatively low-priority matter in many provincial governments. Provincial governments are facing budgetary cuts and are reluctant to accept an obligation which could result in a monetary penalty (however remote the possibility). Moreover, the benefits of joining the agreement, such as the right to instigate a complaint by Canada against the United States or Mexico and the right to participate in the formation of Canadian positions within the Council created by NAAEC, are not "exceedingly tangible."[157]

C. Impact of the Various Techniques on the Goals of Free Trade and Federalism

While non-exhaustive, the illustrations of Techniques #1 through 4 above indicate that the impact of existing trade agreements on sub-federal governments is relatively modest. The question of whether further trade liberalization can be achieved without unduly endangering the goals of federalism and decentralization necessarily arises. While sub-federal measures are currently not a priority item on the agenda of an

---

[156] *Quebec Signs on to NAFTA Environmental Cooperation Pact*, 14 INT'L TRADE REP. 30 (Jan. 1, 1997).

[157] I borrow this last phrase from an official of a Canadian provincial or the federal government with whom I spoke about the agreement.

FTAA, or immediate future negotiations within the NAFTA or WTO,[158] the issue will need to be confronted at some point in the future in one of these forays. When the issue is confronted, policy makers will need to decide simultaneously which of the techniques described above are most threatening to the goals of free trade and which are necessary to protect the goals of federalism (and decentralization).

In distinguishing between Techniques #1 through 4, a distinction between two types of frequently observed obligations in trade agreements needs to be drawn. The first type of obligation is one prohibiting protectionism, or in other words, prohibiting more favorable treatment of in-state products and services vis à vis foreign products and services. The second type of obligation is one promoting harmonization of standards. The second type is a greater threat to the goals of federalism and thus, there may be legitimate reasons for proceeding more cautiously with respect to the second type of obligation.

Why are anti-protectionism obligations less threatening to the goals of federalism than harmonization obligations? Federalism cannot be seen as supporting unbridled local autonomy. While federalism preserves spheres of local authority, exercise of this authority in a protectionist manner necessarily endangers the political and economic union for which federations are created. Economic union was a central goal in the formation of both the United States and Canadian federations. Scholars and judges arguing for an expanded interpretation of the Canadian Constitution's federal trade and commerce power believe that the narrow interpretation has endangered economic union. Legal restraints on protectionism do not impair the non-economic values (and the different weights assigned to these values) pursued by sub-national governments. Anti-protectionism obligations allow local autonomy in decision-making, but not in such a manner as to unnecessarily reduce welfare gains of free trade. To take an easy example, the national treatment obligation within GATT 1994 and GATS does not require states to set identical sales tax or income tax rates. Similarly, anti-protectionism obligations do not require sub-national governments to set identical SPS or technical standards. Each government can achieve its own level of revenue and protection of human health, respectively, consistent with anti-protectionism norms. One of the major goals of federalism and decentralization described above was to promote experimentation and regulatory competition so as to maximize the differing "preference sets" of different

[158] One would need to weigh political considerations as well.

territorial constituencies.[159] Anti-protectionism obligations do not interfere in this goal of federalism and decentralization, but rather ensure that such goals are reached in an economically efficient manner. One experiment that has been tried and failed is protectionism.

In contrast, mandatory harmonization obligations can interfere with experimentation by and regulatory competition among sub-federal jurisdictions. There may be an economic efficiency rational to harmonized standards, however, the pursuit of the goal of economic efficiency in this manner interferes with other non-economic goals and maximizing the attainment of differing "preference sets" of different geographical territories.[160] This is not a claim that harmonization should be avoided in all instances. Harmonization of some standards may not interfere with different preference sets of non-economic values, but rather may be simply matters of efficiency (e.g. standards analogous to laws establishing which side of the road to drive upon). However, a situation involving some "give and take" between the goals of free trade and federalism is likely to be most prevalent in the context of harmonization.

Thus, Technique #1 poses the least amount of concerns if our goal is to maximize welfare gains under trade agreements without unnecessarily diminishing the goals of federalism. In short, Technique #1 may be considered a reasonable balance between the goals of free trade and economic integration on the one hand, and federalism or decentralization on the other. International standards should be promoted and harmonization pursued, but exceptions should be allowed where a particular jurisdiction finds a different standard necessary because its constituents have assigned a different (higher) value to non-economic goals.

Technique #2 similarly does not pose any significant concerns either, at least in terms of the example given. If nations pursue rules with regard to sanitary and phytosanitary measures seeking to effectively eliminate non-science-based trade barriers and sub-national measures are consistent with these rules, then this is the best possible scenario. States base their SPS measures on science and a risk assessment and, thus, arbitrary and protectionist laws are generally avoided. If the United States sought to negotiate rules simply based on whether existing state (and federal) law would be consistent with the proposed rules, then the rules would cease to perform a liberalization function and Technique #2

---

[159] As to the notion of different preference sets, see Trachtman, *supra* note 24.

[160] *See* ALAN SYKES, PRODUCT STANDARDS FOR INTERNATIONALLY INTEGRATED GOODS MARKETS (1995). *See also* Joel P. Trachtman, *L'etat, C'est Nous: Sovereignty, Economic Integration, and Subsidiarity*, 33 HARVARD INT'L L.J. 459, 471 (noting that a "new" approach to harmonization within the European Union may be less threatening).

would be subject to criticism.

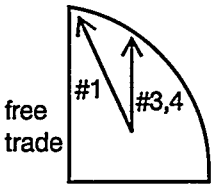
In contrast, Techniques #3 and 4 generally seek to exclude states and provinces from complying with anti-protectionism obligations (or in the case of the NAAEC from other central obligations within the agreement). Use of Technique #3 does interfere with the goal of maximizing welfare gains and economic efficiency. More importantly, the technique often does so without a corresponding gain in legitimate non-economic goals. If measures immunized from Technique #3 were enacted for non-protectionist reasons, such measures would likely fit within the general exceptions clauses of trade agreements and, therefore, would not need protection in the form of grandfathering. Thus, it is the elimination of laws receiving immunity from these techniques (and which could not be justified by the general exception clauses of trade agreements) that are most likely to enhance welfare gains and least likely to interfere with the legitimate pursuit of non-economic values under a federal or decentralized system of government. A further reason for criticizing the use of Technique #3 is its potential effect on domestic constitutional constraints on U.S. state protectionism and liberalization efforts within Canada. Laws immunized through Technique #3 may be less likely to be found in violation of the dormant foreign commerce clause within U.S. jurisprudence.[161] Moreover, the technique diminishes some impetus for the creation of such domestic liberalization devices as the Internal Trade Agreement within Canada.

The two illustrations of Technique #4 must be distinguished. In the case of state involvement in the government procurement agreement, political constraints lead to involvement on a voluntary basis only. Thus, states are prevented from enacting future discriminatory laws only to the extent they choose. In the context of the Government Procurement Agreement, this leads to a result in which existing state laws inconsistent with obligations within the agreement are protected from challenge. Like Technique #3, therefore, the use of this technique interferes with the goal of maximizing welfare gains typically without a corresponding gain in legitimate non-economic goals. In the case of provincial involvement in the NAAEC, constitutional constraints rather than merely political constraints necessitated a voluntary approach. Moreover, the central obligation of the NAAEC is not an anti-protectionism obligation. Rather, it is an obligation to effectively enforce environmental laws. It is questionable whether the lowering of environmental compliance costs through failure to enforce environmental laws is significantly trade distorting in

[161] *See* Schaefer, *supra* note 39, at 616.

most industries.[162] Thus, one can question whether welfare gains of liberalized trade are interfered with as a result of non-participation by the provinces in the side environmental agreement. Indeed, in light of how the agreement defines failure to enforce,[163] it is questionable whether non-participation by the provinces has a significant effect on environmental enforcement.

Effect of Eliminating
Various Techniques



#1: Elimination of this technique by mandating rather than encouraging harmonization enhances free trade but hinders federalism.

#3-4: Elimination of these techniques by not exempting existing sub-federal laws violating anti-protectionism rules enhances free trade without hindering federalism, i.e. leads to Pareto gains.

V. ACHIEVING PARETO GAINS: POSSIBILITIES FOR PARTICIPATION OF SUB-NATIONAL GOVERNMENTS IN RULE FORMATION PROCESSES

The central question that arises is how best to negotiate the elimination of protectionist laws receiving immunity from challenge through Techniques #3-4. Some of these laws, of course, will have concentrated, entrenched interests opposing elimination of the protected status granted these laws by international trade agreements. Techniques #3-4 were followed due to the political constraints of federalism within the United States and the political, as well as in some instances, possible constitutional restraints placed on the Canadian government. How should these political and constitutional restraints best be overcome in future negotiations to secure the elimination of state and provincial laws violating anti-protectionism norms? This question necessitates an examination of sub-national government participation in traditional trade negotiation processes. An additional question that can be raised is how best to negotiate harmonized standards so that harmonization is pursued in a man-

[162] GATT, Report on Trade and the Environment (Feb. 1992).
[163] NAAEC, *supra* note 3, art. 45(1).

ner that does not unduly interfere with the attainment of different preference sets by different geographic constituencies. This question necessitates a look at a second type of rule formation process: trade agreement administration by international bodies.

The second type of rule formation process refers to those instances in which an initial trade agreement establishes administering bodies that are empowered to elaborate further rules. For instance, certain NAFTA chapters establish committees to supervise implementation of the chapter. Many of these committees are charged with developing recommendations for harmonizing standards. These NAFTA committees will be comprised of representatives of the three federal governments who will do the negotiation over harmonization. Any results of the negotiation, in other words any recommendation of a committee, will be a result of consensus. Thus, NAFTA committees may not be seen as so different from traditional trade negotiations in certain respects. Nonetheless, a distinction is still meaningful in that the committees are permanent bodies with a mandate to continually negotiate and hold regularly scheduled meetings. Additionally, executive branch departments outside trade ministries hold primary responsibility for the work of some NAFTA committees.

To be sure, the distinction between traditional trade negotiations and trade agreement administration by international bodies becomes more apparent in agreements delegating legislative functions to an international body. For instance, the agreements creating the European Community create a supranational body, the European Council, with legislative powers in which weighted majority voting of Member State representatives controls most matters. Regulations passed by the European Council also become part of and superior to laws in Member States of the European Community. In contrast, any trade agreement administration capacity granted to FTAA bodies will likely be identical to the capacity of NAFTA committees. The lack of legislative functions to be granted FTAA bodies suggests that the participation and protections afforded sub-national governments need not be as far-reaching as those obtained by the German lander with respect to matters addressed by the European Union. The participation of U.S. states and Canadian provinces in traditional trade negotiations is explored first, followed by a brief analysis of state participation in trade agreement administration undertaken by NAFTA committees. Participation of states and provinces in trade agreement dispute settlement cases involving their laws is also briefly considered because it may be an inducement for state and provincial consent to further liberalization.

A. Traditional Trade Negotiations

1. United States: Current Approaches and Possible Future Approaches

The United States has established an Intergovernmental Policy Advisory Committee (IGPAC) to provide input from state and local governments into trade negotiations. During on-going trade negotiations, the IGPAC is given regular updates on the status of negotiations and is sometimes allowed to view draft negotiating texts. Additionally, the IGPAC is required to issue a report once trade negotiations have concluded, prior to consideration of an agreement by Congress.

The 1974 Trade Act required the president to seek advice and information from "representative elements" of the non-federal governmental sector with respect to trade agreement negotiation and implementation, and consult with "representative elements" of the non-governmental sector on the overall current trade policy of the United States.[164] It also allows the president, "if necessary," to establish policy advisory committees representing non-federal government interests to provide the policy advice.[165] The Trade & Tariff Act of 1984, which granted the executive the authority to negotiate on trade-in-services, stated that the president "shall, as he deems appropriate: (i) consult with state governments on issues of trade policy, including negotiating objectives and implementation of trade agreements, affecting the regulatory authority of non-Federal governments, or their procurement of goods and services; (ii) establish one or more intergovernmental policy advisory committees on trade which shall serve as a principal forum in which State and local governments may consult with the federal government with respect to matters described in clause (i); and (iii) provide to state and local governments . . , upon their request, advice, assistance, and, except as otherwise may be prohibited by law, data, analyses and information concerning U.S. policies on international trade-in-services."[166]

The IGPAC was the committee established as the forum for such consultations. The IGPAC typically is comprised of thirty to forty state and local officials with state governors the most represented office. While the IGPAC provides a manageable forum for advice on negotiations, it is questionable that the body will have the necessary legitimacy to give a political stamp of approval to eliminate state measures

---

[164] 21 U.S.C. 2155, Trade Act of 1974, § 135(a)(2).
[165] *Id.* § 135(b).
[166] 19 U.S.C. 2114b-c.

protected by Techniques #3-4. Many states are not represented on the IGPAC. Moreover, the IGPAC is not required to be bi-partisan and since its members are selected by the Administration, there is a concern that its views may not represent a full spectrum of the views that exist at the state level.

While the federal government would have the legal power to enter into an international trade agreement affecting state laws protected by Techniques #3-4 without the consent of the states as a legal matter, significant political restraints will mean that the federal government must obtain state consent in some fashion. The central question is what type of consent should the federal government seek: individual consent, majority consent, or unanimous consent.

Individual consent is in fact Technique #4, the basic approach followed today with respect to government procurement and the elimination of "grandfathered" or exempted laws. The process of removing protectionist state laws would probably proceed slowest along this course, although educational efforts could have some success. One issue facing the states, particularly the larger states, under an individual consent approach is a sort of "free rider" problem. Foreign countries are most interested in gaining access to the procurement markets of the larger states. Similarly, foreign countries are most interested in the removal of protectionist measures affecting services and investment by the largest states. However, these larger states sometimes worry that part of the benefits of reciprocal concessions gained as a result of their willingness to eliminate procurement preferences (or grandfathered discriminatory laws) will flow to states that have not agreed to liberalize. The question arises as to whether benefits can or should be linked to liberalizing efforts. Should the United States link the use of its "negotiating chips" to a state's willingness to eliminate protectionist procurement and services measures? For instance, if California agrees to eliminate protectionist measures immunized by Techniques #3&4, should it receive the expenditure of U.S. negotiating chips on a sector of importance to the state (e.g. audiovisual)? The problem is the feasibility of making such linkages and the messiness such an approach would create if taken to the extreme.

The United States could also seek majority consent or unanimous consent of states to eliminate the protected status of a particular type of protectionist law. The question becomes whether majority consent will be sufficient and from whom such consent should be sought. Less than unanimous consent could be sufficient since a majority vote in both houses of Congress is all that is needed to approve a trade agreement. Moreover, trade agreements are generally subject to Fast Track proce-

dures which do not allow trade agreement bills to be bottled up in committee or to be filibustered on the Senate floor. Additionally, congressional members will consider a range of other factors in casting their votes. How large a majority of consent of state officials would be needed would likely depend on the political sensitivity of the issue. Another central issue is from which officials of the various states should political consent be sought. In the GATT government procurement negotiations, it was the consent of state governors that was sought. This approach was valid in that context because no commitments were made that would necessitate a change in existing laws. However, elimination or reform of state laws receiving protection from Techniques #3 and 4 will require action by state legislatures and governors. Thus, these issues could be raised in the context of the national associations representing state legislatures and the governors, the National Conference of State Legislatures, and the National Governors' Association. These bodies have supra-majority voting procedures and thus a resolution supporting the reciprocal elimination through trade negotiations of a particular type of discriminatory measure would likely carry significant political weight. An additional or second track of the approach might be to seek the consent of the national association representing the state regulatory officials in the affected area. However, such consent is often more difficult to obtain because such groups do not necessarily take into account a broad spectrum of interests.

2. Canada: Current Approaches and Possible Future Approaches

In practice, the Canadian federal government consults with the provinces before entering into an international agreement that falls wholly or in part within the domestic legislative jurisdiction of the provinces.[167] This consultation process would be politically necessary even without the *Labor Conventions* doctrine, however, the "watertight compartments" approach for implementing international obligations certainly changes the bargaining position and tenor of such negotiations. For instance, extensive consultations between the provinces and the federal government took place during the CUSFTA, NAFTA, and Uruguay Round negotiations although the mechanism for such consultations is informal and not mandated by legislation.[168] As demanded by the federal government,

---

[167] 1986 CAN. Y.B. INT'L L. 399.

[168] *See generally* Doug Brown, *The Federal-Provincial Consultation Process*, CANADA: THE STATE OF THE FEDERATION 77 (1987-88); Manitoba's Position on NAFTA 14 (Dec. 1992).

no provincial representatives were allowed at the negotiating table.[169] Instead, a single negotiator representing Canada received its mandate from the federal government in consultation with First Ministers.[170] However, provincial negotiators have accompanied federal negotiators to trade meetings with the United States on specific trade disputes. For instance, British Columbia and Quebec sent negotiators along with the federal government to discussions with the United States over the long-standing lumber subsidies dispute.

The use of Techniques #3 and 4 has allowed the Canadian federal government to avoid any immediate jurisdictional conflicts with the provinces over areas addressed in trade agreements. However, possible constitutional constraints could arise in any effort to eliminate discriminatory provincial laws protected in international trade agreements through Technique #3. Indeed, interprovincial barriers to trade were recently addressed through an intergovernmental agreement rather than through federal legislation. Accordingly, the Canadian government might seek to use an intergovernmental agreement to eliminate "grandfathered" NAFTA laws or laws reserved in the GATS. The federal government generally does not enter into agreements with jurisdictional ambiguity over their implementation without seeking assurances from the provinces that they are willing and able to carry out the obligations within provincial jurisdiction.[171] The rejected Charlottetown Constitutional Agreement would have clarified and formalized the legal status of intergovernmental and indemnity agreements. As it stands, such arrangements have never been tested in the courts.[172] To the extent such agreements seek to bind future provincial legislatures, their legal basis remains uncertain.[173] The federal government negotiated an intergovernmental agreement with the provinces for participation in the NAAEC, but again the tangible benefits to provinces of entering into such an agreement have not been a sufficient inducement for most provinces to date. Thus, Canada may need to face the question of how and whether to tie tangible benefits to provincial elimination of discriminatory laws protected by Technique #3 in the trade context as well. Constitutional amendment or judicial reinterpretation of certain constitutional provisions may eliminate constitutional restraints on the federal government. However, such devel-

---

[169] *Id.*

[170] *Id.*

[171] 1986 CAN. Y.B. INT'L L. 400-01.

[172] Richard Simeon, *Federalism and Free Trade, in* CANADA:THE STATE OF THE FEDERATION 188, 202 (1987).

[173] *Id.*

opments would not eliminate all political restraints.[174]

B. Treaty Administration Capabilities of International Bodies: U.S. States in NAFTA Committee Activities

The U.S. implementing legislation of the NAFTA provides a consultation process between federal and state governments on implementation and administration of the agreement. Specifically, the implementing law declares: "The states will be involved (including involvement through the inclusion of appropriate representatives of the States) to the greatest extent practicable at each stage of the development of United States positions regarding matters [under the NAFTA that directly relate to, or will potentially have a direct impact on, the States] that will be addressed by committees, subcommittees, or working groups established under the [NAFTA]." The statement of administrative action accompanying the implementing law and approved together with the law by Congress gives further elaboration. It reiterates that the Administration will involve "the states to the greatest extent possible in the development of U.S. positions with respect to issues subject to state jurisdiction that are addressed by the various committees and working groups." States are permitted to be involved in federal agency preparations for NAFTA committee work. The advice states give must be taken into account, but is not binding on the federal government. States are given no guarantee to attend actual committee meetings. However, they will be invited to attend as observers where the federal government determines it is "appropriate and feasible." The federal government traditionally does not allow state representatives to attend international trade negotiations and thus, there was some hesitancy on the part of the federal government to grant a guaranteed right to attend negotiations occurring under the auspices of the committees. State representatives have attended meetings of the Land Transportation Standards subcommittee, but have complained over the lack of consultation on the activities of other committees.[175]

As noted above, any trade agreement administration capability of FTAA bodies is likely to be similar to that of NAFTA bodies. NAFTA committee recommendations regarding harmonization are not legislative actions, but more closely related to traditional negotiations. Recommen-

---

[174] *See* Whyte, *supra* note 99, at 270. Others criticize this possibility as a case of judicial activism or judicial politics. *See, e.g.*, Ivan Bernier, *Commentary on Professor White's Paper*, 13 CAN. BUS. L.J. 303, 305.

[175] *See Kantor Silent on States' Desire to Monitor NAFTA Implementation*, INSIDE NAFTA, Nov. 29, 1995, at 7.

dations require unanimity not qualified majority voting. Additionally, such recommendations are not directly applicable in the three NAFTA countries. Any recommendation would require congressional action and/or Executive Branch action under previously delegated authority. States could obviously enter the debate at the implementation stage. However, it is politically wise to allow for consultations at the negotiating stage as is done during traditional trade negotiations themselves. The involvement of states at the stage of negotiations is particularly appropriate in light of the discussion above of harmonized standards, which can be seen as most threatening to the goals of federalism.

C. Participation of Sub-Federal Governments in NAFTA & WTO Dispute Settlement Cases

Sub-national involvement in trade agreement dispute settlement processes in those cases involving a challenge to their laws could also enhance the possibility of obtaining consent for further liberalization. As noted above, some form of state and provincial consent is necessary to avoid political obstacles, and in the case of Canada possible legal obstacles, to removing protectionist trade measures immunized by Techniques #3 through 4. If states and provinces maintain a role in the dispute settlement cases involving a challenge to their laws, they will have a greater assurance that liberalized rules to which they agree are fairly interpreted and not unfairly expanded. It will likely act as an inducement for their consent to liberalization, although admittedly it probably will not be enough in itself as can be seen from the Canadian intergovernmental agreements on the NAFTA side environmental and labor agreements. These intergovernmental agreements actually grant the Canadian provinces the lead role in disputes involving their enforcement practices, yet only two provinces have agreed to be bound by the NAAEC.

Additionally, involvement of sub-national governments in the process is likely to lead to a greater willingness to comply with any adverse decisions.[176] Such involvement will thus make federal enforcement action, with its consequent political and, in the case of Canada, potential constitutional implications, less likely to be necessary. The mechanisms developed in the U.S. implementing legislation for the NAFTA and Uruguay Round Agreements which highlight federal-state cooperation, but maintain ultimate control with the federal government appear to be

---

[176] *See* Schaefer, *supra* note 39, at 646-48.

proper in light of the potential trade effects on other parts of the nation resulting from an adverse panel report.[177]

VI. CONCLUSION

Federalism, and other movements towards decentralization, seek to enhance democracy and promote experimentation. This allows federations, or other decentralized forms of government, to maximize the attainment of different preference sets of different territorial populations. International trade agreements seek welfare gains by reducing barriers to trade and allowing comparative advantage to operate more fully. While international trade agreements generally apply to sub-federal governments, various techniques have been developed to immunize certain sub-federal government actions from challenge at the expense of welfare gains from free trade. Moreover, not all of the techniques are justifiable as preventing a diminution in the values of federalism. Thus, Pareto gains in the relationship between free trade and federalism can be achieved by scaling back the techniques that are unjustifiable.

Harmonization obligations within trade agreements do lead to potential trade-offs between the goals of federalism and the goals of increased trade. However, trade agreements have encouraged rather than mandated harmonization. Trade agreements should continue to proceed cautiously with respect to harmonization obligations. Moreover, sub-national involvement in the move towards harmonization may be able to identify those standards and areas in which harmonization will increase efficiency without unduly interfering with the attainment of different preference sets of non-economic values.

While federalism is meant to encourage experimentation, actions against foreign interests in the name of protectionism is an experiment that has been tried and has failed. Thus, any less favorable treatment of foreign goods, services, and investors should be justified as essential to achieving a legitimate non-economic goal. Indeed, certain federal states, including the United States, have existing domestic constitutional constraints on sub-federal governments that are similar to and, to a certain extent, overlap with anti-protectionism obligations within trade agreements. It is no surprise that such limits exist in certain federations and in those federations in which limits are not as prevalent, that the absence of such limits is sought to be overcome through other means. The domestic constitutional constraints in the United States and constraints in

---

[177] *Id.*

other forms in Canada, such as the Internal Trade Agreement, are recognition that anti-protectionism obligations are generally not a threat to federalism or decentralization movements. Thus, it is likely that trade agreements can proceed further in constraining the discretion of sub-national governments to take protectionist measures. Techniques #3 and 4, which legally or as a practical matter "grandfather" or exempt existing state discriminatory sub-national measures from anti-protectionism obligations could be scaled back to increase welfare gains from freer trade without threatening federalism.

However, political and, in the case of Canada, potential constitutional constraints, inhibit the attainment of these Pareto gains in the relationship between free trade and federalism. While the United States federal government has an exclusive treaty implementing power and a broad commerce power, states have sufficient political power to make the federal government "reluctant" to bind the states to a anti-protectionism obligations already provided for in the NAFTA and Uruguay Round Agreements. The existence of the dormant Commerce Clause doctrine does not minimize this reluctance to a great extent because of the gaps in its coverage and because of lingering uncertainty over the similarities and differences between the doctrine and anti-protectionism obligations within trade agreements. The constraints in Canada are less veiled; the Canadian federal government does not have an exclusive treaty implementing power nor does it have as broad a commerce power as the U.S. federal government. Thus, it is likely that the consent of sub-national governments will be required in order to remove the immunity sub-national laws receive under Techniques #3 and 4. New, more extensive federal-component unit consultation mechanisms and different consent processes than the individual consent provided for by Technique #4 may need to be developed and relied upon as a result. In the government procurement context, Technique #4 did not lead to liberalization but merely a "standstill" obligation against new protectionism. Formulating an approach to obtaining consent will not be easy, but will clearly be worthwhile as Pareto gains in the relationship between free trade and federalism are possible within the FTAA and other future trade negotiations.