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Note

To Compel or Encourage: Seeking Compliance with International Trade Agreements at the State Level

Kenneth J. Cooper

INTRODUCTION

The relationship between U.S. international trade obligations and the policies of state governments has become an increasingly visible issue in international trade. It is well settled that the federal government can legally preempt state laws that are inconsistent with international trade agreements.¹ Federal officials, however, are often reluctant to use this power. While actual conflicts between state laws and trade agreements have been rare, recent developments have focused attention on the issue of state compliance.

This Note examines the issue of state compliance in two areas. It considers state compliance with respect to the general obligations to eliminate non-tariff barriers to trade,² common to most international trade agreements such as the General Agreement on Tariffs and Trade (GATT),³ and the recently completed North American Free Trade Agreement (NAFTA).⁴ It then considers state compliance with respect to trade agreements that deal specifically with government procurement.

Part I describes the federal government's legal power to bind the states under international trade agreements, and the

1. See *infra* notes 14, 20-21 and accompanying text.

2. The term "non-tariff barriers" refers to practices such as internal taxation and regulations that are applied to foreign products in a discriminatory manner. Such barriers conflict with the national treatment obligations of GATT Article III. See *infra* note 25.

3. General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, 61 Stat. pts 5, 6, T.I.A.S. No. 1700, 55 U.N.T.S. 187 [hereinafter GATT].

4. The North American Free Trade Agreement, the parties to which are the United States, Mexico, and Canada, was completed on September 6, 1992 and was signed on December 17, 1992 by then U.S. President Bush, Canadian Prime Minister Mulroney, and Mexican President Salinas. The Agreement has not yet been adopted. North American Free Trade Agreement, Dec. 17, 1992, U.S.-Mexico-Canada, (draft of Sept. 6, 1992) [hereinafter NAFTA].

political sensitivities that can hinder the use of this power. Part II explores federal obligations to ensure that states comply with GATT's national treatment requirements.⁵ Recent GATT panel findings confirm this obligation under Article XXIV:12.⁶ Part II then details developing proposals in the Uruguay Round⁷ and in NAFTA which address state compliance. Finally, this section argues that state compliance is essential to the success of trade agreements aimed at reducing or eliminating non-tariff barriers to imported goods.

Part III explores the issue of state compliance under current and projected international agreements on government procurement. While states are currently free to discriminate in their procurement practices, as confirmed by several court decisions, subnational procurement has been a central topic of ongoing GATT negotiations. Under a U.S. proposal, states would voluntarily accede to a revised GATT Procurement Code.⁸ NAFTA's chapter on government procurement⁹ adopts this approach. This section argues that voluntary coverage will not produce meaningful results, and that liberalization of subnational procurement can be achieved only through mandatory coverage of the states under international procurement agreements.

I. THE LEGAL AND POLITICAL FRAMEWORK OF STATE COMPLIANCE

The problem of state compliance is rooted in the tensions of U.S. federalism. The U.S. Constitution delegates broad enumerated powers to the national government,¹⁰ but also reserves powers to the states.¹¹ Among the powers granted to Congress is the power to "regulate Commerce with foreign Nations and among

5. See *infra* notes 23-25 and accompanying text.

6. See *infra* text accompanying note 37.

7. The Uruguay Round is the current round of multilateral trade negotiations under GATT, named for the country where it was launched in September 1986. The talks had been stalled over the issue of agricultural subsidies. Talks were expected to move forward following an agreement between the United States and the European Community on farm subsidies reached on November 20, 1992. See, e.g., Keith Bradsher, *Europeans Agree with U.S. on Cutting Farm Subsidies; French Withhold Support*, N.Y. TIMES, Nov. 21, 1992, at A1.

8. See *infra* part III.C.

9. See *infra* part III.C.

10. See U.S. CONST. art. I, § 8.

11. The Tenth Amendment of the U.S. Constitution states that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

the several States,"¹² commonly known as the Commerce Clause. The authority to regulate foreign commerce is particularly broad and is vested exclusively in the national government. As the U.S. Supreme Court has noted, in matters of international trade, the United States "speak[s] with one voice."¹³

Any federal law enacted pursuant to an enumerated power, such as the Commerce Clause, is superior to state law under the Constitution's Supremacy Clause.¹⁴ Thus, when an international trade agreement becomes part of U.S. federal law, it is superior to state law.

International agreements may enter U.S. law in one of two ways.¹⁵ First, an agreement may be self-executing, in which case it enters U.S. law directly.¹⁶ Second, an agreement may be non-self-executing, in which case it enters U.S. law through a separate act embodying the substance of the agreement.¹⁷ The act will usually take the form of congressional implementing legis-

12. U.S. CONST. art. I, § 8, cl. 3.

13. *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 449 (1979). The exclusive congressional power over foreign commerce may be so broad as to invalidate state laws which impact foreign commerce even in the absence of conflicting federal legislation. *See id.* In *Japan Line*, the Supreme Court held that a California tax levied on the containers of a Japanese shipping company whose vessels passed through the state was an invalid state intrusion on the exclusive power of the federal government to regulate foreign commerce. *Id.* The decision was based upon congressional power over international trade granted in the Commerce Clause. U.S. CONST. art. I, § 8, cl. 3. No specific agreement or federal statute preempted the tax. 441 U.S. 434.

14. The Supremacy Clause states that "[t]his Constitution and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land . . ." U.S. CONST. art. VI, § 2. The term "Treaties" has been interpreted broadly to include not only treaties ratified by two-thirds of the Senate under Article II, U.S. CONST. art. II, § 2, cl. 2, but most foreign executive agreements. *See, e.g., United States v. Belmont*, 301 U.S. 324 (1937). *See also* John H. Jackson, *The General Agreement on Tariffs and Trade in United States Domestic Law*, 66 MICH. L. REV. 250, 253 (1967).

15. *See* Robert E. Hudec, *The Legal Status of GATT in the Domestic Law of the United States*, in *THE EUROPEAN COMMUNITY AND GATT 187*, 188-91 (Meinhard Hilf et al. eds., 1986).

16. The significance of a self-executing agreement is that it has "direct applicability" in U.S. domestic law and courts must accept the provisions of the agreement itself as applicable law in appropriate situations. *See* JOHN H. JACKSON & WILLIAM J. DAVEY, *LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS: CASES, MATERIALS AND TEXT 122-25* (2d ed. 1986).

17. Hudec, *supra* note 15, at 188. A corollary of this principle is that a non-self-executing agreement becomes part of U.S. law only to the extent that it is incorporated into the legislation or proclamation by which it is implemented. *Id.*

lation¹⁸ or an executive proclamation pursuant to prior congressional authorization.¹⁹

Any international agreement that becomes part of federal law through appropriate lawmaking procedures is always superior to state law.²⁰ As a result, state laws that conflict with a validly enacted agreement are preempted.²¹ A conflict will, of

18. Such legislation would incorporate the requirements of the negotiated agreement into U.S. law. An example is the Trade Agreements Act of 1979, which implemented the various agreements reached in the Tokyo Round of GATT negotiations. 19 U.S.C. §§ 2502-2582 (1979). Implementing legislation does not always mirror the language of the agreement itself. See *infra* note 45.

19. An executive proclamation would be issued following the completion of an agreement negotiated by the President under authority granted by separate congressional legislation. GATT came into U.S. law through executive proclamation. See *infra* text accompanying notes 31-35. The President may also have the power to enter into international trade agreements without congressional authorization or approval on the basis of his own inherent foreign affairs power. Hudec, *supra* note 15, at 194. The constitutionality of such action is not clear. Because Congress is given authority to regulate foreign commerce, U.S. CONST. art. I, § 8, cl. 3, an agreement entered into by the President without congressional authorization may be held to be a violation of the constitutional separation of powers. See, e.g., *United States v. Guy W. Capps, Inc.*, 204 F.2d 655 (4th Cir. 1953), *aff'd on other grounds*, 348 U.S. 296 (1955). In *Youngstown Sheet & Tube Co. v. Sawyer*, Justice Jackson, in a concurring opinion, discussed three varying levels of authority under which the President can act. 343 U.S. 579 (1952) (Jackson, J. concurring). Jackson noted that the President's authority is at its maximum when he acts pursuant to the express or implied authority of Congress, and is at its lowest ebb when he takes measures that are contrary to the express or implied will of Congress. *Id.* at 635-37. However, Jackson noted that there is a "zone of twilight" in which the distribution of powers may be unclear. *Id.* at 637. In this situation, congressional inertia or indifference may enable the President to act independently. *Id.*

20. See *supra* note 14 and accompanying text. Any domestic federal law passed by Congress and signed by the Executive is superior to state law by virtue of the Supremacy Clause of the U.S. Constitution. U.S. CONST. art. VI, § 2. Validly enacted legislation which implements a trade agreement has the same status as other domestic legislation. Hudec, *supra* note 15, at 190-91. A presidential proclamation pursuant to valid congressional authorization also has this status. *Id.* A self-executing agreement which attains the status of U.S. federal law directly is, by virtue of the Supremacy Clause, also superior to state law. All international agreements which have entered U.S. federal law can be overridden by subsequent federal legislation. Hudec, *supra* note 15, at 191-92.

21. In general, by virtue of the Supremacy Clause, U.S. CONST. art. VI, § 2, a federal law enacted by Congress pursuant to an enumerated power preempts state law where there is a direct conflict between the two laws. In addition, a state law not in direct conflict with a federal law may be preempted if it affects an area in which Congress has legislated so thoroughly as to "occupy the field." *Hines v. Davidowitz*, 312 U.S. 52 (1941); See also 1 RONALD D. ROTUNDA ET AL., TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE §§ 12.1-12.2 (1986) [hereinafter ROTUNDA].

In order to preempt inconsistent state law, an international trade agreement must actually be applicable at the state level. The 1979 GATT Procure-

course, exist only if the agreement requires compliance at the state level. Because the Constitution prohibits the states from laying duties on imports and exports,²² there is never a conflict between state laws and provisions of trade agreements that regulate tariffs. Certain state laws and regulations may, however, be preempted by trade agreements that require national treatment of foreign products.

National treatment obligations require that once imported products enter a country, they must be treated no worse than any like domestic product for purposes of internal sale.²³ The goal of national treatment is to prevent the discriminatory application of internal taxes and regulations to foreign products.²⁴ GATT Article III aims specifically at eliminating such non-tariff barriers to trade.²⁵

The preemption of state laws that conflict with national treatment provisions such as GATT Article III may be perceived as an infringement upon the ability of state lawmakers to set local policy. It is not politically desirable for federal officials to appear to be interfering in policies traditionally set at the state level. Consequently, federal officials often seek to play down the preemptive effects of an international trade agreement.²⁶ To date, such reticence has not caused serious problems because ac-

ment Code, for example, does not apply to state procurement. *See infra* text accompanying note 111.

22. U.S. CONST. art. I, § 10.

23. *See* John H. Jackson, *National Treatment Obligations and Non-Tariff Barriers*, 10 MICH. J. INT'L L. 207, 208-09 (1989) [hereinafter *Nat'l Treatment Obligations*].

24. *Id.* at 209.

25. In relevant part, GATT Article III states that:

1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale . . . should not be applied to imported or domestic products so as to afford protection to domestic production.

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.

* * *

4. The products of the territory of any contracting party . . . shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale

26. In GATT, for example, federal officials have sometimes maintained that the Agreement requires only that the federal government encourage states to comply. *See infra* text accompanying note 45.

tual violations of GATT at the state level have been rare.²⁷

Recent legal and political developments have heightened the sensitivity of state officials to the potential preemption of their policies. In 1992, a GATT panel ruled that various state regulations favoring local beer producers are in violation of GATT.²⁸ Further, environmental and agricultural interest groups that are opposed to NAFTA and the Uruguay Round have been warning state governments that their policy making ability will be curtailed by the new agreements.²⁹ These developments have reportedly caused some state governments to edge closer to groups opposed to NAFTA and GATT.³⁰ Thus, state compliance has become a conspicuous issue in international trade.

II. NON-TARIFF BARRIERS TO TRADE IN GOODS

A. GATT'S NATIONAL TREATMENT OBLIGATIONS AND THE STATES: ARTICLE XXIV:12

GATT was proclaimed into U.S. law by President Truman on December 30, 1947,³¹ pursuant to section 350 of the Recipro-

27. A 1992 GATT panel ruling marked the first time a GATT panel has ruled that U.S. state measures violate the agreement. See *infra* text accompanying notes 62-77. A few state court decisions have invalidated state laws held to be in violation of GATT. See, e.g., *Hawaii v. Ho*, 41 Haw. 565 (1957) and *Baldwin-Lima-Hamilton Corp. v. Superior Court*, 25 Cal. Rptr. 798 (Cal. Dist. Ct. App. 1962).

28. The panel ruling is discussed in detail, *infra* notes 62-77 and accompanying text.

29. In July 1992, a representative of the Institute for Agriculture and Trade Policy told the National Conference of State Legislatures that GATT (especially if the Uruguay Round is successfully completed) and NAFTA will affect a state's ability to legislate in the areas of taxes, economic development, health and safety, and environmental policy. *GATT Threatens to Preempt States' Rights to Make Policy, Annual Meeting of NCSL Told*, 9 Int'l Trade Rep. (BNA) 1344 (Aug. 5, 1992).

30. See Bob Davis, *Fighting Nafta: Free Trade Pact Spurs a Diverse Coalition of Grass Roots Foes*, WALL ST. J., Dec. 23, 1992, at A1, A6. For example, an adviser to the state of Maine has expressed concern that NAFTA will affect Maine's regulation of organically grown produce. *Id.*

State concerns will likely increase if GATT is extended to service industries as currently proposed in the Uruguay Round negotiations. Coverage of service industries could require policy changes in areas such as banking, insurance, and legal services which have been traditionally regulated at the state level. See generally Tommy G. Thompson, *A Governor's Perspective on the Trade*, BUSINESS AMERICA, May 6, 1991, at 13, available in LEXIS, Nexis library, Mags file.

31. Proclamation 2761A, 3 C.F.R. 139 (1987).

cal Trade Agreements Act of 1934.³² Section 350 authorized the President to "enter into foreign trade agreements,"³³ and to "proclaim such modifications of existing duties and other import restrictions," necessary to carry out the agreements.³⁴ Although there is some dispute over whether the language of section 350 authorized the President to proclaim all of GATT's commercial policy rules, it is generally accepted that GATT entered U.S. federal law as a valid executive agreement.³⁵

Because GATT is part of federal law, it is superior to state law. Thus, if GATT was intended to cover the conduct of subnational units of government, inconsistent state laws would have been legally preempted immediately upon the President's 1947 proclamation,³⁶ and they would continue to be preempted unless GATT is superseded by subsequent federal law. If GATT does not require compliance at the state level, however, then no state laws will be in conflict with the agreement.

The language of GATT Article XXIV:12 raises questions about whether the U.S. federal government is obligated to bring state level practices into compliance with GATT. Article XXIV:12 states that "[e]ach contracting party *shall take* such

32. Reciprocal Trade Agreement Act of 1934, ch. 474, 48 Stat. 943 (1934) (codified as amended at 19 U.S.C. § 1351 (1988)). The authority was reenacted in 1945. Ch. 269, 59 Stat. 410 (1945).

33. 19 U.S.C. § 1351(a)(1)(A) (1988).

34. *Id.* § 1351(a)(1)(B) (1988).

35. See Hudec, *supra* note 15, at 199. Professor Hudec notes that the validity of the agreement rests either on the authorization of section 350 or the President's inherent foreign affairs power. *Id.* at 208-09. Hudec argues that Congress may authorize an executive agreement without giving the President the authority to change federal law in every area covered by the agreement. *Id.* Section 350 required the President to obtain authorization before proclaiming new tariff rates because such action involved changing prior federal law. *Id.* No special authority was needed to proclaim GATT's commercial policy rules, however, because no existing federal laws were in conflict with these rules. *Id.* The end result is that GATT's commercial policy rules are inferior to federal law and superior to state law. Since no existing federal laws conflicted with the GATT commercial policies, the practical effect of this inferior position is minimal. *Id.*

Professor Jackson asserts that GATT is a valid executive agreement because Congress knew that a trade agreement would involve extensive non-tariff provisions when it authorized the President to negotiate such an agreement under section 350. Jackson, *supra* note 14, at 262. Jackson notes further that Congress' subsequent acceptance of GATT as an integral part of U.S. trade confirms the validity of the proclamation which placed GATT into U.S. federal law. *Id.* at 268.

36. Assuming that GATT requires subnational compliance, the 1947 proclamation resulted in total and immediate preemption of state laws inconsistent with GATT. See Hudec, *supra* note 15, at 219.

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.”³⁷ The provision imposes a qualified obligation on central governments to ensure that the GATT provisions are observed below the national level. In carrying out this obligation, a national government is required to take measures which are both “available” and “reasonable” to bring about state compliance.

Whether the qualification of Article XXIV:12 applies to the United States depends upon whether the U.S. federal government has means “available” to compel state compliance, and whether the use of such means is “reasonable.” Because GATT is part of federal law, which is superior to state law, it is clear that the legal means to ensure state compliance are “available” to the federal government. Indeed, by making GATT part of federal law, the federal government has already preempted any conflicting state laws.

Article XXIV:12 requires only that “reasonable measures” be taken to ensure state compliance. The drafting history of GATT indicates that compelling subnational compliance is “reasonable” under Article XXIV:12, unless such action would cause a sudden disruption of government.³⁸ For example, the immediate elimination of a discriminatory tax that is a major source of a state’s revenue would not be “reasonable.”³⁹ U.S. states are constitutionally prohibited from imposing duties on imported goods.⁴⁰ Furthermore, the power to regulate foreign commerce is vested in the Congress.⁴¹ It is unlikely, therefore, that any state has been so dependent upon the discriminatory treatment of foreign goods, such that the elimination of these practices would cause serious hardship.⁴² Thus, it is “reasonable” for the U.S. federal government to use its legally “available” power to preempt state laws that conflict with GATT.⁴³

Several U.S. state courts, though not directly implicating

37. GATT, art. XXIV:12 (emphasis added).

38. See Jackson, *supra* note 14, at 304-08.

39. *Id.* Even this situation would probably not be an absolute exemption to changing a discriminatory state tax. An interpretative note to GATT Article III states that the term “reasonable measures” in Article XXIV:12 would permit the elimination of “inconsistent taxation gradually . . . if abrupt action would create serious administrative and financial difficulties.” GATT, ad art. III. Cf. *infra* note 76.

40. U.S. CONST. art. I, § 10, cl. 2.

41. *Id.* art. I, § 8, cl. 3.

42. Hudec, *supra* note 15, at 220.

43. *Id.*

Article XXIV:12, have held that GATT, as part of federal law, prevails over conflicting state law.⁴⁴ Federal officials, however, have not always acknowledged GATT's preemption of state law. A state department official testifying before the Senate Finance Committee in 1949 took the position that Article XXIV:12 only obligates the federal government to persuade states to voluntarily comply with GATT.⁴⁵ This position contradicted the drafting history of Article XXIV:12.⁴⁶ More recently, the U.S. government has taken inconsistent litigation positions in two GATT disputes involving Article XXIV:12.

In *Canada: Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*,⁴⁷ the United States asserted that certain practices of Canadian provincial liquor boards, which control the conditions for sale and distribution of beer in each province, discriminated against imports in violation of GATT Article III.⁴⁸ The complaint focused on two

44. In *Hawaii v. Ho*, the Hawaii Supreme Court held that a territorial law which required all sellers of foreign eggs to post a sign reading "WE SELL FOREIGN EGGS" was in conflict with GATT's national treatment obligations. 41 Haw. 565, 571 (1957). The court held that GATT was a valid executive agreement, and thus, under the Supremacy Clause, U.S. CONST. art. VI, § 2, preempts inconsistent state law. 41 Haw. at 568. In *K.S.B. Technical Sales Corp. v. North Jersey Dist. Water Supply Commission*, the New Jersey Supreme Court recognized GATT as a valid agreement and thus superior to conflicting state law. 381 A.2d 774, 778 (N.J. 1977). The state measure at issue, however, was related to government procurement which the court held was not subject to GATT's national treatment requirements. *Id.* at 778.

45. See Jackson, *supra* note 14, at 303-04. Thirty years later, Congress took a similar position in implementing the 1979 GATT Standards Code. *Agreement on Technical Barriers to Trade*, BISD 26th Supp. 8 (Apr. 12, 1979). The Standards Code covers measures aimed at protecting areas such as health, safety, and the environment. The Standards Code itself contains a provision that mirrors the language of GATT Article XXIV:12. *Id.* at 12. The implementing legislation, however, speaks only of a "sense of Congress" that states should not maintain discriminatory product standards, and provides that the President shall take reasonable measures to "promote" state compliance. 19 U.S.C. § 2533 (1980) (emphasis added). The use of the aspirational term "promote," rather than the mandatory term "ensure" means that the Standards Code provisions do not apply directly to state measures. See Hudec, *supra* note 15, at 233. Because the Standards Code has force in U.S. domestic law only through the implementing legislation, inconsistent state law is not preempted. *Id.* at 220.

46. The drafting history of Article XXIV:12 indicates that the provision was meant to apply only to central governments which do not have the authority to control subsidiary units of government. See Jackson, *supra* note 14, at 308-10.

47. *Canada-Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, GATT Doc. DS/17/R (Oct. 16, 1991), ¶¶ 5.36-5.37 [hereinafter *Panel Report on Canadian Alcohol Restrictions*].

48. *Id.* ¶¶ 4.26-4.78.

major practices of the liquor boards. First, the United States complained that the boards applied higher price mark-ups to imported beer than they applied to locally brewed beer.⁴⁹ Second, the United States complained that in several provinces, domestic brewers were allowed to operate private delivery systems and to sell directly to points of sale, while only provincial boards could distribute imports.⁵⁰ The GATT panel found that these practices violated GATT.⁵¹

On the Article XXIV:12 issue, the United States argued that "reasonable measures" were available to Canada to ensure provincial compliance because the Canadian Parliament had the legal power to impose discipline on the provincial liquor boards.⁵² Canada argued that the determination of what is "reasonable and available" must not rest solely on legal terms, but must also incorporate "domestic politics and policies."⁵³ Canada argued further that the contracting party itself must be the judge of what is "reasonable" and "available."⁵⁴

The panel rejected Canada's arguments and held that GATT, not the contracting party, is the judge of whether all "reasonable measures" have been taken.⁵⁵ The panel noted that the provisions of GATT are applicable to measures at the regional and local level,⁵⁶ and that Article XXIV:12 merely qualifies the obligation to implement GATT requirements with respect to such measures.⁵⁷ The panel further noted that when subnational practices violate GATT, the contracting party must demonstrate that it has taken all "reasonable measures as may be available to it" to bring such practices into compliance.⁵⁸

The panel found that Canada had not taken reasonable measures to ensure compliance by the provinces following a 1988 GATT panel ruling that similar practices of the provincial liquor

49. *Id.* ¶¶ 4.26-4.38.

50. *Id.* ¶¶ 4.8-4.13.

51. *Id.* ¶ 6.1.

52. *Id.* ¶ 4.81. The United States pointed out that the Canadian Parliament had demonstrated power over provincial liquor boards in the legislation that implemented the U.S.-Canada Free Trade Agreement. *Id.* The panel did not comment on whether this legal measure proposed by the United States was reasonable or available to Canada.

53. *Id.* ¶ 4.82.

54. *Id.* ¶ 5.35.

55. *Id.* ¶ 5.36.

56. *Id.*

57. *Id.*

58. *Id.*

boards violated GATT.⁵⁹ The panel did not specifically define what constitutes a reasonable measure and did not comment on whether the legal measure suggested by the United States was reasonable or available.⁶⁰ The panel did state that Canada would have to demonstrate a "serious, persistent, and convincing effort" to secure compliance by the provinces.⁶¹

In a reversal of roles several months after the dispute discussed above, Canada requested a GATT panel to resolve a dispute over U.S. treatment of imported beer.⁶² The dispute centered on excise taxes levied on beer and wine at both the federal and state levels. The federal government maintained a lower tax rate for beer brewed domestically by relatively small brewers.⁶³ Eighteen states maintained similar policies whereby in-state brewers were either taxed at a lower rate or received

59. *Id.* ¶¶ 5.37-5.38. The 1988 complaint was brought by the European Community. See *Canada-Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, BISD 35th Supp. 37 (1988) (GATT panel report adopted Mar. 22, 1988). The EC complaint focused on substantially similar provincial measures as did the 1991 U.S. complaint. In the EC dispute, Canada claimed that the contracting party itself should be the one to determine what is a reasonable measure under Article XXIV:12. *Id.* at 39. The panel ruled that Canada would have to demonstrate to the GATT parties that it had taken all reasonable, available measures. *Id.* at 91-92. GATT would then have to determine whether Canada had met its obligation under Article XXIV:12. *Id.*

In the 1991 complaint, the United States charged that the discriminatory measures were still in place. *Panel Report on Canadian Alcohol Restrictions*, *supra* note 47, ¶ 4.79. Canada claimed that it had taken all reasonable measures through a settlement agreement with the European Community following the 1988 dispute, and an interprovincial agreement in which both the national government and many, but not all, of the provinces had agreed to work towards the elimination of discriminatory practices with regard to alcoholic beverage imports. *Id.* ¶ 4.80. The panel concluded that neither the settlement nor the interprovincial agreement specifically addressed the practices at issue. *Id.* ¶ 5.37. It concluded, therefore, that Canada had not taken reasonable measures to ensure provincial compliance in accordance with its obligations under Article XXIV:12. *Id.* ¶¶ 5.37-5.38.

60. See *supra* note 52 and accompanying text.

61. *Panel Report on Canadian Alcohol Restrictions*, *supra* note 47, ¶ 5.37. GATT has previously found that due to the Canadian constitutional structure, in at least some instances, the national government does not have "available to it" reasonable measures to ensure provincial compliance. See *infra* note 76. Here the panel seems to be saying that even if there are no ultimate measures to which Canada can resort to, it must first demonstrate that it has made a rigorous effort to achieve provincial compliance before GATT will recognize a limitation on its duty under Article XXIV:12.

62. *United States: Measures Affecting Alcoholic and Malt Beverages*, GATT Doc. DS/23/R (GATT panel report) (Mar. 16, 1992) [hereinafter *Panel Report on U.S. Alcohol Restrictions*].

63. *Id.* ¶ 2.7. The first 60,000 barrels produced by U.S. breweries with an-

tax credits.⁶⁴ In *United States: Measures Affecting Alcoholic and Malt Beverages*,⁶⁵ the GATT panel found that these tax policies violated the national treatment requirements of Article III:2.⁶⁶ Other state practices, which included higher licensing fees imposed on importers by some states,⁶⁷ and the requirement in several states that importers sell through wholesalers while in-state brewers were permitted to sell directly to retailers,⁶⁸ were also found to be in violation of GATT.

In contrast to its posture as the complainant in the earlier dispute with Canada, the United States, now the defending party, argued that any country with a federal system can invoke Article XXIV:12 as a limitation on its duty to bring subnational laws into compliance with GATT.⁶⁹ Although in the earlier dispute the U.S. government focused on the legal means available to the Canadian government with respect to the provinces,⁷⁰ its arguments in the second case ignored the U.S. federal government's constitutional ability to preempt state laws.⁷¹ Essentially, the United States claimed that the identification of reasonable measures, which might be available to ensure state compliance, would depend upon the specific panel finding and upon the particular state practice that was involved.⁷² Further, the United States noted that it would need more time to implement the panel's findings than would a contracting party that did not have a federal system of government.⁷³ Canada argued that Article XXIV:12 obligated the U.S. federal government to

nual production of less than 2 million barrels are taxed at a rate of \$7 per barrel while all other beer is taxed at \$18 per barrel. *Id.*

64. *Id.* ¶¶ 2.10-2.18. Georgia applies a lower rate to all in-state production. *Id.* at table 1. Most of the other states apply the lower rate only to specified levels of annual production. *Id.* Pennsylvania applies a lower rate to all U.S. brewers with annual production of less than 300,000 barrels. *Id.*

65. *Panel Report on U.S. Alcohol Restrictions*, *supra* note 62.

66. *Id.* ¶ 6.1. For text of GATT Article III:2, see *supra* note 25.

67. *Id.* ¶¶ 2.23-2.26.

68. *Id.* ¶ 6.1(j).

69. *Id.* ¶ 3.132.

70. See *supra* note 52 and accompanying text.

71. Canada also ignored its own arguments in the earlier dispute. In that case, Canada argued that the contracting party itself should be the one to determine what is "reasonable" and "available" and that domestic political sensitivities should be part of such a determination. See *supra* text accompanying notes 53-54. In the second dispute, Canada argued that, given the constitutional structure of the United States, GATT Article XXIV:12 obligates the U.S. government to compel state adherence to GATT. *Panel Report on U.S. Alcohol Restrictions*, *supra* note 62, ¶ 3.133.

72. *Panel Report on U.S. Alcohol Restrictions*, *supra* note 62, ¶ 3.132.

73. *Id.*

compel state adherence to GATT.⁷⁴

The GATT panel rejected the U.S. argument, stating that the United States offered no evidence that "reasonable measures [were not] available" to ensure state compliance with the relevant GATT provisions.⁷⁵ The panel found that Article XXIV:12 applies as a limitation on state compliance only where there are "measures by regional or local authorities which the central government cannot control under the constitutional distribution of powers."⁷⁶ The panel reasoned that because GATT is part of U.S. federal law, which is superior to state law, there is no constitutional impediment to bringing a state into compliance.⁷⁷

74. *Id.* ¶ 3.133.

75. *Id.* ¶ 5.78.

76. *Id.* ¶ 5.79. The narrow limitation on the duty of national governments to bring their regional governments into compliance was found to be applicable in *Canada: Discriminatory Application of Retail Sales Tax on Gold Coins*, summarized in ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: GATT DISPUTE SETTLEMENT IN THE 1980S app. (Case no. 132) (forthcoming; Butterworths U.S.A. 1993) (on file with the *Minnesota Journal of Global Trade*). In 1983, South Africa complained that a provincial tax on the sale of gold coins in Ontario, which exempted coins made in Canada, violated the national treatment obligations of GATT Article III. The panel did find the policy to be inconsistent with Article III. Because under the Canadian Constitution, however, power over taxation within a province is controlled exclusively by the individual province, the panel could not definitively say that Canada had measures "available to it" to ensure provincial compliance. *Id.* The only legal means of seeking provincial compliance would have been for the Canadian government to invoke its seldom used power to refer constitutional issues to the Canadian Supreme Court. *Id.* The panel could not clearly determine whether such a measure was "reasonable." *Id.*

Significantly, the panel found that even where the duty to ensure subnational compliance is limited under Article XXIV:12, the contracting party is still responsible for GATT-inconsistent measures below the national level. *Id.* Such measures would constitute a prima facie case of nullification and impairment under GATT Article XXIII:1(b), and the contracting party may have to compensate other parties whose benefits under GATT are impaired by the measures. *Id.*

The position on nullification and impairment has essentially been agreed upon in the Uruguay Round negotiations. See *infra* notes 84-88 and accompanying text.

77. *Panel Report on U.S. Alcohol Restrictions*, *supra* note 62, ¶ 5.80. The panel also examined whether the Twenty-First Amendment to the U.S. Constitution limits the federal government's power to preempt state liquor laws. *Id.* ¶ 5.46. In relevant part, the Twenty-First Amendment states that "[t]he transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." U.S. CONST. amend. XXI, § 2. The panel, citing several U.S. Supreme Court decisions, concluded that the Twenty-First Amendment grants broad regulatory powers to the states in the sale and distribution of alcoholic beverages but does not grant the states power to protect in-state producers of alcoholic beverages from outside competition. *Panel Report on U.S.*

Neither GATT panel discussed what constitutes a reasonable measure⁷⁸ under Article XXIV:12, other than the first panel's reference to a "serious, persistent, and convincing effort."⁷⁹ It is clear, however, that where the federal government has the legal authority to compel state compliance, GATT expects the federal government to force the states to change their GATT-inconsistent policies. Domestic political sensitivities are not part of the analysis.

The panel report's conclusion in *United States: Measures Affecting Alcoholic and Malt Beverages* is consistent with the U.S. constitutional structure and the drafting history of GATT Article XXIV:12.⁸⁰ The limitations of Article XXIV:12 were meant to apply only where there is either no legal power over subnational units of government, or where eliminating a state measure is disruptive to government.⁸¹ Arguments that either qualification applies to the United States cannot withstand scrutiny.⁸² When GATT entered U.S. federal law through the executive proclamation, it preempted all inconsistent state law. As noted, several state court decisions confirm this conclusion.⁸³ Thus, GATT obligates the U.S. federal government to compel state compliance.

B. STATE OBLIGATIONS UNDER THE URUGUAY ROUND AND NAFTA

The recent GATT disputes demonstrate the growing international attention being paid to subnational barriers to trade. New language regarding subnational compliance has been proposed in the Uruguay Round talks. Additionally, the recently completed North American Free Trade Agreement (NAFTA) contains explicit language regarding state obligations.

Under the Uruguay Round proposals, the core Article XXIV:12 language of "reasonable measures as may be available to it" will remain. Proposed revisions would add that "[e]ach

Alcohol Restrictions, *supra* note 62, ¶¶ 5.46-5.47. Cases cited by the panel included *Hostetler v. Idlewild*, 377 U.S. 324 (1964), and *Bachus Imports v. Dias*, Director of Taxation of Hawaii, 486 U.S. 263 (1984).

78. The drafting history of Article XXIV:12 indicates that a measure is not reasonable if it causes a sudden disruption of government. See *supra* text accompanying notes 38-39.

79. *Panel Report on Canadian Alcohol Restrictions*, *supra* note 47, ¶ 5.37.

80. See *supra* note 46.

81. See *supra* notes 38-39 and accompanying text.

82. See *supra* text accompanying notes 40-43.

83. See *supra* note 44.

contracting party is fully responsible . . . for the observance of all provisions of the General Agreement,"⁸⁴ and that "[t]he dispute settlement provisions of the General Agreement may be invoked in respect of measures affecting its observance taken by regional or local governments."⁸⁵ Furthermore, the revisions state that "[t]he provisions relating to compensation and suspension of concessions or other obligations apply in cases where it has not been possible to secure such observance."⁸⁶

The new language neither clarifies the extent of the national government's obligation under Article XXIV:12 nor specifies what constitutes "reasonable measures." By making each contracting party responsible for subnational violations, however, the language does make it clear that Article XXIV:12 cannot be used as an exception to other GATT provisions where subnational measures are involved. Even if a party does not have reasonable measures available to it to change the subnational policy, a case of nonviolation, nullification and impairment would exist.⁸⁷ To remedy the situation, the party would likely have to compensate other parties whose benefits were "nullified or impaired"⁸⁸ by the violation.

NAFTA goes further in requiring state compliance. The scope provision of the agreement states that "[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,⁸⁹ by state and provincial governments."⁹⁰

With respect to national treatment, NAFTA affirmatively requires a state to accord treatment "no less favorable than the most favorable treatment accorded by such province or state to

84. *Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, GATT Doc. MTN.TNC/W/FA (Dec. 20, 1991) § U.4., art. XXIV:12:13 (available from the office of the United States Trade Representative). The draft was tabled by GATT Director-General Arthur Dunkel on December 20, 1991.

85. *Id.* § U.4, art. XXIV:12:14.

86. *Id.* The provisions referred to in this language are contained in GATT Article XXIII.

87. *See* GATT, art. XXIII:1(b).

88. The GATT provision on nullification and impairment is Article XXIII. The provision provides that if GATT determines that the benefits of one party have been nullified or impaired by the actions of another party, GATT may authorize the affected party to withdraw concessions from the offending party. GATT, art. XXIII:2.

89. The most notable exception is government procurement, where voluntary state accession is contemplated. *See infra* text accompanying note 145.

90. NAFTA, art. 105.

any like, directly competitive or substitutable goods, as the case may be, of the Party of which it forms a part."⁹¹

NAFTA eliminates the ambiguities of the rule stated in GATT Article XXIV:12 by requiring the parties to take "all necessary measures," and by referring directly to provinces and states in the national treatment section. Under these provisions,⁹² there will be no room for dispute over the extent to which states are obligated to comply.

C. SEEKING STATE COMPLIANCE

NAFTA's strong language on state national treatment obligations demonstrates an awareness that state compliance is crucial to the elimination of non-tariff barriers to trade. A trade agreement requiring national treatment of goods can only succeed if the agreement is followed at both the national and subnational levels.

The goal of national treatment is to prevent discrimination against foreign products once they have crossed the border and are being distributed and sold internally.⁹³ In the United States, products are distributed and sold within individual states. There is no federal market. Thus, even if the federal government eliminated all discriminatory internal regulations and taxes, the United States could never guarantee national treatment to foreign products if the states were free to maintain such measures. Any reduction in trade barriers achieved through GATT could always be undermined by discriminatory measures at the state level.

The situation involved in the second beer dispute⁹⁴ illustrates this point. Excise taxes that favor domestic producers of alcoholic beverages exist at both the federal and state levels.⁹⁵ If only the federal government were to eliminate the discriminatory tax policies, foreign producers would still face formidable non-tariff barriers in the states. Absent affirmative steps to ensure state compliance, other nations will have little incentive to reduce their trade barriers.

If NAFTA's provision on state national treatment is not

91. NAFTA, art. 301:2.

92. In the United States, it remains to be seen whether Congress will incorporate the strong language regarding state national treatment obligations into the implementing legislation necessary to bring NAFTA into U.S. domestic law.

93. See *supra* notes 23-24 and accompanying text.

94. See *supra* notes 62-68 and accompanying text.

95. See *supra* text accompanying notes 63-64.

strictly followed once the agreement is adopted, NAFTA will not fully open North American trade. Canada and Mexico will have no reason to fully eliminate their barriers while impediments to trade are allowed to exist at the state level in the United States.⁹⁶

The shifting stances taken by the United States and Canada in the beer dispute cases⁹⁷ foster this type of unproductive atmosphere. The GATT panel noted in the second beer case that the use of Article XXIV:12 as a limitation on state obligations would effectively give "a special right to federal states without giving an offsetting privilege to unitary states."⁹⁸ By arguing that Article XXIV:12 obligates Canada to ensure provincial compliance, and later arguing that the same provision limits U.S. obligations with respect to the states, the United States effectively seeks an advantage over both unitary countries and other federal countries. A similar characterization can of course be made with regard to Canada's arguments in the two beer dispute cases.⁹⁹

The inclusion of an explicit reference to states and provinces in NAFTA's national treatment section shows better judgment than the arguments made in the GATT beer cases. The drafters obviously recognized that NAFTA cannot create a true free trade area without obligating the parties to eliminate trade barriers at all levels. Recognition of the same truth in GATT affairs, and in GATT litigation, would be a major step in the multilateral reduction of world trade barriers.

III. GOVERNMENT PROCUREMENT

As the role of governments has expanded in recent decades, so has the volume of government purchases. When negotiations for a Government Procurement Code¹⁰⁰ began in the 1970s, it was estimated that purchases by the government sector in some countries accounted for over forty percent of the gross national product.¹⁰¹ In the United States today, annual state and local government purchases alone total approximately \$200 billion.¹⁰²

96. Similarly, the United States will have no incentive to fully eliminate its trade barriers if the Canadian provinces continue to maintain discriminatory measures.

97. See *supra* notes 52-54, 69-74 and accompanying text.

98. *Panel Report on U.S. Alcohol Restrictions*, *supra* note 62, ¶ 5.79.

99. See *supra* note 71.

100. See *infra* note 105 and accompanying text.

101. See *Nat'l Treatment Obligations*, *supra* note 23, at 221.

102. *Governors Adopt Resolutions Supporting NAFTA, GATT Procurement*,

Thus, efforts to open world procurement markets are important to the general goal of opening world trade.

Despite the economic magnitude of government procurement, present international trade agreements cover government purchases in a very limited fashion. No current agreement covers subnational procurement.

The national treatment obligations of GATT do not apply to government procurement. Article III:8(a) makes this clear by exempting "laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes" from GATT's national treatment rules.¹⁰³ Because all government procurement is expressly exempted from GATT, state procurement practices are not affected in any way by the fact that GATT is federal law.¹⁰⁴

A. THE TOKYO ROUND GATT PROCUREMENT CODE

While GATT itself does not cover government procurement, a separate Agreement on Government Procurement, the Procurement Code, was completed in 1979 as part of the Tokyo Round negotiations.¹⁰⁵ The range of contracts actually covered by the 1979 Code is limited. Only contracts valued at SDR 130,000 or more are covered.¹⁰⁶ Service and construction con-

8 Int'l Trade Rep. (BNA) 1237 (Aug. 21, 1991) [hereinafter *Governors Adopt Resolutions*]. According to figures released by the U.S. Department of Commerce, state and local government purchases totalled \$207.6 billion in 1991, and \$205.4 billion in 1990. U.S. DEPARTMENT OF COMMERCE, ECONOMICS AND STATISTICS ADMINISTRATION, BUREAU OF ECONOMIC ANALYSIS, SURVEY OF CURRENT BUSINESS Sept. 1992 at 11, tab. 3.7(b) (these figures do not include employee compensation). Total federal, state and local government purchases were \$462.9 billion in 1991, and \$451.5 billion in 1990. *Id.* (These figures do not include employee compensation, but do include federal national defense purchases).

103. GATT, art. III:8a. The exemption does not apply to goods purchased by governments "with a view to commercial resale or with a view to use in the production of goods for commercial resale." *Id.*

In *Baldwin-Lima-Hamilton Corp. v. Superior Court*, a contract proposal requiring that electric generating equipment purchased by the city of San Francisco be manufactured in the United States, was held to conflict with GATT, and thus invalid under the Supremacy Clause. *Baldwin-Lima-Hamilton Corp. v. Superior Court*, 25 Cal Rptr. 798, 809 (Cal. Dist. Ct. App. 1962). The court stated that the Article III:8a exemption did not apply because the equipment would be used to generate electric power for resale. *Id.* (emphasis added).

104. See *K.S.B. Technical Sales Corp. v. North Jersey Dist. Water Supply Commission*, 381 A.2d 774 (N.J. 1977).

105. GATT, *Agreement on Government Procurement*, BISD 26th Supp. 33 (1980) [hereinafter *Procurement Code*].

106. SDR refers to "Special Drawing Right," which is an international re-

tracts are not covered at all. In addition, only those governmental entities specifically designated by each signatory nation are subject to the 1979 Code's provisions.¹⁰⁷

The 1979 Procurement Code contains a national treatment provision which requires that the procurement practices of covered governmental entities accord treatment to the goods of other parties that is "no less favourable than that accorded to domestic products and suppliers."¹⁰⁸ There are presently twenty-three signatories to the 1979 Code.¹⁰⁹

In contrast to the ambiguities of the GATT rule stated in Article XXIV:12,¹¹⁰ it is clear that the 1979 GATT Procurement Code does not cover state procurement. Article I:2 of the 1979 Code requires only that the Parties "inform their entities not covered by this Agreement and the regional and local governments and authorities within their territories of the objectives, principles and rules of this Agreement, . . . and draw their attention to the overall benefits of liberalization of government procurement."¹¹¹

The absence of state coverage is significant. As mentioned

serve asset created by the International Monetary Fund. See JACKSON & DAVEY, *supra* note 16, at 856. All Fund members are eligible to receive SDR allocations and use them in transactions among themselves or with the Fund itself. *Id.* The original threshold for coverage under the GATT Procurement Code was SDR 150,000. *Procurement Code*, art. I, *supra* note 105, at 34. It was lowered to SDR 130,000 in 1986 and took effect at various times after that date. GATT, *Decision of 21 November 1986 on Exchange Rate Questions Relevant to the Threshold Requirement in Article I:1(b) of the Agreement*, BISD 33d Supp. 190 (1987).

Under Executive Order 12,260, the U.S. Trade Representative is required from time to time to determine the dollar equivalent of 150,000 SDR (now 130,000 SDR). Exec. Order No. 12,260, 3 C.F.R. 311 (1980), *reprinted in* 19 U.S.C. § 2511 (1988). For 1992, the U.S. government valued SDR 130,000 at \$176,000. 56 Fed. Reg. 66,117-01 (1991). The practice of the U.S. Trade Representative is to set the dollar equivalent every two years. Telephone interview with Mark Linscott, Director, Government Procurement, Office of the United States Trade Representative (Jan. 14, 1993). The 1992 rate will remain in effect during 1993. *Id.*

107. For example, U.S. entities such as the Tennessee Valley Authority and the Department of Energy are not covered. For the European Community, publicly owned telecommunications entities are not covered. S. REP. NO. 249, 96th Cong., 1st Sess. 128 (1979), *reprinted in* 1979 U.S.C.C.A.N. 514, 515, 529.

108. *Procurement Code*, art. II, *supra* note 105, at 35.

109. The signatories are: Austria, Canada, the European Economic Community (each member country is bound by the Procurement Code), Finland, Hong Kong, Israel, Japan, Norway, Singapore, Sweden, Switzerland, and the United States. *Committee on Government Procurement*, BISD 38th Supp. 91 (1992).

110. See *supra* text accompanying note 37.

111. *Procurement Code*, art. I:2, *supra* note 105, at 35.

above, the market for state and local government procurement in the United States is estimated at \$200 billion annually.¹¹² The European Community contends that it is effectively shut out of this market because of various state "Buy American"¹¹³ or "Buy In-State" statutes. Presently, thirty-seven states have "Buy In-State" provisions.¹¹⁴ Sixteen states, including fourteen of the states that have "Buy In-State" requirements, maintain provisions that either require or encourage the procurement of American made goods and services.¹¹⁵

B. THE VIEW OF U.S. COURTS ON THE STATES AND GOVERNMENT PROCUREMENT

One avenue available to parties affected by "Buy American" laws or other discriminatory state practices is to challenge the measures in the U.S. courts. Such challenges may be predicated upon the preemption of inconsistent state law under the Supremacy Clause,¹¹⁶ or on the federal government's exclusive power to regulate foreign commerce.¹¹⁷

State regulations which interfere with Congress' authority over foreign commerce may be held to be unconstitutional even in the absence of specific conflicting federal legislation.¹¹⁸ Two state court opinions reached different conclusions on this issue in evaluating state "Buy American" legislation. In *Bethlehem Steel Corp. v. Board of Commissioners*, the California Court of Appeal held that the California "Buy American" Act was "an

112. See *supra* note 102 and accompanying text.

113. The federal government also maintains a "Buy America" Act. 41 U.S.C. § 10 (1988). The Trade Agreements Act of 1979 implemented the Procurement Code by authorizing the President to waive the requirements of the national "Buy America" Act for countries who were signatories to the Code. 19 U.S.C. § 2511 (1979).

114. James D. Southwick, *Binding the States: A Survey of State Law Conformance with the Standards of the GATT Procurement Code*, 13 U. PA. J. INT'L BUS. L. 57, 76 (1992). "Buy In-State" provisions take one of the following three forms: 1) a preference for in-state bidders or products when all other factors are equal; 2) a preference for in-state bidders or products up to a specified percentage above the cost of outside products; 3) a preference for in-state bidders over bidders from states which have in-state preference policies. *Id.*

115. *Id.* at 75-78. For example, Minnesota requires that "[t]o the extent possible, specifications must be written so as to permit the public agency to purchase materials manufactured in the United States." MINN. STAT. ANN. § 16B.101(2) (1992).

116. U.S. CONST. art. VI, cl. 2. See also *supra* notes 14, 20-21 and accompanying text.

117. U.S. CONST. art. I, § 8, cl. 3. See also *supra* notes 12-13 and accompanying text.

118. See *supra* note 13 and accompanying text.

unconstitutional encroachment upon the federal government's exclusive power over foreign affairs."¹¹⁹ In *K.S.B. Technical Sales Corp. v. North Jersey District Water Supply Commission*, the New Jersey Supreme Court upheld a "Buy American" law.¹²⁰ The court did not find the law to be unconstitutional, and held that GATT did not preempt the law because of the exclusion of government procurement.¹²¹ These cases were decided prior to the existence of the 1979 GATT Procurement Code.

In *Reeves, Inc. v. Stake*,¹²² the Supreme Court held that South Dakota's policy of restricting the sale of cement produced at a state owned plant to South Dakota residents was not invalid under the interstate commerce clause.¹²³ The Court noted the two conflicting state court opinions on "Buy American" laws,¹²⁴ and indicated in dicta that state laws which burden foreign commerce may be subject to heightened scrutiny.¹²⁵ The Court, however, did not decide the issue.

More recently, the Third Circuit Federal Court of Appeals comprehensively addressed the relationship between state procurement law and international trade agreements. In *Trojan Technologies, Inc. v. Pennsylvania*,¹²⁶ a Canadian manufacturer (Trojan) challenged the validity of the Pennsylvania Steel Products Procurement Act, which required that suppliers use only

119. *Bethlehem Steel Corp. v. Board of Comm'rs*, 80 Cal. Rptr. 800, 802 (Cal. Ct. App. 1969).

120. *K.S.B. Technical Sales Corp. v. North Jersey Dist. Water Supply Comm'n*, 381 A.2d 774 (N.J. 1977).

121. *Id.* at 789. The court noted that GATT had the same force as a U.S. treaty obligation, and thus was superior to state law. *Id.* at 778. Because of the exemption of government purchases, however, the "Buy American" law was not inconsistent with GATT. *Id.* at 782. *See also supra* note 44.

122. *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980).

123. *Id.* at 446-47. The Court reasoned that because South Dakota was acting as a "market participant" rather than a "market regulator," its actions were not invalidated by the Commerce Clause. *Id.* at 440. For further discussion of "market participant" doctrine, see *infra* note 131 and accompanying text.

124. *Id.* at 437 n.9.

125. *Id.* In a 1984 plurality opinion, the U.S. Supreme Court noted that "[i]t is a well accepted rule that state restrictions burdening foreign commerce are subjected to a more rigorous and searching scrutiny. It is crucial to the efficient execution of the Nation's foreign policy that 'the Federal Government . . . speak with one voice when regulating commercial relations with foreign governments.'" *South-Central Timber Development, Inc. v. Wunnicke*, 467 U.S. 82, 100 (1984) (quoting *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 285 (1976)).

126. *Trojan Technologies, Inc. v. Pennsylvania*, 916 F.2d 903 (3d Cir. 1990), *cert. denied*, — U.S. —, 111 S.Ct. 2814 (1991).

American made steel in products sold to public agencies.¹²⁷ Any payments made in violation of the Act were recoverable directly from the supplier.¹²⁸ Trojan had supplied water-disinfection systems that contained steel components to several Pennsylvania municipalities. Following a request by the Pennsylvania Attorney General for documentation showing that the steel used in the systems was American made, Trojan sought declaratory and injunctive relief from the enforcement of the statute.¹²⁹ The district court denied the requested relief and the case was appealed.¹³⁰

In affirming the district court, the court of appeals found that the Pennsylvania statute was not invalidated by the Commerce Clause because the state was acting as a "market participant," rather than a "market regulator."¹³¹ The state's policy did not amount to regulation of foreign commerce, in the court's view, because the state was acting only as a purchaser of goods.¹³²

Additionally, the court held that present international agreements on government procurement did not preempt the Pennsylvania statute. The court pointed to the language in the GATT Procurement Code which merely requires parties to encourage state compliance,¹³³ as well as to legislative history indicating that Congress and the Executive understood that state governments would not be covered.¹³⁴ The court further noted that U.S. trade policy in the government procurement area ap-

127. *Id.* at 904.

128. *Id.* at 905.

129. *Id.*

130. *Id.*

131. *Id.* at 910-11. The "market participant" doctrine has been articulated in a series of Supreme Court cases. Essentially, when the state itself enters the market as a purchaser or seller, nothing in the Commerce Clause forbids it from restricting its own sales or purchases. *See generally* ROTUNDA, *supra* note 21, § 11.9.

In *Reeves*, the Supreme Court said in dicta that state policies burdening foreign commerce may be subject to heightened scrutiny. *Reeves, Inc. v. Stake*, 447 U.S. 429, 437 n.9 (1980). Trojan indicates, however, that the "market participant" doctrine is applicable in both the foreign and interstate commerce contexts. *Trojan Technologies, Inc. v. Pennsylvania*, 916 F.2d 903, 910 (3d Cir. 1990).

132. 916 F.2d at 911. The court contrasted this situation with instances in which a state acts as a market regulator. The court mentioned tax schemes as an example of the latter. While acknowledging that the regulatory situation would warrant greater scrutiny, the court did not say whether regulations affecting foreign commerce would be invalidated. *Id.*

133. *See supra* note 111 and accompanying text.

134. 916 F.2d at 908. The court also found that the U.S.-Canada Free Trade

peared to be based upon a reciprocal negotiating strategy, whereby the United States intended to reduce its procurement barriers only in return for equivalent action by other nations.¹³⁵

Although it rejected the specific challenge to the Pennsylvania statute,¹³⁶ the court stated that “[i]f Congress and the Executive conclude that a state statute . . . is antithetic to the national interest, they have full authority to foreclose its continuing operation.”¹³⁷ The court indicated that state “Buy American” laws could be invalidated by a “comprehensive scheme so pervasive” as to indicate clear congressional intent to preempt such legislation.¹³⁸

The holding in *Trojan* demonstrates that state procurement practices are not affected by current international trade agreements, and that the Commerce Clause does not restrict discriminatory state procurement policies. The case, however, also confirms that the federal government does have the power to bind the states under a procurement agreement, and thereby preempt state “Buy American” laws. It remains to be seen whether Congress and the Executive will develop the political will to enact “a comprehensive scheme” to bind the states.

C. PROPOSALS TO COVER SUBNATIONAL PROCUREMENT UNDER THE GATT PROCUREMENT CODE AND NAFTA

State coverage has been a central focus of negotiations aimed at broadening the scope of the 1979 GATT Procurement Code.¹³⁹ Subnational procurement is also addressed in

Agreement did not evince an intent to preempt inconsistent state procurement laws. *Id.*

135. *Id.* at 909. The reciprocal strategy is illustrated by the Trade Agreements Act of 1979, which implemented the GATT Procurement Code provisions by giving the President authority to waive the national “Buy America Act” for those countries signing on to the code. See 19 U.S.C. § 2511 (1979), amended by 19 U.S.C. § 2511(d) (1988).

The court in *Trojan* rejected a further challenge to the Pennsylvania statute based on the federal government’s exclusive power over foreign affairs. *Trojan Technologies, Inc. v. Pennsylvania*, 916 F.2d 903, 913-14 (3d Cir. 1990). The court noted that, given the evident reciprocal trade strategy, striking down the statute would amount to “judicial redirection of established foreign trade policy.” *Id.* at 914.

136. The court also rejected equal protection and vagueness challenges to the Pennsylvania statute. 916 F.2d at 914-15.

137. *Id.* at 909.

138. *Id.*

139. *Success of Procurement Talks Hinges on Inclusion of State, Local Procurements*, 8 Int’l Trade Rep. (BNA) 17 (Jan. 2, 1991). The talks, which are in conjunction with, though not technically part of, the Uruguay Round have

NAFTA.¹⁴⁰ U.S. federal officials, however, have thus far been unwilling to enter into an agreement that would commit the federal government to preempt state "Buy American" laws.

In September 1990, the European Community proposed that the 1979 GATT Procurement Code be revised to include all sub-central government procurement. In contrast, the United States proposed allowing state and local governments, eighteen months after the completion of an agreement, to decide voluntarily whether to participate.¹⁴¹ On August 20, 1991, the National Governors' Association passed a resolution in support of state inclusion in the GATT Procurement Code.¹⁴² The resolution is not legally binding,¹⁴³ but could potentially provide political support for preemptive federal action on state procurement.

NAFTA contains a chapter on government procurement¹⁴⁴

also focused on the inclusion of the European Community's publicly-owned telecommunications operators. The United States has insisted on their inclusion. The European Community has offered to include these operators only if the United States includes its privately-owned operators in the Code. The United States has rejected such a plan. See *Europe and USA Reach Stalemate on Government Procurement Talks*, FINTECH TELECOM MARKETS, Mar. 5, 1992, available in LEXIS, Nexis Library, Omni File.

Other proposals under consideration include the coverage of service contracts and the establishment of a bid protest procedure. Southwick, *supra* note 114, at 61.

140. See *infra* note 145 and accompanying text.

141. EC is 'Worried' About States and GATT Code, 55 Fed. Cont. Rep. (BNA) 349 (Mar. 18, 1991), available in LEXIS, Nexis Library, Omni File. A draft of a revised Procurement Code was produced on December 20, 1991. The draft states that subcentral entities listed in Annex 2 are covered, but the annex itself is left blank. There is no reference to whether state accession is to be voluntary or compulsory. GATT, *Draft Agreement on Government Procurement*, GATT Doc. GPR/64, art. I (Dec. 20, 1991).

142. *Governors Adopt Resolutions*, *supra* note 102, at 1237. Judy Thomas, Staff Director for the National Governors' Association Committee on International Trade and Foreign Relations, cited the potential of a revised Procurement Code to expand U.S. export markets, as well as lower costs that would result from a wider range of competition for state purchases, as reasons for supporting state accession to the GATT Procurement Code. *Id.*

143. In order for a state to actually join the agreement, the state legislature would have to approve it. The legislature would also have to implement changes to the state's procurement practices, if existing practices are inconsistent with the GATT Code. See Southwick, *supra* note 114, at 64.

144. NAFTA, ch. 10. The range of contracts covered in this chapter is broader than that in the 1979 GATT Procurement Code. See *supra* text accompanying notes 106-07. Most notably, NAFTA covers service and construction contracts. See NAFTA, Annexes 1002.4, 1002.5. However, various types of service contracts are excluded from coverage. See *id.* Annex 1002.4. For all types of contracts, only specified federal entities and enterprises are presently covered. *Id.* art. 1002:1.

Dollar thresholds for coverage under NAFTA vary according to the type of

which adopts the voluntary approach to state coverage. A provision in the chapter states that “[t]he parties will endeavor to consult with their state and provincial governments with a view to obtaining commitments, on a *voluntary* and reciprocal basis, to include within the obligations of this Chapter procurement by state and provincial government entities and enterprises.”¹⁴⁵ There is an annex to the procurement chapter, presently left blank, in which state and provincial entities, voluntarily submitted for coverage under the chapter, will be listed.¹⁴⁶

D. SEEKING STATE COVERAGE

Because there are separate federal and state procurement markets, state coverage is not technically necessary to procurement agreements.¹⁴⁷ Agreements such as the 1979 Procurement Code which reduce procurement barriers only at the national level can be valuable, particularly if they are expanded to cover more federal entities and more types of contracts. In light of the large annual volume of state and local procurement,¹⁴⁸ however, the coverage of state procurement under a new GATT Procurement Code and NAFTA would contribute significantly to the liberalization of world procurement markets.

As in other trade issues, there are domestic political obstacles to affirmatively binding the states under a procurement agreement. “Buy American” laws are politically difficult to eliminate at any level because of their nationalistic tone. State procurement is particularly sensitive because preemption of state practices would be perceived as federal intrusion not only in policy making, but also in how the states spend their own revenues. Indeed, U.S. courts have recognized few constraints on a state government’s ability to discriminate among domestic or foreign entities when it is acting as a purchaser or seller of goods.¹⁴⁹

contract and the type of procuring body. For federal entities (generally agencies) the minimum dollar values of covered contracts are \$50,000 for goods, \$50,000 for services, and \$6.5 million for construction services. *Id.* art. 1002:3(a). For federal enterprises (generally companies with significant government ownership such as the Tennessee Valley Authority) the minimum dollar values of covered contracts are \$250,000 for goods, \$250,000 for services, and \$8.0 million for construction services. *Id.* art. 1002:3(b).

145. NAFTA, art. 1024:3 (emphasis added).

146. *See id.* Annex 1002.2.

147. This is in contrast to agreements aimed at reducing non-tariff barriers to goods, where state compliance is essential. *See supra* Part II.C.

148. *See supra* note 102 and accompanying text.

149. *See supra* notes 122-23, 131-32 and accompanying text.

On the surface, the approach adopted in NAFTA whereby states themselves will voluntarily accede to the government procurement chapter¹⁵⁰ might appear to be a way out of the state coverage dilemma. As noted, a similar approach has been proposed by the United States in the GATT Procurement Code negotiations.¹⁵¹

The voluntary approach is attractive because it shifts the political decision making to the state level. Once the Governor and state legislature agree that it is beneficial for the state to be covered under the agreement, presumably they will have mustered the political will to change any inconsistent legislation such as a "Buy American" law. In contrast, a Congressman who votes in favor of an agreement that affirmatively binds the states would be in the awkward position of having to explain to legislators and constituents in his home state that purchasing policies must be changed.

A close examination of the voluntary approach, however, reveals serious flaws. Each state has little incentive to assent to the agreement individually. Because no mechanism exists by which the fifty states can collectively volunteer to sign the agreement,¹⁵² each state legislature will have to evaluate the costs and benefits of such a move and act accordingly. The benefits that accrue to a particular state individually, however, are difficult to measure.

The reciprocal benefits of state coverage are likely to accrue on a nationwide basis, rather than directly to a state that chooses to participate. Thus, the incentives for an individual state to voluntarily join the agreement are weak. For example, if Minnesota decided to commit to NAFTA's government procurement requirements, it is unlikely that the Mexican government would enter into increased procurement contracts with Minnesota firms. Rather, the Mexican government would most likely open a particular subcentral market in Mexico to all American firms.

An individual state might find it beneficial to open its procurement market if the state determined that it could save money by procuring goods from foreign firms. There is, however, nothing which prevents a state from eliminating "Buy

150. See *supra* note 145 and accompanying text.

151. See *supra* note 141 and accompanying text.

152. Although the National Governors' Association has passed a resolution favoring such a step, the resolution is non-binding. Accession to NAFTA or the GATT Code would have to be approved by each state legislature. See *supra* note 143 and accompanying text.

American" requirements now if it makes such a determination. No further incentive is provided by the prospect of joining an international agreement. Thus, it makes little sense for an individual state to accede on its own to the NAFTA or GATT government procurement agreements.

Because the potential benefits of open procurement markets will accrue on a nationwide basis, and not directly to individual states, the United States can realize reciprocal benefits in the procurement area only if it acts as a unit. It is the federal government's role to determine whether a trade agreement is in the U.S. national interest and to act accordingly. If federal officials believe that opening state procurement markets will yield substantial reciprocal benefits, they should seek political support for mandatory state coverage, rather than waiting for voluntary commitments.

Neither mandatory state coverage nor voluntary accession can be effectuated without political support from the states. If there is no firm state support for the idea of state coverage, the voluntary accession plan is meaningless. If state governments have the political will to voluntarily join the NAFTA or GATT procurement agreements, surely they have the will to support federal action on state procurement. Indeed, mandatory state coverage may help state officials who favor the economic benefits of open procurement, but wish to avoid direct political heat for relaxing "Buy American" laws.

The 1991 National Governors' Association resolution¹⁵³ indicates that there is support for opening procurement markets at the state level. This is not surprising, given the lower state expenditures that would result from potentially increased competition for state contracts.¹⁵⁴ Federal officials should test this support by proposing mandatory state coverage. Relying on voluntary state accession will ultimately do little to open procurement markets.

CONCLUSION

Although it is well settled that the federal government has the legal power to bind the states under international trade agreements, political considerations often make Congress and the Executive reluctant to use this power. Recent disputes over state-level non-tariff trade barriers, as well as negotiations on

153. See *supra* note 142 and accompanying text.

154. A spokesperson for the Governors, in fact, cited lower state expenditures as a reason for supporting state coverage. See *supra* note 142.

government procurement, have reflected this dichotomy between what is legally possible, but politically difficult.

State compliance is crucial to trade agreements that require the elimination of non-tariff barriers. NAFTA recognizes this by explicitly requiring subnational compliance with its national treatment requirements. The U.S. government should consistently follow this policy in GATT, as well as in NAFTA.

While state coverage is not essential to agreements on government procurement, such coverage would be valuable given the large volume of state and local procurement. Rather than evading the issue by proposing voluntary state coverage, federal officials should seek political support for definitive action on state coverage. If Congress and the Executive determine that opening state procurement markets will yield significant national benefits, they should commit to mandatory state coverage under international procurement agreements.