

# INTERNATIONAL ECONOMIC AGREEMENTS AND THE CONSTITUTION

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## INTRODUCTION

International agreements, such as the General Agreement on Tariffs and Trade (GATT) and the North American Free Trade Agreement (NAFTA), generally aim to facilitate the free flow of goods and services among nations.<sup>1</sup> The U.S. Supreme Court has developed a jurisprudence similarly aiming to facilitate the free flow of goods and services among the several states. That jurisprudence has developed from litigation challenging the constitutionality of state actions on the basis of the Commerce and Supremacy Clauses of the Constitution (art. I, § 8, cl. 3, and art. VI, cl. 2). In some subject areas, Commerce Clause decisions closely align with international agreements. In other areas, either or both fall short of achieving economic integration.

Part of the problem when federal courts deal with state laws affecting interstate commerce is that issues take on a “states’ rights” tone and sometimes can become highly politicized. In fact, a recent decision by the First Circuit Court of Appeals upheld a federal district court’s ruling in which the states were reminded that “state interests, no matter how noble, do not trump the federal government’s exclusive

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† Richard M. Goodman (1936-1997) began this study in 1997 as a Visiting Fellow at the Institute on leave from the U.S. Treasury Department. He completed an initial draft before his tragic and untimely death in November 1997 and we were determined to finish the project. Hence we deeply appreciate the diligent and thoughtful work of John M. Frost in converting Richard’s ideas and preliminary work into this publication, which we release both because of its substantive merit and as a memorial to Richard’s long and valuable service to his country.

<sup>1</sup> For texts of many of the agreements, see STEPHEN ZAMORA AND RONALD A. BRAND (EDS.), BASIC DOCUMENTS OF INTERNATIONAL ECONOMIC LAW (1990).

foreign affairs power.”<sup>2</sup> This decision, to which we will return later, brings into sharp focus the lines between foreign policy, interstate commerce and rights that are reserved to the states. It also shows the important role that the federal court system plays in serving as final arbiter in such disputes.

This paper provides a brief overview of Commerce Clause jurisprudence, comparing and contrasting it with principles of economic integration found in international agreements. We argue that international agreements, such as the GATT and the NAFTA, can serve as useful interpretive guidelines for the Court where the challenged state measure restricts the cross-border flow of goods or services.<sup>3</sup>

Our analysis does not imply that a radical change is necessary in the way the Court has been deciding these cases, but at times it does imply that modification would be desirable. The Court has by and large adhered to principles of economic integration in cases dealing with trade in goods, and to a lesser extent trade in services. Nevertheless, in cases dealing with state procurement or state-run enterprises, cross-border investment, and fiscal policy, the Court could benefit a great deal from the principles embodied in international agreements. We begin by presenting a rudimentary outline of how the Court has decided Commerce Clause cases. We then proceed systematically through several Commerce Clause cases dealing with issues related to cross-border trade, comparing the Supreme Court’s treatment of the issues with the treatment of similar issues under international agreements. We note areas where the two are in harmony, and offer suggestions for the Court where they differ.

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<sup>2</sup> *National Foreign Trade Council v. Baker*, 26 F. Supp. 2d 287, 293 (D. Mass. 1998), *aff’d sub nom. National Foreign Trade Council v. Natsios*, 181 F.3d 38 (1st Cir. 1999), *cert. granted*, 120 S. Ct. 525 (1999). The First Circuit’s decision is binding precedent only in Maine, Massachusetts, New Hampshire, Rhode Island, and Puerto Rico. Meanwhile, 29 other states and local governments outside the First Circuit have passed or proposed 42 similar sanctions. For an interesting discussion of the whole matter of states’ rights and foreign policy, see Brannon P. Denning and Jack H. McCall, *States’ Rights and Foreign Policy: Some Things Should Be Left to Washington*, 79 FOREIGN AFF. 9 (Jan./Feb. 2000).

<sup>3</sup> The fit between agreements of economic integration and the Commerce Clause is not exact, and some subjects—e.g., transportation, insurance, banking, free movement of services and labor—merit special attention and will be addressed only obliquely here. In some areas, other constitutional doctrines are more appropriate. For example, the treatment of financial services in a common market may more properly be a subject of the Privileges and Immunities Clause, art. IV, § 2, cl. 1 and amend. XIV, § 1, not the Commerce Clause. State regulations in such fields as banking and insurance, where the Congress has given considerable discretion to the states, fall outside the Commerce Clause. In other areas, such as the promulgation of product standards, Congress will have enacted legislation preempting state action.

In some fields, notably agriculture, the Supreme Court is far more supportive of economic integration than are international agreements, which contain sectoral and other exceptions that should not apply in a market as integrated as the United States. Examples in the GATT include the Escape Clause, *see* GATT art. XIX, and rules on antidumping, *see* GATT art. VI. The NAFTA also has exceptions related to trade in goods and investment.

## THE COMMERCE CLAUSE: THE COURT'S POLICY INSTRUMENT

Ultimately, the question that is posed in challenges to state regulatory actions is this: In the absence of express congressional action,<sup>4</sup> does the mere fact that the Constitution gives Congress the power to regulate interstate commerce prevent the state from taking the disputed action? That is, is the Commerce Clause self-executing, or must Congress enact laws expressly forbidding particular state regulations?<sup>5</sup> And if it is self-executing, what principles should guide federal courts in deciding whether a particular state action violates the Commerce Clause?

The answers to these questions have both domestic and international implications. The Supreme Court established long ago that the Commerce Clause is self-executing, but has been less than unified on the principles it has been willing to follow in deciding Commerce Clause cases. Nevertheless, one guiding principle that the Court has adhered to—one that also happened to be a basic aim of the Constitution's framers—is the economic integration of the states. For over 175 years<sup>6</sup> the Supreme Court has acknowledged the framers' view that a fundamental purpose of the Commerce Clause is the development and nurturing of a common market among the states, and the abolition of barriers to trade.<sup>7</sup> While the Constitution does not address interstate tariffs and quotas per se,<sup>8</sup> such policies can distort or impede

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<sup>4</sup> Thereby we control for Supremacy Clause issues. It is an entirely separate issue whether a particular congressional action preempts a particular state action. At times the answer to this question is not clear at all, but Congress can clarify things considerably when it legislates by expressly declaring its intent to preempt a particular state law, if in fact that is its intent.

<sup>5</sup> A self-executing Commerce Clause means that, even absent preempting federal legislation, states may *not* enact certain laws. That is, the mere existence of the Commerce Clause suggests limits on state power. When viewed this way, scholars often refer to it as the “negative” or “dormant” Commerce Clause, thereby distinguishing its self-executing nature from affirmative actions taken by Congress under its authority granted by the Commerce Clause. The analysis of this paper mainly applies to the negative Commerce Clause.

<sup>6</sup> The seminal Commerce Clause case is *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1 (1824) (invalidating a New York law prohibiting out-of-state competition in the ferry industry).

<sup>7</sup> See RONALD D. ROTUNDA AND JOHN E. NOWAK, 2 TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE § 11.1, at 4 (2d ed. 1992) (“the rationale of the Commerce Clause was to create and foster the development of a common market among the states, eradicating internal trade barriers, and prohibiting the economic Balkanization of the Union”); see also ALEXANDER HAMILTON, THE FEDERALIST, NO. 32.

<sup>8</sup> The Constitution does bar states from “lay[ing] Imposts or Duties on Imports or Exports” on goods entering from or destined for foreign countries. U.S. CONST. art. I, § 10, cl. 2. There appears to be some debate regarding the magnitude of the burden interstate tariffs may have imposed on trade among the colonies. While the framers were well aware that each of the separate states would, as Alexander Hamilton put it in THE FEDERALIST No. 7, “pursue a system of commerce peculiar to itself [which might] occasion distinctions, preferences, and exclusions, which [in turn] would beget discontent,” they may not have been of major consequence. HAROLD U. FAULKNER, AMERICAN ECONOMIC HISTORY 142 (7th ed.

trade flows, and hence may violate this underlying principle of the Commerce Clause. State policies promoting foreign direct investment may disadvantage local competitors as well as businesses from other states. Local content requirements may promote local business at the expense of out-of-state and foreign interests. All these actions tend to distort or impede the free flow of goods and services across borders and therefore limit economic integration. As such, they may also violate a basic principle underlying the Commerce Clause, and if challenged, may be struck down by federal courts. Congress generally has the option to overrule the judiciary by enacting laws that declare the discriminatory measures constitutional,<sup>9</sup> but absent specific congressional action, federal courts make the law here. So the Supreme Court's interpretation of the Commerce Clause determines in large part the degree of economic integration among the states as well as the states' ability to discriminate against foreign commerce.

Since the larger issue here is what the Court can do to regulate state measures infringing upon *international* trade, and not just *interstate* trade, we might begin by speculating on how it would treat a challenge to such a state law. A useful first approach in deciding whether such a state action ought to be invalidated is to sort out the domestic implications of the measure in light of the Commerce Clause. If the Court would find the measure contrary to the Commerce Clause as applied to domestic competitors, there would seem to be little reason for it to be valid as against foreign competitors. For example, suppose Alaska imposed a local processing requirement preventing timber from being exported unless processed in the state. If that were unconstitutional, Alaska would have to permit the processing of its timber in the other 49 states. That would deprive in-state processors of any competitive advantage relative to out-of-state processors, but at the same time there would be no compelling reason to allow Alaska to prevent foreign processors from competing as well.<sup>10</sup> So how does the Court actually go about deciding whether such state actions violate the Commerce Clause?

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1954); *see also* EMORY R. JOHNSON, T.W. VAN METRE, G.G. HEUBNER, AND D.S. HANCHETT, *HISTORY OF DOMESTIC AND FOREIGN COMMERCE OF THE UNITED STATES* 138 (1922 reprint) and JOHN H. FREDERICK, *THE DEVELOPMENT OF AMERICAN COMMERCE* 47 (1932) (interstate trade during colonial times not especially large, tariffs not high relative to those on British goods). One scholar remarked, "The first thing that strikes one's attention in seeking references directed to interstate commerce is their paucity." *See* Albert S. Abel, *The Commerce Clause in the Constitutional Convention and in Contemporary Comment*, 25 MINN. L. REV. 432, 470 (1941). This may explain in part why the framers did not include an express "no interstate tariffs" clause.

<sup>9</sup> "Congress may 'confe[r] upon the States an ability to restrict the flow of interstate commerce that they would not otherwise enjoy.'" *Western & S. Life Ins. Co. v. Board of Equalization*, 451 U.S. 648, 652 (1981) (quoting *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 44 (1980)).

<sup>10</sup> This scenario outlines the facts of a famous Commerce Clause case, *South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82 (1984), where the plaintiff was an Alaska corporation that sold unprocessed timber almost exclusively to Japan. The Court struck down the Alaska law.

Judicial review under the Commerce Clause involves two steps: First, the Court examines whether the challenged state measure discriminates against interstate commerce.<sup>11</sup> If the Court finds the measure discriminatory, it will “strictly scrutinize” the law to decide whether it *necessarily* relates to a *compelling* state objective. This is a difficult standard to meet, and most challenged laws do not survive it. If the Court finds that the measure is *not* discriminatory, it balances the burden the measure imposes on interstate commerce against the benefit it provides local interests, keeping in mind the possibility of nondiscriminatory alternatives. Statutes creating burdens not justified by legitimate local policy interests are struck down.

As there is no express constitutional provision declaring the Commerce Clause self-executing, the Supreme Court’s rulings in this area technically are not grounded in the Constitution. They are policy choices made by the Court, and the policies have varied over time. At one extreme the rules can be viewed as promoting economic integration. At the other extreme commentators believe the rules serve political and not economic goals. Some, indeed, would lay the Commerce Clause to rest.<sup>12</sup> But the Court continues to decide Commerce Clause cases because states continue to enact measures that advance their own parochial commercial interests. It may thus be optimal for the Court to take an active role in this area, as the sheer number of state measures may be “individually too petty, too diversified, and too local to get the attention of Congress hard pressed with more urgent matters.”<sup>13</sup>

Unfortunately, Commerce Clause jurisprudence is “hopelessly confused.”<sup>14</sup> Justices disagree over which cases should be governed by the clause, and consensus has not been reached even on the policies at its heart. Dissents abound, and majorities are difficult to muster. Although there appears to be general agreement among the Justices that the fundamental purpose of the clause is to create a common

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<sup>11</sup> The Court may also examine a statute for “economic protectionism.” In *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978), the Court stated that “simple economic protectionism” is to be disposed of by a “virtually per se rule of invalidity.” But even here the rule is qualified. In *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981), the Court upheld a ruling that the actual basis for the disputed requirement was the promotion of local industry. The Court ruled that although out-of-state industries may be burdened, the burdens were “not ‘clearly excessive’” in light of state interests. *Id.* at 473.

In passing we note that the Commerce Clause prohibits discrimination against “interstate commerce.” Other constitutional provisions, mainly the Fourteenth Amendment, prohibit discrimination against “persons.”

<sup>12</sup> See Winkfield F. Twyman, Jr., *Beyond Purpose: Addressing State Discrimination in Interstate Commerce*, 46 SO. CAROLINA L. REV. 381, 410 at note 172 (1995) for a collection of sources. See also Amy M. Petragani, *The Dormant Commerce Clause: On Its Last Leg*, 57 ALB. L. REV. 1215 (1994).

<sup>13</sup> *Duckworth v. Arkansas*, 314 U.S. 390, 400 (1941).

<sup>14</sup> *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662, 706 (1981) (Rehnquist, J., dissenting).

market or free trade area within the United States,<sup>15</sup> none has taken the next logical step and examined how international agreements creating common markets or free trade areas have dealt with similar measures.<sup>16</sup> The present paper initiates that task.

While international agreements can set only minimal standards for the states (since the United States is already so highly economically integrated), they can help Commerce Clause jurisprudence in other ways. First, agreements state rules for disciplining the behavior of nation-states which reflect the best judgment of both the executive and legislative branches regarding sound economic policies. The judiciary could apply comparable rules to discipline states within the much more highly integrated U.S. markets. Otherwise, inconsistencies could arise. Foreign nationals might have treaty claims against

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<sup>15</sup> *Wyoming v. Oklahoma*, 502 U.S. 437, 470 (1992) (Scalia, J., dissenting, quoting *Westinghouse Elec. Corp. v. Tulley*, 466 U.S. 388, 402–403 (1984)) (“Virtually every one of our cases in this area thus begins its analysis with some form of the incantation that ‘the very purpose of the Commerce Clause was to create an area of free trade among the several states’”). Similarly, the Court repeatedly asserts that a goal of the Commerce Clause is to create a “common market” in the United States. *See, e.g., World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 186, 293 (1979); *Hunt v. Washington Apple Adver. Comm’n*, 432 U.S. 333, 350 (1977); *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 803 (1976); and *Great Atl. & Pac. Tea Co. v. Cottrell*, 424 U.S. 366, 380 (1976). The ringing statement of Justice Cardozo, *see Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 523 (1935), also assumes that interstate economic competition is one element of our national solidarity:

[ex][A] state ... in times of stress and strain [may] say that the farmers and merchants and workers must be protected from competition from without, lest they go on the poor relief lists or perish altogether. To give entrance to that excuse would be to invite a speedy end to our national solidarity. The Constitution was fixed under the dominion of a political philosophy less parochial in range. It was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division.

While there are technical differences between a free trade area and a common market, they are not of concern for present purposes. The NAFTA, by its title a “free trade agreement,” addresses subjects found in common market agreements, notably, cross-border services, the treatment of foreign investors and their in-state investments, and government procurement. Those subjects are among the topics of this paper.

<sup>16</sup> The Court’s institutional shortcomings become clear when examined in light of the institutions of a common market. The Court must decide the case at hand, and cannot systematically survey national laws (as can the European Commission) to decide whether particular categories of national laws are or are not consistent with a common market. Unlike the European Court of Justice, the Supreme Court creates new rules, rather than interpreting rules drafted by policymakers. Unlike the European Commission, it cannot initiate suit against an offending member state. It cannot function like the European political institutions, building a political consensus in favor of a new liberalizing rule, and then issuing a directive approved at a political level, while leaving details of implementation to member states.

In the United States, where Congress has extensive powers, where the market is highly integrated, and where the separate states may have but few and limited opportunities to take measures that can undermine a common market, there may be no need for institutions like those of the European Commission. The Commission is perhaps 10,000 strong and has been principally responsible for efforts at harmonizing laws—“the cornerstone of Community action in the first 25 years.” COMMISSION OF THE EUROPEAN COMMUNITIES, COMPLETING THE INTERNAL MARKET (WHITE PAPER FROM THE COMMISSION TO THE EUROPEAN COUNCIL) 18 (1985).

offending states, while U.S. nationals from outside offending states would not.<sup>17</sup> Second, international agreements provide a rich source of information and law about whether particular governmental measures would be compatible with the notion of a common market. The rules are generally accessible and phrased in plainer terms than the rules currently guiding Commerce Clause analysis. One need not sift through hundreds of cases and competing dicta to reach a decision on a particular matter. Third, these agreements provide a rational framework for analyzing past Commerce Clause cases, and a consistent policy rationale for guiding future decisions.<sup>18</sup>

The agreements aim at economic integration. If the Court relied on those agreements, it could put aside the conventional wisdom that the Commerce Clause has no economic rationale, but serves only the “political” goal of protecting out-of-state interests not represented in state legislatures.<sup>19</sup> The Court would instead have a coherent economic rationale for its decisions, incorporating the judgment of both the executive and legislative branches. That policy rationale addresses the fundamental questions of federalism that are at the heart of Commerce Clause jurisprudence. In essence, the agreements accept that often the economic gains of integration outweigh the political costs to state “sovereignty.”<sup>20</sup>

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<sup>17</sup> A foreign company might even have a claim in U.S. courts under a “self-executing” treaty, but not under the NAFTA. *Compare* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES, § 302 and North American Free Trade Agreement Implementation Act § 102(c), Pub. L. No. 103-182, 107 Stat. 2057 (1994).

<sup>18</sup> For works on the subjects and agreements in question, see generally TERRANCE SANDALOW AND ERIC STEIN, *COURTS AND FREE MARKETS* (1982); JOHN H. JACKSON, *WORLD TRADE AND THE LAW OF THE GATT* (1969); LORD HAILSHAM AND DAVID VAUGHAN (EDS.), *LAW OF THE EUROPEAN COMMUNITIES* (1986); P.J.G. KAPTEYN AND P. VERLOREN VAN THEMATT, *INTRODUCTION TO THE LAW OF THE EUROPEAN COMMUNITIES* (1989).

<sup>19</sup> A familiar quotation is: “[W]hen [a] regulation is of such a character that its burden falls principally upon those without the state, legislative action is not likely to be subjected to those political restraints which are normally exerted on legislation where it affects adversely some interests within the state.” *See* *South Carolina State Highway Dep’t v. Barnwell Bros.*, 303 U.S. 177, 185 n.2 (1938).

But the Commerce Clause presumably can serve both political and economic goals. If it served only political goals, numerous cases would fall outside its scope. Examples include the landfill cases, *see, e.g., Philadelphia v. New Jersey*, 437 U.S. 617 (1978), *Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334 (1992), where the plaintiffs included in-staters capable of representing themselves in state legislatures, and cases involving discrimination against exports, where in-state producers would have an interest in opposing the legislation. For an example of some of the issues raised by the political theory of the Commerce Clause, *see West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994).

<sup>20</sup> *See, e.g.,* President’s Message to the Congress Transmitting the NAFTA Legislation, 29 WEEKLY COMP. PRES. DOC. 2254 (Nov. 3, 1993).

## TRADE AND INVESTMENT

Characteristic of integrated markets is the absence of tariffs and quotas. Goods and services flowing across international borders unencumbered by tariffs or quantity restrictions or like market distortions allow prices to more accurately convey information regarding relative scarcities. With more accurate information, consumer choices align more closely with true marginal costs, and welfare is enhanced.

This tenet is reflected in the Rome Treaty of the European Union (EU) and the GATT, as well as by many Supreme Court decisions. International agreements like the Rome Treaty, the GATT, and the NAFTA actually codify principles embodied in the U.S. Constitution, as they pertain to the goal of an integrated economy, and hence can serve as an interpretive aid for Commerce Clause cases. Interpreting the Commerce Clause in light of these agreements will contribute additional insights to these cases and can lend greater consistency to Commerce Clause adjudication.

### Trade in Goods

When the former colonies were governed by the Articles of Confederation, it quickly became obvious to everyone that 13 independent trade policies greatly complicated things. States aggressively imposed tariffs, not just on goods from foreign nations but on goods from other states as well. One could quite accurately describe the states at that time as quasi-independent nations.<sup>21</sup> In fact, when the delegates met at Philadelphia in 1787, their intention was to try to come up with some sort of agreement on economic integration, to “revise” the Articles, so to speak, not to devise an entirely new system of government.<sup>22</sup> Perhaps because economic integration was foremost in the delegates’ minds, Commerce Clause cases tend to parallel modern international agreements on economic integration, at least insofar as they pertain to the trade in goods.

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<sup>21</sup> ALBERT BEVERIDGE, *in* THE LIFE OF JOHN MARSHALL 310–312 (1916), described the situation as follows:

[ex]Finance, commerce, and business assembled the historic Philadelphia Convention; although it must be said that statesmanship guided its turbulent councils. The senseless and selfish nagging at trade in which the States indulged, after peace was declared, produced a brood of civil [abuses]. The States passed tariff laws against one another as well as against foreign nations; and, indeed, as far as commerce was concerned, each State treated the others as foreign nations. There were retaliations, discriminations, and every manner of trade restrictions and impediments which local ingenuity and selfishness could devise. . . . Merchants and commercial bodies were at their wits’ end to carry on business and petitioned for a general power over commerce.

<sup>22</sup> See generally, Robert L. Stern, *That Commerce which Concerns More States Than One*, 47 HARV. L. REV. 1335, 1337–1341 (1934).



### ***Import Restrictions***

One way in which international agreements and past Supreme Court Commerce Clause decisions in general have sought to remove encumbrances on the free flow of goods is by prohibiting discrimination against imports. Both the EU and the GATT prohibit quantitative restrictions, subject to “general exceptions.”<sup>23</sup> At least in theory, the EU and the Supreme Court have reached somewhat further. The EU prohibits measures “capable of hindering, directly or indirectly, actually or potentially, intra-Community trade,”<sup>24</sup> in essence creating a right of entry for imported goods,<sup>25</sup> while the Supreme Court has struck down some “nonincidental” but nondiscriminatory “burdens” on interstate commerce.<sup>26</sup>

International agreements contain “general exceptions” to rules prohibiting discrimination against imports.<sup>27</sup> Typically such exceptions fall under the category of protecting the public health, safety, or the environment. There are no exceptions to protect local industry from competition. Exceptions must conform to certain standards. For example, a valid import ban must be accompanied by comparable restrictions on the domestic marketing and sales of the same or similar products.<sup>28</sup> Furthermore, a ban

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<sup>23</sup> ROME TREATY arts. 30–35; GATT art. XI.

<sup>24</sup> Case No. 8/74, *Procureur du Roi v. Dassonville*, 5 E.C.R. 837, [1974–1975 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8276 (1974).

<sup>25</sup> Case 120/78, *Rewe Zentral AG v. Bundesmonopolverwaltung für Branntwein*, 1979 E.C.R. 649, 664 [1978–1979 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8543 (1979). In *Rewe Zentral*, Germany sought to prohibit entry of a liqueur having a wine-spirit (or alcohol) content lower than the minimum fixed by German law. After concluding that the measure could not be justified under any of the “general exceptions” to the Rome Treaty, the Court of Justice noted that “there is . . . no valid reason why, provided that they have been lawfully produced and marketed in one of the Member States, alcoholic beverages should not be introduced into any other Member State.” *Id.* at 664.

<sup>26</sup> *Pike v. Bruce Church, Inc.*, 386 U.S. 137, 142 (1970).

<sup>27</sup> These general exceptions apply only if they do not “constitute a means of arbitrary discrimination or a disguised restriction on trade.” ROME TREATY art. 36; GATT art. XX. The NAFTA basically accepts the GATT exceptions as applied to trade in goods. NAFTA art. 2101, ¶ 1. We do not address “exceptions” not relevant to Commerce Clause cases, such as a balance of payments or a national security exception. The EU also applies “exceptions” under a “rule of reason,” which would permit restrictions on imports for such reasons as consumer protection, environmental protection, and the improvement of working conditions. See 2 HAILSHAM & VAUGHAN, *supra* note 18, at ¶¶ 12.83–12.91.

<sup>28</sup> For the EU, see 2 HAILSHAM & VAUGHAN, *supra* note 18, at ¶ 12.60. Article 36 does not contain such a requirement, but recent cases have assumed that a restriction must apply equally to domestic and foreign goods as a precondition to applying art. 36.

Under GATT art. XX, the general exceptions apply only if the measure in question is not “a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail,” or a “disguised restriction on international trade.” With respect to conservation measures, the GATT would permit restrictions on imports only if “made effective in conjunction with restrictions on domestic production or consumption.” See *United States—Prohibition of Imports of Tuna and Tuna Products from Canada*, B.I.S.D. (29th Supp.) (1983). For other “general exceptions,” such as those related to public

must be a measure which, when compared to alternative policies achieving the same effect, least restricts the free movement of goods.<sup>29</sup>

After a rocky start with “quarantine” and “original package” cases,<sup>30</sup> the Supreme Court established rules comparable to the “general exceptions” provisions of the EU and the GATT with its

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health, GATT drafting history indicates that an import restriction that was not matched by corresponding restrictions in the importing country would be a “disguised restriction” on imports that could not be justified under article XX. *See* GATT Analytic Index, 439 (6th ed. 1993).

<sup>29</sup> This policy resembles the least intrusive alternative test employed by the Supreme Court. *See* text accompanying note 36.

An import restriction, to be permissible in the EU, must be “proportionate to the aim in view,” so that if a “member state has a choice between various measures for achieving the same goal, it should choose the least restrictive to the movement of goods.” *See* Case 302/86, *Commission v. Denmark*, 1990 E.C.R. 167, 182 (1990). For example, Germany banned imports of meat products using certain animal or vegetable substances (and also banned their domestic marketing and sale), ostensibly to protect public health and to assure fair trading. The European Court of Justice, in holding the ban contrary to the Rome Treaty, observed that consumers could as well be protected by suitable labeling. *See* Case 274/87, *Commission v. Germany*, 1990 E.C.R. 300 (1990).

An import ban can be considered “necessary” within the meaning of an article XX exception “only if there were no alternative measure consistent with the [GATT] which [a member] could reasonably be expected to employ to achieve its ... policy objectives.” *See* *Thailand—Restrictions on Importation of and Internal Taxes on Cigarettes*, B.I.S.D. (37th Supp.) at 223 (1991). Thus, if Thailand wants to protect public health, it need not ban imports of cigarettes, but could instead follow the practice of other countries and adopt *nondiscriminatory* labeling and ingredient disclosure regulations, ban unhealthy substances generally, or use other nondiscriminatory measures to control demand. *Id.* at 224. The panel observed that “other countries had introduced ... non-discriminatory labeling and ingredient disclosure regulations.” *Id.* Similarly, in *United States—Restrictions on Imports of Tuna*, B.I.S.D. (39th Supp.) at 155, 199 (1991), the panel found that the United States had “not exhausted all options reasonably available to it” to achieve the goal—dolphin protection—it sought to defend under a “general exception.” *See also* *United States—Section 337 of the Tariff Act of 1930*, B.I.S.D. (36th Supp.) at 345 (1989). The panel addressed the difficulties in obtaining redress against imported products that infringed upon patents as compared with domestic products that infringed upon patents. Section 337 provided one mechanism to redress those difficulties, but the panel was willing to say that some elements went too far. Emphasizing the relevance of domestic practice, the panel noted that the “United States could bring the provision of general exclusion orders into consistency with article III:4 by providing for the application in like situations of equivalent measures against products of United States origin.” *Id.* at 395.

<sup>30</sup> Quarantine cases include *Bowman v. Chicago & Northwestern R’way Co.*, 125 U.S. 465 (1888) and *Smith v. St. Louis & Southwestern R’way*, 181 U.S. 248 (1901). Original package cases include *Leisy v. Hardin*, 135 U.S. 100 (1890); *Austin v. Tennessee*, 179 U.S. 343 (1900); and *Schollenberger v. Pennsylvania*, 171 U.S. 1 (1898).

One method of inquiry employed in early Supreme Court cases was to ask whether Congress recognized a particular good as an article of interstate commerce, and hence whether the Court had jurisdiction over it. *See, e.g.,* *Bowman*, 125 U.S. at 489 (goods that “bring in and spread disease [are not] merchantable [and hence are not] legitimate subjects of trade and commerce”). The general question has been put to rest by the ruling in *Philadelphia v. New Jersey*, 437 U.S. 617 (1978), where the Court read *Bowman* in such a way that all objects of interstate trade may merit Commerce Clause protection.

decisions in *Philadelphia v. New Jersey*<sup>31</sup> and *Maine v. Taylor*.<sup>32</sup> When the Court balances “legitimate local interests” against the burdens imposed by a given state or local law, in effect it is applying the EU doctrine of “general exceptions.” Read together, *Philadelphia* and *Maine* reject the earlier “quarantine” cases,<sup>33</sup> and stand for two propositions: (1) a state ban on imports—even imports harmful to the environment—is unconstitutional (as discriminatory) when there are no comparable restrictions placed on similar products produced in-state;<sup>34</sup> and (2) in the extraordinarily rare circumstance where there are no similar products produced in-state, an import ban can survive only if there are no realistic and less intrusive alternatives, such as inspection, to weed out harmful products.<sup>35</sup> This second test, which we

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However, when goods were in their “original package” (like beer in kegs or cigarettes in “wholesale” packages), a state had no power over them until their first in-state sale, whether or not there was a legitimate local interest to protect. *See* *Leisy* (beer); *Austin* (cigarettes); and *Schollenberger* (oleomargarine). Shortly after *Leisy*, Congress passed the Wilson Act, 27 U.S.C. § 121, which ended original package protection from local laws for imported liquor.

When goods were not in their original package (diseased cattle and cigarettes in packages of 10), the Court accorded the highest deference to a *bona fide* exercise of a state’s police power. In *Austin*, 179 U.S. at 350, the Court would not go so far as to say that cigarettes were inherently bad, but saw “no reason to doubt the good faith of the legislature of Tennessee in prohibiting the sale of cigarettes as a sanitary measure.” Similarly, in *Smith*, the Court deferred to the Texas Live Stock Commission, which had banned cattle imports from Louisiana, even though the record did not clearly indicate that Louisiana cattle were diseased or exposed to disease. *See* 181 U.S. at 258, 262. In *Austin*, 179 U.S. at 349, the law did apply to all sales of cigarettes in Tennessee, but the Court appeared only concerned whether there was “discrimination ... as against such as are imported from other states.”

<sup>31</sup> 437 U.S. 617 (1978). We accept the Court’s statement of doctrine about import bans, though elsewhere we suggest that the case is better viewed as involving restrictions on the export of services. *See also infra* notes 33, 34, and 86.

<sup>32</sup> 477 U.S. 131 (1986).

<sup>33</sup> In *Philadelphia v. New Jersey*, 437 U.S. 617, 628–629 (1978), the Court cited and distinguished the quarantine cases, believing that those cases “banned the importation of articles ... that required destruction as soon as possible because their very movement risked contagion and other evils.” In dissent, Justice Rehnquist thought the distinction lacked substance: “I do not understand why a State may ban the importation of items whose movement risks contagion, but cannot ban the importation of items which, although ... transported into the State without undue hazard, will then simply pile up in an ever increasing danger to the public’s health and safety.” *Id.* at 632–633.

Although *Maine v. Taylor*, 477 U.S. 131 (1986), appeared on its face to be a typical quarantine case, the Court did not apply quarantine-case-like analysis, nor did it cite a single quarantine case. Rather, the Court decided the case entirely on the basis of modern Commerce Clause jurisprudence.

<sup>34</sup> Since there were no comparable restrictions on waste from New Jersey, the Court held in *Philadelphia* that the import ban was unconstitutional. In *Maine* there was apparently no domestic “parasite” problem. While the statute discriminated against imports on its face, there was no need to ban the sale of domestic products because there was no “domestic” problem to cure.

<sup>35</sup> *Maine* “succeeded in making a difficult factual showing that few litigants will be able to match.” *See* LAWRENCE W. TRIBE, *AMERICAN CONSTITUTIONAL LAW*, 416 n.13 (2d ed. 1988). It was able to prove

shall call the least intrusive alternative test, represents a rejection of earlier cases where the Court was apparently indifferent as to whether inspection or comparable techniques to protect local policy interests occurred.<sup>36</sup>

In addition to quantitative restrictions, agreements on economic integration seek to eliminate or reduce tariffs<sup>37</sup> and tariff equivalents.<sup>38</sup> Tariffs raise the prices of imported goods, providing domestic producers with a legislated comparative advantage. Tariff equivalents, specifically tax reductions, exemptions, or credits that apply only to domestically produced goods, have similar effect. While such policies may temporarily protect local producers, they fail to improve public health, safety, or welfare, and hence fail as “general exceptions.” Reducing or eliminating tariffs and tariff equivalents facilitates greater domestic competition among suppliers, which means lower prices for consumers. Commerce

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that scientifically accepted techniques for inspecting baitfish—in contrast to inspections for salmon and trout—had not been devised.

<sup>36</sup> *Mintz v. Baldwin*, 289 U.S. 346 (1933), examined a New York inspection system to detect Bang’s disease in imported cattle. While upholding that inspection system, which certainly was far less restrictive than an import ban, the Court did not address whether New York had a comparable inspection system or other preventative measures to identify and deal with Bang’s disease in local herds. On the facts, 289 U.S. at 349, it was clear that there were diseased animals in those herds, and the Court did not routinely examine whether there were “less restrictive” alternatives to a ban on imports. In other cases the prohibitions on the import of cattle were upheld without there being any inspection system whatever. *See Smith v. St. Louis & Southwestern R’way Co.*, 181 U.S. 248 (1901). In *Reid v. Colorado*, 187 U.S. 137 (1902), for example, Colorado required that all imported cattle be certified by the State Veterinary Sanitary Board. The Court upheld the certificate requirement because it did not appear to be unreasonable on its face. 187 U.S. at 152. It was a rare case when the Court would say that an apparently “less restrictive” measure, such as an inspection requirement ostensibly protecting the public health, was so burdensome to comply with that it was in effect a ban on imports contrary to the Commerce Clause. *See Minnesota v. Barber*, 136 U.S. 313 (1890).

<sup>37</sup> Article 13 of the Rome Treaty provides that “customs duties on imports in force between Member States shall be progressively abolished by them during the transitional period. . . .” It also abolishes “charges having an effect equivalent to customs duties.” The EU thus abolished internal tariffs among the Six by the end of 1968; between the Six and Denmark, Ireland, and the United Kingdom by 1977; and at later dates for other countries. The NAFTA calls for the staged elimination of tariffs. NAFTA art. 3.02.2, annex 3.02.2. The GATT seeks tariff reduction in negotiation rounds.

The Rome Treaty admits no general exceptions for local policy goals. We know of no case where a GATT Panel has held that the article XX exceptions would apply to unbind a bound tariff or a discriminatory tax or other levy imposed on a good after import. For example, a GATT Panel has decided not to expand the “general exceptions” to permit differential internal taxes related to the ability of consumers to pay. *See Japan—Customs Duties, Taxes, and Labeling Practices on Imported Wines and Alcoholic Beverages*, B.I.S.D. (34th Supp.) at 83 (1987). Tariffs and equivalent charges are phased out or abolished, whatever purpose they may serve. At best the Japan Liquor Panel, *id.* at 124, hinted that differential taxes might be justified to protect human or plant life, but never explained its reasoning.

<sup>38</sup> GATT art. III.2. Even tax exemptions or credits designed to favor small producers may be treaty violations because of their impact on imports. *See United States—Measures Affecting Alcoholic and Malt Beverages*, B.I.S.D. (39th Supp.) at 206 (1991–1992).

Clause adjudication of tariffs and tariff equivalents basically parallels the reasoning in international agreements. After a hesitant start,<sup>39</sup> the Supreme Court held that interstate tariffs are per se unconstitutional.<sup>40</sup> Although some states continue to impose excise and other taxes that discriminate against out-of-state imports,<sup>41</sup> the Supreme Court recently reiterated that tariff equivalents cannot survive Commerce Clause scrutiny.<sup>42</sup>

Regulations that set minimum prices for imports also function much like tariffs, and have been treated similarly in the jurisprudence of the EU<sup>43</sup> and the Supreme Court. A price floor set too high above the price a foreign supplier would set may cancel out any comparative advantage previously enjoyed by that supplier. The EU Court of Justice has condemned such price controls.<sup>44</sup> Where the

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<sup>39</sup> In *Brown v. Maryland*, 25 U.S. (12 Wheat.) 419 (1827), the Court applied an “original package doctrine” to prevent states from taxing items imported from abroad. Chief Justice Marshall suggested that the principles of that case would also limit a state’s ability to tax items imported from other states. Later, when addressing nondiscriminatory taxes on all goods sold within a state, the Court stated that a tax would survive the Commerce Clause if there was “no attempt to discriminate injuriously against products of another State.” See *Woodruff v. Parham*, 75 U.S. (8 Wall.) 123, 140 (1868). Justice Cardozo in 1935 declared that “imposts and duties on interstate commerce are placed beyond the power of a state.” See *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 522 (1935); see also *James B. Beam Distilling Co. v. Georgia*, 501 U.S. 529 (1991).

<sup>40</sup> See *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) (tax exemption); *Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334 (1992) (discriminatory fee).

<sup>41</sup> Hawaii has argued that a tax exemption discriminating against imports from other states was permissible because it served a legitimate local concern, namely, protecting a weak local industry. See *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984). Alabama claimed that a discriminatory fee against waste imports was justified for public health and environmental purposes. See *Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334 (1992). Massachusetts sought to justify a tariff equivalent on the ground that it would safeguard the local dairy industry. See *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994).

<sup>42</sup> *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 193 (1994).

<sup>43</sup> No GATT Panel has apparently addressed price regulations applicable to imports. We know of no EU cases that condone price regulations because they fit within one of the “general exceptions.”

<sup>44</sup> 2 HAILSHAM & VAUGHAN, *supra* note 18, at ¶ 12.79 state:

[ex][N]ational price regulatory measures which apply without distinction to domestic and imported products alike will have prohibited effects if the price or profit margin is fixed at such a level that the sale of imported products becomes, if not impossible, more difficult than that of domestic products. It will, therefore, be incompatible with article 30 to fix prices or profit margins at such a level that imported products are placed at a disadvantage in relation to identical domestic products either because they cannot profitably be marketed on the conditions laid down or because the competitive advantage conferred by lower cost prices is canceled out.

A special system for setting import prices, as compared with the system for setting prices for local goods, could itself be a violation of the treaty, without any evidence that imports were disadvantaged in fact. The Netherlands once set prices for medicine produced domestically at a percentage of a reference price charged before a 1981 date. Because import prices in the Netherlands tended to be higher than prices in

Supreme Court has had the opportunity to do so, it too has struck down state-enacted price controls. In one of the leading Commerce Clause cases, *Baldwin v. G.A.F. Seelig, Inc.*,<sup>45</sup> the Court invalidated a New York law obliging dealers to pay the same regulated price for milk produced outside the state as for milk produced inside the state. Minimum import price requirements, in the language of Justice Cardozo, “set a barrier to traffic between one state and another as effective as if customs duties, equal to the price differential, had been laid upon the thing being transported,” the effect of which is to forgo “the consequences of competition between the states.”<sup>46</sup> More recently, the Court has reiterated its disdain for price controls by invalidating those set by reference to out-of-state prices, even in the absence of a competing in-state producer.<sup>47</sup>

Moreover, the Supreme Court has struck down state measures that amount to quotas on imports from other states. Like tariffs, the primary beneficiaries of quotas are the competing domestic producers; quotas do little to improve the public health, safety, or the environment. Also like tariffs, quotas tend to raise the price of imports. But unlike tariffs, the importer retains the premium; the state imposing the quotas gets nothing. Reflecting these principles, the GATT,<sup>48</sup> the EU,<sup>49</sup> and the Supreme Court<sup>50</sup> prohibit import quotas.

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the country of origin, it set prices for imported medicine at the manufacturer’s basic price in the country of origin as of a date in 1982. The Court of Justice concluded that the price regulations put imports at a disadvantage, apparently only because there were two different systems of setting prices. The Court did not address whether such differential treatment was justified under a “general exception,” but its general jurisprudence would probably preclude that result.

<sup>45</sup> 294 U.S. 511 (1935).

<sup>46</sup> *Id.* at 521–522.

<sup>47</sup> *See Healy v. Beer Inst.*, 491 U.S. 324 (1989) (striking down a state price ceiling on beer equal to the price charged in bordering states). The fact that beer prices were set by reference to out-of-state prices led the Court to conclude that the statute in question operated “extraterritorially” to affect prices in other states. In dissent, Chief Justice Rehnquist, joined by Justices Stevens and O’Connor, 491 U.S. at 347, noted that the disputed law may have been a remedy for “some market imperfection that permits supracompetitive prices to be charged to . . . consumers,” but they did not explain what that market imperfection might be. The case could as easily have been decided on grounds that the statute involved government intervention to increase the costs of imports, in ways not offset by any legitimate local interests. One would have hoped that government intervention, to correct a market imperfection, would have been to raise the price of beer, and not lower it.

We know of no Supreme Court case addressing whether a price ceiling, applied to domestically produced goods as well as imports, is permissible under the Commerce Clause. One rationale that might be offered for a price ceiling would be to hold down the costs of, say, public health.

<sup>48</sup> GATT art. XI. Under the GATT a country may restrict imports of fish or other “exhaustible natural resources,” but any such restriction must be “made effective in conjunction with restrictions on domestic production or consumption.” GATT art. XX(g).

<sup>49</sup> ROME TREATY arts. 30–33.

Local content requirements represent yet another barrier to the free flow of goods. By obliging producers to employ domestically produced inputs or to process outputs domestically, local content requirements temporarily protect local suppliers and processors at the expense of consumers and nonlocal competitors. Hence the EU, the GATT, and the NAFTA all ban local content and local processing requirements.<sup>51</sup> We know of no GATT or EU cases holding that local content or local processing requirements are justified under the “general exceptions” provisions. The NAFTA does not even allow “general exceptions” to its prohibition of local content requirements.<sup>52</sup> Perhaps the most obvious reason for this stalwart position on local content requirements is that they plainly fail the least intrusive alternative test.<sup>53</sup> For example, product quality inspections will almost always be available to safeguard local policy interests, and they would generally be less expensive and less intrusive while still safeguarding the goals of a common market.

On these points the jurisprudence of the Supreme Court has been remarkably similar to the jurisprudence of the EU. The Court has struck down local *content* requirements,<sup>54</sup> and has gone even

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<sup>50</sup> *See, e.g.*, *Polar Ice Cream & Creamery Co. v. Andrews*, 375 U.S. 361 (1964) (invalidating a state regulation requiring local milk processors to purchase domestically produced milk).

<sup>51</sup> The Rome Treaty bans these requirements under the basic rule proscribing “measures having an equivalent effect” to quantitative restrictions.” ROME TREATY art. 30. Commission orders first prohibited those requirements. Commission Directive 66/683, 1966 O.J. (L 220) 3748. For an example of a Commission Directive reaching nontariff barriers, see Commission Directive 70/50, 1970 O.J. (L 13) 17. For Court of Justice decisions on local content requirements, see generally Case 13/78, *Joh. Eggers Sohn & Co. v. Bremen*, 8 E.C.R. 1935, [1978–1979 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8512 (1978), where the Court of Justice addressed a German law that permitted wine to be labeled a particular quality only if 85 percent of the alcoholic content was derived from wine distillate produced in Germany, and if the wine distillate was kept for six months in casks in Germany. The Court stated the rule broadly: “[A] national measure which makes the right to use a designation of quality for a domestic product subject to the condition that the semi-finished product from which it was manufactured was either produced or treated on national territory, and refuses to allow the use of that designation simply because the semi-finished product was imported from another Member State, is a measure having an effect equivalent to a quantitative restriction.” *Id.* at 7273.

GATT art. III, ¶ 5 specifically bans an “internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product . . . be supplied from domestic sources.” *See also* Uruguay Round Agreement on Trade-Related Investment Measures, annex ¶ 1.

NAFTA art. 1106(1)(b)(c) contains the relevant provision. For the United States, the NAFTA has a few specific exceptions for existing legislation. *See, e.g.*, NAFTA art. 1108.1, annex I, I-U-23.

<sup>52</sup> NAFTA art. 2101 does not apply to the Investment chapter, which proscribes local content requirements.

<sup>53</sup> *See* note 36 and accompanying text.

<sup>54</sup> *See* *New Energy Co. v. Limbach*, 486 U.S. 269 (1988) (tax credit available only for ethanol produced in-state); *Toomer v. Witsell*, 334 U.S. 385 (1947) (requirement that shrimp caught in-state be unloaded and packed there); *Wyoming v. Oklahoma*, 502 U.S. 437 (1992) (requirement that coal-fired electric

further than the rules of international agreements by proscribing local *processing* requirements as well.<sup>55</sup> Its decisions in this area can be read as opening services for interstate competition, and allowing out-of-state service providers the same opportunities as in-state service providers. So, for instance, local governments are prohibited from requiring that all solid waste produced in a jurisdiction be processed in a local plant.<sup>56</sup> Although even an ardent supporter of economic integration might agree that such an arrangement “directly aids the government in satisfying a traditional government responsibility,”<sup>57</sup> and that such activity perhaps ought to survive Commerce Clause scrutiny under certain circumstances, the Court declared that such a requirement would “bar the import of the processing service, [and] squelch competition in the waste-processing [industry].”<sup>58</sup>

There are parallels when local measures may discriminate against imports but in fact serve essential public services, such as promoting health or safety. To deal with such potential nontariff trade

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plants burn a mixture containing at least 10 percent state-mined coal); *see also* *C & A Carbone, Inc. v. Clarkstown*, 511 U.S. 383 (1994), discussed *infra*.

<sup>55</sup> For example, the GATT does not reach local processing requirements involving services. In *Dean Milk Co. v. Madison*, 340 U.S. 349 (1951), a Madison, Wisconsin, ordinance made it unlawful to sell milk in Madison unless it had been processed and bottled at a plant within 5 miles of the city. Even though other producers in Wisconsin were affected by the legislation, the ordinance still was “an economic barrier protecting a major local industry against competition from without the State.” *Id.* at 356. A possibly countervailing interest, public health, could be protected in ways that were less burdensome.

<sup>56</sup> *See C & A Carbone, Inc. v. Clarkstown*, 511 U.S. 383 (1994) (invalidating a city local waste processing requirement).

<sup>57</sup> Assume that the city of Clarkstown, when considering the construction of the waste processing facility, had behaved rationally, with a view to minimizing the costs to taxpayers. That is, it considered alternative techniques for waste disposal, including using out-of-state processors. Assume further that, in the town’s judgment, construction of a local processing facility would be least expensive for its citizens in the long run. The community then might have agreed to send all local waste to that facility, with a view to assuring sufficient input so that the facility could process waste efficiently. On these assumptions, there could be no conceivable reason for striking down the town ordinance, even if in the short term an out-of-state processor were disadvantaged.

An alternative would be to assume that the citizens of Clarkstown, for reasons of local pride, wanted their own facility, and were willing to pay a premium to that end. Again, if the taxpayers were willing to bear that burden, it would appear to be a legitimate governmental task to undertake the construction and financing of that facility. The town ordinance again might survive Commerce Clause scrutiny, although the case is not clear, as under the first assumption.

The paradigmatic Commerce Clause case would occur if the town, to protect a locally owned *private* waste processor, would have entered into arrangements that disadvantaged its competitors in other states. The facts in *Carbone* do not provide sufficient information to determine which of these assumptions are correct. It is thus difficult to appraise the results of the decision.

<sup>58</sup> *C & A Carbone*, 511 U.S. at 392.



barriers, the EU and the GATT rely on a principle of nondiscrimination.<sup>59</sup> The EU bans burdens on interstate commerce or “trading rules ... which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade.”<sup>60</sup> Prohibitions are subject to the familiar “general exceptions” intended to protect “legitimate local interests.”<sup>61</sup> The GATT focuses on eliminating all nontariff discrimination against imports and converting them into tariffs which can then be reduced in periodic negotiations.<sup>62</sup>

In doctrine both the EU and the Supreme Court reach beyond the principle of nondiscrimination, and in many cases would prohibit restrictions on imports not meeting host country or host state manufacturing requirements, but having accurate labels to that effect. For example, EU members mutually recognize product standards set by other members. Members may not discriminate against each other’s imports on the basis of divergent product standards. Thus Germany may not block the import of a liqueur with an alcohol content lower than that fixed by German law, so long as an accurate label to that effect appears on the bottle.<sup>63</sup> A requirement that goods be labeled “foreign” would be considered discriminatory and hence not permissible in the EU.<sup>64</sup> The Court of Justice goes further and prohibits labeling requirements which are nondiscriminatory but which would set special product standards that

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<sup>59</sup> For an example of a Commission Directive reaching non-tariff barriers generally, see Commission Directive 70/50, 1970 O.J. (L 13) 17, which seeks to abolish measures which, inter alia, “lay down conditions of payment in respect of imported products only, or subject imported products to conditions which are different from those laid down for domestic products and more difficult to satisfy.” See ROME TREATY art. 2, ¶ 3(h) at 18. As noted above, these directives were issued before the end of the transitional phase, and are currently of importance as guides to interpretation.

<sup>60</sup> For a review of cases, see E. White, *In Search of the Limits to Article 30 of the EEC Treaty*, 26 COMMON MKT. L. REV. 235 (1989).

<sup>61</sup> *Id.* at 235.

<sup>62</sup> GATT art. III thus provides detailed provisions to assure “national treatment.” That is, imported products are to receive no less favorable treatment than like domestic products. GATT panels have been rigorous in their enforcement of this principle, finding as contrary to the GATT credit facilities extended to domestically produced but not imported goods.

<sup>63</sup> See *Rewe Zentral AG v. Bundesmonopolverwaltung für Branntwein*, 1979 E.C.R. 649, [1978–1979 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8543 (1979), discussed *supra* note 25. For a discussion of labeling and other presentation requirements, see 2 HAILSHAM & VAUGHAN, *supra* note 18 at ¶ 12.75, and cited works therein.

<sup>64</sup> The EU Commission took initial steps with directives. See Commission Directive 70/50, art. 2.3(j), 1970 O.J. (L 13) 17, which precludes measures that “subject imported products only to conditions in respect [of] presentation, identification or putting up, or subject imported products to conditions which are different from those for domestic products and more difficult to satisfy.” The Court of Justice has held discriminatory and contrary to article 30 an Irish requirement that souvenirs identify the place of origin or be marked as foreign. Case 113/80, *Commission v. Ireland*, 5 E.C.R. 1625, [1979–1981 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8762 (1981).

might disadvantage imports,<sup>65</sup> as well as nondiscriminatory advertising rules which could prevent consumers from obtaining information about imported products which would be relevant to their purchases.<sup>66</sup> GATT jurisprudence is similar, though hardly as extensive.<sup>67</sup>

The Supreme Court has not yet articulated a comparable doctrine, but it has in fact reached the same results. It has invalidated labeling requirements that were nondiscriminatory on their face, but discriminatory in effect. That decision was reached in *Hunt v. Washington State Apple Advertising Commission*, where the dispute was over a North Carolina statute mandating that “[a]ll apples sold, offered for sale or shipped into this State in closed containers shall bear ... no grade other than the applicable U.S. grade or standard.”<sup>68</sup> In particular, Washington growers were prohibited from posting the Washington grade on their containers, which would have increased the attractiveness of their apples. The Court’s decision in *Hunt* reached almost exactly the same results as similar Court of Justice cases, but by a more confusing route. It did not examine statistics and conclude that a large number of out-of-state apple growers were adversely affected by the statute, and hence that there was in fact discrimination.<sup>69</sup> Rather, the Court found that although the statute was facially neutral, it raised the costs to out-of-state growers, and hence it had discriminatory effects. Washington-grown apples could arrive in North Carolina from any number of routes, and it was prohibitively costly for Washington growers to isolate only those containers destined for North Carolina and remove the grades only on them. In effect, then, the statute meant that if Washington growers wanted to sell apples in North Carolina, they had to remove the Washington grades from *all* their containers. Thus the statute not only raised growers’ costs, it also eroded the market advantage they had earned through their more stringent grading system. The statute did nothing “to purify the flow of information at the retail level [or] protect consumers against the problems it

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<sup>65</sup> The Court of Justice has struck down an Italian law prohibiting the marketing of goods labeled “pasta” if made from other forms of wheat than durum wheat.

<sup>66</sup> The Court of Justice held contrary to the Rome Treaty a Luxembourg regulation that prevented advertisements from offering price reductions for a stated period. It noted that “the provision of information to the consumer is considered one of the principal requirements [of Community law].” *See* Case 362/88, *GB-INNO-BM v. Confederation du Commerce*, 1990 E.C.R. 346 (1990). Consumer protection thus could not justify a measure denying consumers information.

<sup>67</sup> *See* GATT art. IX. Australia thus complained of a Hawaii statute which in effect required that certain eggs be identified as “foreign,” later withdrawing its complaint after the Hawaiian Supreme Court struck down the labeling requirement as contrary to the GATT. *See* *Territory of Hawaii v. Harry M. Y. Ho*, 41 Haw. 565 (1957). For a discussion of the case, see JOHN H. JACKSON, *INTERNATIONAL ECONOMIC RELATIONS* 589 (1977).

<sup>68</sup> 432 U.S. 333, 339 (1977) (quoting N.C. GEN. STAT. 106-189.1 (1973)).

<sup>69</sup> In fact 13 states shipped apples into North Carolina at the time; of them, seven had their own grading systems, six apparently did not. *Hunt*, 432 U.S. at 349.

was designed to eliminate.”<sup>70</sup> A less restrictive alternative, which was similarly adopted by the Court of Justice in a German labeling case, would have been to prohibit states from imposing labeling requirements to the disadvantage of out-of-state suppliers when they deny useful information to consumers.

In still other trade areas the EU and the Supreme Court have reached parallel results. The Court of Justice has struck down requirements that sales representatives be established or deposits made in the importing state, that imported goods be subject to particular delivery conditions, and other like measures.<sup>71</sup> These requirements either burdened or discriminated against imports, and could not be justified under the “general exceptions.” In contrast, the Court of Justice has upheld measures, nondiscriminatory on their face and in their effect, which may have hindered imports but which could have been justified as appropriate protections of local interests. Examples include laws proscribing sales activities or work on Sundays, laws precluding the rental of videocassettes until a period of time passed after the movie was released, laws prohibiting door-to-door solicitation of educational materials, and laws precluding the sale in bars and restaurants of alcoholic beverages over a certain proof.<sup>72</sup>

The Supreme Court’s jurisprudence reaches as broadly as the EU’s jurisprudence, and is roughly comparable. It is replete with statements that discriminatory nontariff barriers cannot withstand scrutiny under the Commerce Clause. As for nondiscriminatory barriers, the Supreme Court has upheld nondiscriminatory packaging requirements<sup>73</sup> and laws preventing door-to-door canvassing to sell periodicals.<sup>74</sup> In both cases it found that a local policy interest outweighed the burdens imposed on interstate commerce.

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<sup>70</sup> Hunt, 432 U.S. at 353.

<sup>71</sup> For a more detailed discussion, see 2 HAILSHAM & VAUGHAN, *supra* note 18, at ¶ 12.69.

<sup>72</sup> See D.T. Keeling, *The Free Movement of Goods in EEC Law: Basic Principles and Recent Developments in the Case Law of the Court of Justice of the European Communities*, 26 INT’L L. 467, 470 (1992).

<sup>73</sup> In *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981), the Court accepted that the out-of-state plastics industry was burdened relatively more heavily than in-state industry by a requirement banning the sale of milk in plastic nonreturnable, nonrefillable containers. It found a countervailing state interest and sustained the measure. In *Pacific States Box & Basket Co v. White*, 296 U.S. 176 (1935) the Court noted that an order fixing packaging requirements for fruit did not unduly burden interstate commerce, though it was clear that the plaintiff (an out-of-stater) would lose in-state sales.

<sup>74</sup> In *Breard v. Alexandria*, 341 U.S. 622 (1951), a municipal ordinance forbade canvassing to sell goods generally. The ordinance apparently applied to all goods, whether produced in-state or not. Yet the Court did not address the question of whether it was in fact discriminatory. The Court seems simply to have balanced an admitted “burden” on interstate commerce against the local interest in protecting citizens from “practices deemed subversive of privacy and of quiet.” *Id.* at 622.

### ***Export Restrictions***

While export promotion is a major goal of state and local governments, export restrictions are rare. Nonetheless, the Supreme Court subjects state export restrictions to the Commerce Clause: If restrictions are discriminatory, they are subject to strict scrutiny. If not, the Court balances the burdens imposed on out-of-state interests against the benefits to local interests served by the measure. Agreements on economic integration start from similar foundations. In general, they preclude states from imposing burdens on exports.<sup>75</sup> Set against this rule are the familiar “general exceptions.”<sup>76</sup> The GATT adds specific exceptions permitting a member to restrict exports when “essential” goods are in short supply.<sup>77</sup> The NAFTA limits that exception for its signatories.<sup>78</sup> The Rome Treaty has no comparable exception, and apparently none is accepted in practice.<sup>79</sup> However, the EU permits restrictions to safeguard national treasures possessing artistic, historic, or archeological value.<sup>80</sup>

EU jurisprudence, unlike the Supreme Court’s, stops at the nondiscrimination test. The Court of Justice eschews any further analysis of export restrictions such as “balancing.” It does not determine, as it does for imports, whether nondiscriminatory measures are “capable of hindering, directly or indirectly, actually or potentially, intra-Community trade.”<sup>81</sup> The Court of Justice has not stated reasons for this result, but we may intuit some. First, the sheer scope of review would be much larger. Almost every

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<sup>75</sup> Like the article 30 prohibition regarding imports, article 34 of the Rome Treaty prohibits “quantitative restrictions on exports and any measures with equivalent effect.” GATT art. XI provides that “[n]o prohibitions or restrictions other than duties, taxes or other charges . . . shall be instituted or maintained by any contracting party . . . on the exportation or sale for export of any product destined for the territory of any other contracting party.”

<sup>76</sup> An exception is the EU’s permitting prohibitions or restrictions on exports justified “on the grounds of . . . the protection of national treasures possessing artistic, historic or archaeological value,” but even that condition has been construed narrowly. In Case 7/68, *Commission v. Italian Republic*, 1968 E.C.R. 617 [1967–1970 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8057 (1968), Italy had imposed a progressive charge on the value of artistic or historic objects. The Court noted that the charge simply made it more expensive to export, and did not help realize the objectives of article 36, which was to protect objects of artistic or historic value. It therefore held the contested charge could not be justified under article 36.

<sup>77</sup> GATT art. XI, ¶ 2(a); art. XX(j). *See generally* JACKSON, *supra* note 67, at 497. Under article XX(j), short supply measures “shall be consistent with the principle that all contracting parties are entitled to an equitable share of the international supply of such products.”

<sup>78</sup> NAFTA art. 315.

<sup>79</sup> While the Court of Justice has not directly addressed the issue, EC practice favors free movement of goods (and exports), and eschews controls over goods in short supply. Even when energy was in short supply, the Commission sought and was able to persuade governments to remove restrictions on the export of oil and gas, and to end attempts to reserve gas for domestic users.

<sup>80</sup> For a more detailed discussion, see 2 HAILSHAM & VAUGHAN, *supra* note 18, at ¶¶ 12.92, 12.98, and 12.105.

nondiscriminatory measure affecting local production—whether environmental controls, taxes, or social security levies—will affect exports and therefore would be subject to challenge. And because any such measure is bound to raise local production costs, it will not be “protectionist” in any traditional sense. It will not discriminate against other members of the EU. No questions of democracy would arise, because both local consumers and producers will be represented in local legislatures. In sum, the Court may simply have decided to refrain from second-guessing on a wide range of economic and social policies for each member state when the measure in question, assumed to be nondiscriminatory, would likely have only marginal impacts on the development of a common market. It thus bans discriminatory measures,<sup>82</sup> but permits nondiscriminatory measures even if they seem to negatively affect exports.<sup>83</sup>

The Supreme Court has also accepted a rule preventing discrimination against exports<sup>84</sup> and has rejected the “short supply” rationale for limiting exports.<sup>85</sup> It does not, for example, permit a state to

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<sup>81</sup> For background, see White, *supra* note 60.

<sup>82</sup> The Court of Justice has struck down measures that [ex]have as their specified object or effect the restriction of patterns of exports and thereby the establishment of a difference in treatment between the domestic trade of a Member State and its export trade, in such a way as to provide a particular advantage for national production or for the domestic market of the State in question.

Case 155/80, *In re. Oebel*, 6 E.C.R. 1993, 9210 [1979–1981 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8767 (1981). In Case 53/76, *Procureur de la Republique v. Bouhelier*, 1977 E.C.R. 197, [1977–1978 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8399 (1977), a French law required certificates of quality for exports of watches. The certificates were granted free and quickly. The Court nonetheless noted that “[t]he fact the obligatory quality standards apply only to products intended for export and are not imposed on products marketed within the Member States leads to arbitrary discrimination between the two types of products which constitutes an obstacle to intra-Community trade, governed by Art. 34.” *Id.* at 7205.

<sup>83</sup> A leading case is Case 155/80, *In re Oebel*, 6 E.C.R. 1993, [1979–1981 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8767 (1981), where the Court confronted a German law which prevented night work in bakeries (and the transport at night of those goods), and which therefore made it difficult for German bakeries to sell fresh baked goods in neighboring countries. The measure, while hindering intra-Community trade, could have been justified under the general exception for protecting “public health.” Instead the Court used an absolute nondiscrimination test. The Court observed that the rules at issue were “part of economic and social policy and apply by virtue of objective criteria to all the undertakings in a particular industry, without leading to any difference in treatment whatsoever on the ground of the traders and without distinguishing between the domestic trade of the State and the export trade.” *Id.* at 9210–9211; *see also*, Case 15/79, *P.B. Groenveld BV v. Produktschap*, 9 E.C.R. 3409, [1979–1981 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8617 (1979) (Netherlands law prohibiting sausage manufacturers from stocking or processing horse meat). In *Groenveld* the Court held that the prohibition was not incompatible with article 34 of the Rome Treaty because “it does not discriminate between products intended for export and those marketed within the Member State.” *Id.* at 7315.

<sup>84</sup> *See, e.g.*, *Oklahoma v. Kansas Nat. Gas Co.*, 221 U.S. 229 (1911). We have noted that a “local processing” requirement may discriminate against imports, because, for example, it will tend to prevent import of nonprocessed inputs. A local processing requirement for exports will discriminate against out-of-staters, which otherwise could do the processing, and such requirements have been contrary to the

reserve scarce landfill sites for the disposal of in-state garbage or to give in-state garbage a preference at those sites.<sup>86</sup> The Supreme Court's jurisprudence, in contrast with that of the EU Court of Justice (and

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Commerce Clause. *See, e.g.,* *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (invalidating an Arizona law which would have required packing in that state of cantaloupes grown there); *Foster-Foundation Packing Co. v. Haydel*, 278 U.S. 1, 9 (1928) (invalidating a Louisiana law which favored in-state canning of shrimp even though it was "more economical to can those shrimp in Mississippi.").

In *South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82 (1984), the Court struck down a local processing requirement where the vast majority of the exports were to go to Japan. A state "local processing" requirement for those exports would not appear to burden interstate commerce, or be counter to a common market within the United States. While we agree with the decision, we feel the foreign Commerce Clause would have been more appropriate authority, as the case should have turned on the proper allocation of responsibilities between state and federal governments regarding foreign commerce.

<sup>85</sup> Under *Hughes v. Oklahoma*, 441 U.S. 322 (1979), a state may not even reserve to its citizens fish and wildlife which it may claim to "own" and seek to conserve. *See also* *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982), where the Court struck down a New Hampshire statute which authorized a commission to prohibit a power company from selling power outside New Hampshire. The Court found a direct and substantial burden on transactions in interstate commerce, and suggested that the statute served to advance simple economic protectionism. For a discussion of cases prior to *Hughes*, see Vincent Blasi, *Constitutional Limitations on the Power of States to Regulate the Movement of Goods in Interstate Commerce*, in SANDALOW & STEIN, *supra* note 18, at 192. Earlier we noted that in *Philadelphia v. New Jersey*, the Court struck down a New Jersey statute limiting the import of wastes. That case is better viewed as holding that New Jersey cannot limit the use of its own resources (waste disposal sites) to its own residents. *See* note 33 and accompanying text.

Hopefully, the ruling in *Sporhase v. Nebraska*, 458 U.S. 941 (1982) will not have changed these results. In *Sporhase*, a Nebraska statute required a permit to withdraw groundwater for use in neighboring states, and gave a state official wide discretion in deciding whether to issue the permit. The statute clearly discriminated against exports of groundwater. Apparently a goal of the statute was conservation, but there was apparently no measure in place to limit consumption by Nebraskans. The statute should have been struck down on traditional Commerce Clause balancing, but the Court was reluctant to reach this result, and struck it down on other grounds (the presence of a "reciprocity" requirement). The result is best explained by reference to interstate water law.

<sup>86</sup> The landfill cases dealt with protests by in-state landfill operators over local measures making it more difficult for them to sell their services to out-of-state interests. In *Philadelphia v. New Jersey*, 437 U.S. 617 (1978), where landfill operators were among the plaintiffs, New Jersey had prohibited them from selling those services by banning the shipment of out-of-state garbage into New Jersey. In *Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334 (1992), Alabama reached a similar result by imposing a special fee on hazardous wastes generated outside the state but disposed of at a commercial facility in Alabama. In *Fort Gratiot Sanitary Landfill, Inc. v. Michigan Dep't of Nat. Res.*, 504 U.S. 353 (1992), a Michigan county denied a license to a landfill operator under a policy which did not authorize it to accept out-of-county waste. In *Oregon Waste Systems, Inc. v. Department of Env'l Quality*, 511 U.S. 93 (1994), Oregon imposed a surcharge on out-of-state waste about three times higher than in-state waste, claiming that the difference compensated Oregon for the costs of disposing of out-of-state waste. All of these cases involved state efforts to safeguard scarce in-state resources (landfill sites) for in-state interests, and to prevent their "sale" to out-of-state interests. Viewing the cases in this manner avoids the untenable position that the garbage or hazardous waste itself is the "article of commerce." In *C & A Carbone, Inc. v. Clarkstown*, 511 U.S. 383, 390 (1994), the Court appears to have finally agreed that "the article of commerce is not so much the solid waste itself, but rather the service of processing and disposing of it."

perhaps unwisely), goes further. It assesses export restrictions that are not discriminatory. The Supreme Court continues to balance the burdens of nondiscriminatory measures affecting exports against relevant local policy objectives—in effect, second-guessing local legislative judgment. In some cases, this approach has been consistent with the notion of economic integration. For example, the Court would correctly uphold some nondiscriminatory measures aimed at such specific trade goals as improving product quality,<sup>87</sup> or aimed at more general goals when the measures had only marginal impacts on exports.<sup>88</sup> On the other hand, it is exceedingly difficult to discern themes or trends in Supreme Court decisions. For example, some statutes that set minimum or maximum prices on goods (including exports) have been justified in light of local interests;<sup>89</sup> others have been struck down, with local interests all but neglected.<sup>90</sup>

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In *C & A Carbone*, the Supreme Court may have gone somewhat beyond the Court of Justice in preserving a common market in the United States. The Court of Justice recently addressed the Commission's claim that Belgium was in violation of the Rome Treaty because Wallonia had prohibited the deposit or discharge of waste from other member states. Like the Supreme Court, the Court of Justice found that waste was a good protected by the Treaty provisions on free movement of goods. For hazardous waste, which was subject to Commission Directives, the Court found that Wallonia had violated the Treaty by its prohibition: the directive established criteria and procedures which had not been followed. For nonhazardous waste, the Court of Justice found that the prohibition was not "discriminatory" in light of article 130(r), which provides that "environmental damage should as a priority be rectified at its source." Case No. C-2/90, *Commission v. Belgium*, 1992 E.C.R. I-4431 (1992).

<sup>87</sup> In *Sligh v. Kirkwood*, 237 U.S. 52 (1915), a Florida statute banned all sales of immature citrus fruits, whether to in-state or out-of-state markets. The Court concluded that the statute was a valid exercise of Florida's police powers.

<sup>88</sup> In *Milk Control Bd. v. Eisenberg Farm Products*, 306 U.S. 346 (1939), exports of products for which prices were fixed amounted to slightly more than 10 percent of total in-state production. No attempt was made in this case to suggest that price-fixing was an appropriate method to deal with what many would believe are market imperfections in the agricultural field. In *Lone Star Gas Co. v. Texas*, 304 U.S. 224 (1938), prices were apparently fixed only for gas delivered in-state and to in-state consumers.

<sup>89</sup> See *Cities Service Co. v. Peerless Co.*, 340 U.S. 179 (1950) (upholding price controls imposed to prevent the waste of natural gas); *Parker v. Brown*, 317 U.S. 541 (1943) (upholding a state-directed program for stabilizing commodity prices). In *Parker*, more than 90 percent of the commodities produced were shipped in interstate commerce. By controlling supply, the stabilization program presumably kept prices at artificially high levels. Producers were assured at least "reasonable profits," and "economic protection" of producers was in fact a stated goal of the system. *Parker*, 317 U.S. at 363. There was no price discrimination between sales in-state and out-of-state. Facts about the program are obscure. For example, if the state program were simply a method of conferring monopoly profits on what would otherwise have been competing producers, the program would raise the gravest concerns for a common market. In fact the program may have sought to correct market imperfections which some believed existed in agriculture, where increases in production and productivity meant increased supply, which depressed prices and lowered farm income. Officials of the U.S. Department of Agriculture helped design the stabilization plan, which may have been a reasonable way to assure a constant supply of a commodity over time. The Court, unfortunately, did not identify this as the "legitimate local interest" being protected,

The Supreme Court would do well to adopt the more deferential stance of the EU. A rule against discriminatory export restrictions (including restrictions that were discriminatory in effect) and eschewing balancing would do much to limit the Court's docket, while still preserving a high degree of economic integration in the United States.

### **Trade in Services and Labor Mobility**

Another fundamental tenet of integrated markets is the unencumbered flow of services and labor across borders. As with trade in goods, allowing services and labor to flow across international borders unencumbered by licensure or other restrictions minimizes market distortions and allows prices to more accurately convey information regarding relative scarcities. The absence of redundant licensure and other restrictions increases competition in the provision of services, and generally makes markets more efficient. Greater labor mobility can reduce unemployment, as workers can migrate from slow-growth or stagnant areas to areas with more labor demand. It also reduces structural rigidities in the labor market, providing workers with greater diversity of opportunity, which tends to improve job matches.<sup>91</sup>

In contrast to trade in goods, international agreements on trade in services are still in their infancy, though in some areas there has been significant progress. The NAFTA may contain one of the most comprehensive packages of trade in services liberalization to date, particularly with regard to financial services. Its overriding principles are the same as those for trade in goods: to wit, nondiscrimination as applied to cross-border trade in services. Licensing and certification requirements by the host state must be based on objective and transparent criteria (such as competence), and must not be unnecessarily burdensome. The EU further requires that host states mutually recognize licensing and certification standards. EU directives establish minimum standards in such fields as professional services,

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or examine whether the stabilization measures were the “least restrictive” technique to solve a perceived problem.

<sup>90</sup> See *Lempke v. Farmers Grain Co.*, 258 U.S. 50 (1922) (striking down a price-fixing statute designed, together with grading measures, to combat systemic fraud committed by farmers). The same local interests were later advanced to justify subsequent revisions of the statute, but the Court, in *Shafer v. Farmers Grain Co.*, 268 U.S. 189, 202 (1925), ruled, “If the evils suggested are real, the power of correction does not rest with [the local government] but with Congress.”

<sup>91</sup> This is not to say that increasing labor mobility does not also introduce problems, particularly when mobility is increased between countries with extremely divergent labor standards (e.g., industrialized nations with relatively high labor standards, and developed countries with relatively benign labor standards). For a review of the issues associated with implementing uniform international standards, see generally Richard B. Freeman, *International Labor Standards and World Trade: Friends or Foes?* in *THE WORLD TRADING SYSTEM: CHALLENGES AHEAD* 87 (Jeffrey J. Schott ed., 1996).



telecommunications, and road and air transport.<sup>92</sup> The General Agreement on Trade in Services (GATS) is the first attempt to liberalize trade in services under the auspices of the World Trade Organization. While it currently focuses on financial services, telecommunications, and air transportation services, the GATS mandates that negotiators meet periodically to continue their efforts at expanding its coverage to other services.<sup>93</sup>

The Supreme Court has yet to articulate clearly the principle that services should also be free to move across state borders, perhaps because it has often failed to understand that trade in services is the principal issue involved in some cases. For example, in *Philadelphia v. New Jersey*,<sup>94</sup> a case that involved a state ban on the storage of waste originating outside the state, the Court deemed the waste itself the article of commerce, although one generally does not associate *waste* with *goods*. Viewed this way, it would appear that the Court decided that import bans were per se unconstitutional. But the real dispute was over a service, namely, waste *storage* on scarce landfill space.

By the mid-1990s, with its decision in *C & A Carbone v. Clarkstown*,<sup>95</sup> the Court seemed to finally recognize the relevance of certain services in interstate commerce. *Carbone* involved a local government ordinance mandating that all town waste be disposed of at a designated local processing facility. The Court struck down that law essentially on the grounds that it discriminated against out-of-state waste disposal facilities, that is, out-of-state service suppliers. Thus while it has been hesitant to explicitly articulate a doctrine about the free cross-border flow of services, the Court has obliquely done so in some of its Commerce Clause cases. The rule appears to be that trade in services is not to be burdened unless there are compelling reasons to protect essential state interests. So while the Supreme Court obviously cannot issue EU Commission-style directives to that effect—a semblance of that role more properly belonging to the Interstate Commerce Commission—it has supported national uniformity in areas such as the interstate transport of goods by truck and, for rail transport, by car lengths.

With the possible exception of the EU, international agreements regarding labor mobility have not enjoyed the same level of progress as trade in goods and services. Europe has long had a high degree of labor mobility, and labor mobility is a principal tenet of the EU.<sup>96</sup> Under the European Economic

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<sup>92</sup> Among the professional services, those in health-related industries enjoy the greatest amount of mobility in the EU member states. *See, inter alia*, 2 HAILSHAM & VAUGHAN, *supra* note 18, at ¶¶ 16.112–16.127.

<sup>93</sup> *See generally* JEFFREY J. SCHOTT & JOHANNA W. BUURMAN, THE URUGUAY ROUND: AN ASSESSMENT 99–111 (1994).

<sup>94</sup> 437 U.S. 617 (1978). *See also supra* notes 33, 34, and 86 and accompanying text.

<sup>95</sup> 511 U.S. 383 (1994). *See also supra* note 86 and accompanying text.

<sup>96</sup> 2 HAILSHAM & VAUGHAN, *supra* note 18, at ¶ 15.01 remark:

Community Treaty, workers may not be discriminated against on the basis of nationality. Subject to the familiar “general exceptions,” workers are free to accept offers of employment, and to move freely within the territory of member states.<sup>97</sup> In contrast, other international agreements remain far less liberal. Even U.S. state and local governments retain assorted residency requirements that prevent out-of-state workers from entering trades. Moreover, states generally have citizenship requirements that bar alien residents from working in-state.

When challenged, many state and local government residency requirements have been struck down. The Supreme Court, calling upon the Privileges and Immunities Clause,<sup>98</sup> has invalidated, *inter alia*, a city ordinance mandating a 40 percent residency requirement for all labor employed by municipal contractors, a state law mandating resident hiring preferences for all employers in the state’s oil and gas extraction sector, a state license fee charging nonresidents significantly more than residents for the same license, and a state law prohibiting nonresidents from being admitted to the bar.<sup>99</sup> While the Court has refrained from declaring all residency requirements unconstitutional, excessive residency requirements seem destined to fail constitutional scrutiny.

In addition, states impose citizenship requirements for participation in various activities, including certain professions. The Privileges and Immunities Clause does not apply here, as it only applies to *citizens* of the United States. Nevertheless, the Constitution also protects certain rights inhering in *persons*, regardless of their nationality. The Fourteenth Amendment mandates that states apply their laws equally to everyone,<sup>100</sup> and in practice the Supreme Court has closely scrutinized statutory

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[ex]The freedom of movement for workers is now recognised as one of the Community’s principal foundations, together with the freedom of movement for goods, services, and capital. It is not a mere adjunct to the Community’s economic policies but is a social objective in its own right.

<sup>97</sup> See TREATY ESTABLISHING THE EUROPEAN COMMUNITY art. 48(2)-(3), March 25, 1957, 1997 O.J. (C 340) 197. See also 2 HAILSHAM & VAUGHAN, *supra* note 18, at ¶¶ 15.01–15.38.

<sup>98</sup> “The Citizens of each State shall be entitled to the Privileges and Immunities of Citizens in the several States.” U.S. CONST. art. IV, § 2, cl. 1. See also U.S. CONST. amend. XIV, § 1 (“No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States”).

<sup>99</sup> See generally *United Bldg. & Constr. Trade Council v. Mayor of Camden*, 465 U.S. 208 (1984) (striking down a municipal ordinance requiring 40 percent of municipal contractors be residents); *Hicklin v. Orbeck*, 437 U.S. 518 (1978) (striking down a state law conditioning oil and gas extraction leases, easements or right of way permits on residency); *New Hampshire v. Piper*, 470 U.S. 274 (1985) (striking down a state law conditioning admission to state bar on residency).

<sup>100</sup> “[N]or shall any State ... deny to any person within its jurisdiction the equal protection of the laws.” U.S. CONST. amend. XIV, § 1.

classifications based on alienage.<sup>101</sup> Close judicial scrutiny means that states may not preclude alien residents from obtaining certain professional licenses or jobs, nor even from receiving certain welfare benefits or state-funded financial assistance for higher education. A very narrow exception is for government jobs of a policy nature, such as serving as a police officer or teaching school. However, even against this somewhat confusing background, numerous state citizenship requirements are probably unconstitutional.

## Investment

It is widely recognized that foreign direct investment brings enormous benefits to the host country. In addition to the advantages that naturally arise from increased competition in capital markets, direct investment is one of the principal vehicles for technological spillovers between countries, and between regions of the same country. Investment enhances productivity, which in turn fuels growth. Thus an important element of an integrated economy is the free flow of investment capital.<sup>102</sup>

Agreements on economic integration encourage the free flow of investment capital by adhering to a principle of nondiscrimination. For example, the Rome Treaty prohibits member-hosts from discriminating against foreign member-investors. Member-investors have a “right of establishment,” which means they can invest, establish new businesses, and acquire existing businesses free from discriminatory bias.<sup>103</sup> Moreover, hosts may not discriminate against capital once it has already been

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<sup>101</sup> See, e.g., *Graham v. Richardson*, 403 U.S. 365 (1971) (striking down a state law conditioning welfare benefits on residency).

<sup>102</sup> See generally Edward M. Graham, *Direct Investment and the Future Agenda of the World Trade Organization*, in Schott (ed.), *supra* note 91, at 205.

<sup>103</sup> The Rome Treaty provides for the “progressive abolition” of restrictions on “freedom of establishment” on a nondiscriminatory basis. ROME TREATY art. 52. The right of establishment applies to both individuals and corporations, and includes the right to pursue activities both as a self-employed person and to set up and manage enterprises in a member state. ROME TREATY art. 58; see also 2 HAILSHAM & VAUGHAN, *supra* note 18, at ¶ 16.02. The Court of Justice has held that article 52 applies directly (to preclude discrimination based on nationality), even though the Council had failed to issue directives for liberalization called for in articles 54 and 57. See Case 2/74, *Reyners v. Belgian State*, 5 E.C.R. 631, [1974 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8256 (1974). Prior to *Reyners*, the Council had issued numerous directives to end restrictions in such fields as food manufacturing and the film industry. For more background, see 2 HAILSHAM & VAUGHAN, *supra* note 18, at ¶¶ 16.64–16.73.

The investment provisions of the NAFTA appear to be based on the same philosophy as the EC. They apply a principle of nondiscrimination, called “national treatment,” to the establishment of new businesses and the acquisition of existing businesses. The principle also applies to those businesses once established. See NAFTA art. 1102.

In the field of international investment, a vast network of bilateral treaties sets the basic rules. See THE WORLD BANK GROUP, *LEGAL FRAMEWORK FOR THE TREATMENT OF FOREIGN INVESTMENT* (1992). While in general investment treaties do not call for nondiscriminatory treatment toward establishments

invested and has lost some of its mobility.<sup>104</sup> Foreign nationals and foreign-owned companies can freely transfer capital to and from their businesses (subject, in some cases, to balance of payments exceptions).<sup>105</sup> Although the EU has yet to fully implement these principles, it will almost certainly give substance to them in coming years.<sup>106</sup>

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(but rather subject inward investment to the host state's laws, *Id.* at 24–25), some treaties do call for nondiscrimination toward establishments, *see, e.g.*, Treaty of Friendship, Commerce and Navigation, Apr. 2, 1953, U.S.-Japan, art. VII, 4 U.S.T. 2065 [hereinafter “FCN-Japan”], as do a few of the U.S. bilateral investment treaties. *See* Kenneth J. Vandavelde, *The Bilateral Investment Treaty Program of the United States*, 21 CORNELL INT'L L. J. 201, 216 (1988); Investment Treaty, U.S.-Senegal, art. II, S. Treaty Doc. No. 15, 99th Cong., 2d Sess. (1986); Investment Treaty, U.S.-Cameroon, art. II, S. Treaty Doc. No. 22, 99th Cong., 2d Sess. (1986).

<sup>104</sup> ROME TREATY art. 58 thus provides that “[c]ompanies ... formed in accordance with the law of a Member State and having their registered office ... or principal place of business within the Community shall ... be treated in the same way as natural persons who are nationals of Member States.” *See generally* HAILSHAM & VAUGHAN, *supra* note 18, at ¶¶ 16.25. For a similar approach to treaty practice, *see* NAFTA art. 1102.2; FCN-Japan, *supra* note 103, art. VI; and art. II of the investment treaties cited *supra* note 103.

<sup>105</sup> ROME TREATY art. 67 provides for “free movement of capital”; members are to progressively abolish “all restrictions on the movement of capital ... and any discrimination based on the nationality or on the place of residence of the parties.” *Id.* Council Directive 88/361, 1988 O.J. (L 178) 5, implemented this provision after decades of slow movement. It obliges members to abolish restrictions on movements of capital between residents of member states. Capital is broadly defined to include direct investments and long-term loans.

NAFTA art. 1109 calls for free transfer for both inward and outward remittances. *See* FCN-Japan, *supra* note 103, art. XI for an example of a qualified “free transfers” provision, and THE WORLD BANK GROUP, *supra* note 103, at 34.

As an example of a balance of payments exception, Council Directive 88/361 permits the Council to authorize a member state to take protective measures where short-term capital movements of exceptional magnitude impose severe strains on foreign-exchange markets and lead to serious disturbances in the conduct of a member state's monetary and exchange rate policies.

<sup>106</sup> The Maastricht Treaty amends the Rome Treaty provisions on free movement of capital. Article 73(b) abolishes all restrictions on the movement of capital and payments within the EU, but subject to other provisions in the chapter. Article 73(d) permits members to maintain restrictions on the right of establishment which are compatible with the Treaty (and therefore its provisions on nondiscrimination), to apply tax laws to taxpayers in differing situations, to take measures to prevent infringements of national law and regulations, and to take measures “which are justified on grounds of public policy or public security.” Those measures, however, must not “constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Art. 73(b).”

MAASTRICHT TREATY art. 73(d)(3). “Public policy” is apparently a narrower exception in the Rome Treaty than in English (or U.S.) law, and will not be a concept permitting wholesale exceptions to the basic principles. *See* HAILSHAM & VAUGHAN, *supra* note 18, at ¶ 12.100.

Under certain narrowly defined circumstances, international agreements do allow some discriminatory treatment of foreign direct investment.<sup>107</sup> However, they do not recognize “general exceptions,” like those applicable to trade in goods, permitting states to discriminate for the purpose of advancing public health, safety, the environment, or like local policy interests. The intuition here is that because direct investment will typically be located (or about to be located) in the host country, the local policymaker will not need to single out foreign-owned local businesses in order to promote local public health, safety, or welfare. It can simply regulate foreign-owned businesses and domestically owned businesses simultaneously within the same regulatory framework. Thus if a given state wants to ban gambling casinos because it believes gambling would adversely affect the welfare of its citizenry, it makes no sense to ban foreign-owned casinos but not domestically owned casinos. The EU Court of Justice generally defers to such policy choices, wisely opting not to engage in Supreme Court-style balancing. While it is true that in some situations a host state may have a legitimate interest in imposing requirements on new investment, perhaps to assure that the investors have the character or financial strength to conduct a particular trade,<sup>108</sup> those requirements should presumably apply equally to new in-state investors as well. Otherwise, the claim that the regulation is intended to protect a legitimate local interest lacks credibility. This may explain why the NAFTA’s “general exceptions” do not apply with respect to the Investment Chapter.<sup>109</sup>

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<sup>107</sup> For example, virtually all common markets have exceptions permitting differential treatment of individuals crossing borders in connection with an investment. Under article 56 of the Rome Treaty, members can take measures “providing for special treatment for foreign nationals on grounds of public policy, public security or public health.” That addresses only measures related to natural persons. *See HAILSHAM & VAUGHAN, supra* note 18, at ¶ 16.23; *see also* NAFTA, ch. 16.

Sensitive sectors or matters may also require special treatment, for political or other reasons. Among the examples is transportation, which is dealt with specially in article 61(1) of the Rome Treaty. Maritime transport is generally excepted (in annex II) from the principles prohibiting future discrimination in the NAFTA. Even in “sensitive sectors,” such as banking, the EU has achieved considerable liberalization. The Second Banking Directive thus allows EU banks, when authorized to operate in their “home state,” to provide services and open branches in other member states without having to obtain separate authorization from their banking authorities. *See* David Reid and Andrew Ballheimer, *The Legal Framework of the Securities Industry in the European Community under the 1992 Program*, 29 *COL. J. TRANS’L L.* 103 (1991). Other exceptions would grandfather in all or some existing measures, so rules on nondiscrimination would not apply. *See* NAFTA art. 1108, annexes I–II.

<sup>108</sup> We noted above that agreements on economic integration do permit immigration restrictions on individual investors seeking to cross national borders. In those circumstances the “general exceptions” to such principles of nondiscrimination would of course apply.

<sup>109</sup> NAFTA art. 2101.

Although the U.S. Supreme Court has reached sound results in some investment cases,<sup>110</sup> its jurisprudence stands in marked contrast to the rules in international agreements.<sup>111</sup> The Court has not accepted a basic tenet of common markets that capital should freely flow to its most productive uses.<sup>112</sup> While it has come close,<sup>113</sup> it has not yet articulated a principle resembling the EU’s “right of establishment.” It generally does not accept that “interstate commerce” can include cross-border investment. Rather, the Court has grasped for links to interstate commerce, such as finding jurisdiction because the investment was carried over the mails or other traditional media of interstate commerce.<sup>114</sup>

More important, the Court’s approach to disciplining state measures affecting investment flows has not been as rigorous as its approach to disciplining trade in goods. It has been shy about applying the

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<sup>110</sup> Examples include *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27 (1980), discussed *infra* note 113, and *Edgar v. Mite Corp.*, 457 U.S. 624 (1982), striking down an Illinois statute that imposed procedural and other obstacles on out-of-state tender offers.

<sup>111</sup> We put to the side questions about when an out-of-state corporation is “doing enough business” that it must obtain a certificate of authority to transact business in-state. *See* REV. MODEL BUS. CORP. ACT § 15.01 (1991); *see also* TRIBE, *supra* note 35, at 439. Commerce Clause jurisprudence has limited assertions of state jurisdiction when out-of-state interests lack sufficient nexus in a state to comply with these rules. *See, e.g.*, *Dahnke-Walker Milling Co. v. Bondurant*, 257 U.S. 282 (1921); *Allenberg Cotton Co. v. Pittman*, 419 U.S. 20 (1974); *Bendix Autolite Corp. v. Midwesco Enters., Inc.*, 486 U.S. 888 (1988). Conversely, when an out-of-state corporation does have sufficient nexus in-state, it should obtain a license to transact business in the host state, and failure to do so should subject it to penalties. *See, e.g.*, *Union Brokerage Co. v. Jensen*, 322 U.S. 202 (1944); *Eli Lilly & Co. v. Sav-on Drugs, Inc.*, 366 U.S. 276 (1961).

<sup>112</sup> Vestiges may remain of the doctrine that a state has power to completely exclude a foreign corporation from investing in a domestically owned business with operations wholly within the state and not affecting interstate commerce at all. Amici briefs in *Lewis v. B.T. Inv. Managers, Inc.*, 447 U.S. 27 (1980), made such an argument. Perhaps because states compete for new investment, we have not been able to find cases, other than those mentioned in the text or footnotes, where a state has imposed a clear restriction on an inward investment or has discriminated against an existing investment.

<sup>113</sup> The Court has affirmed that burdens exist when a state prevents a foreign enterprise from competing in local markets, but whether this applies to investing in local markets is not clear. In *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27 (1980), the Court unanimously struck down a Florida statute which was apparently enacted to keep Bankers Trust from establishing a subsidiary to provide portfolio investment advice. The goal of the statute was “economic protectionism,” and any state interest could have been protected by less intrusive means. While not protecting “investment” as such, the Court noted that the statute “overtly prevents foreign enterprises from competing in local markets.” *Lewis*, 447 U.S. at 39.

<sup>114</sup> In *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), the Court, without discussing whether interstate commerce was limited to “trade” or included “investment,” simply found that interstate commerce was implicated because tender offers are communicated by means of interstate commerce, and securities are tendered and transactions closed by similar means.

rule of nondiscrimination.<sup>115</sup> While the Court has found discrimination in trade in goods cases even when a significant number of out-of-state goods were not adversely affected by a trade measure, it has tended to focus on trade effects rather than discrimination in cases where the real issue has been the burden on cross-border investment.<sup>116</sup> And instead of balancing, it has upheld some measures as falling within the state's regulatory discretion even though there were significant burdens on transactions between both in-state and out-of-state interests.

The Court's decision in *Exxon Corp. v. Governor of Maryland* illustrates the weakness of its approach.<sup>117</sup> In *Exxon*, a Maryland statute prevented producers or refiners of petroleum products from operating retail service stations in the state. Producers or refiners were therefore required to divest themselves of their service stations, and owners of retail stations were prevented from investing "backwards" into production or refining operations. The Court did not focus on whether a large portion of the targeted class were in fact from out of state. Rather, it found that investors were not discriminated against since *some* non-Maryland investors were *not* affected by the statute. Furthermore, the Court found no "protected" Maryland interests, private or public, as there were no local producers or refiners. It thus did not systematically compare the treatment of out-of-state *investors* with in-state *investors*. In fact

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<sup>115</sup> In *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27 (1980), the Court refrained from concluding that a discriminatory statute was per se invalid, even though a "neutral" statute was aimed at a single out-of-state investor. It instead found the "burden" on interstate commerce was not justified by legitimate local concerns.

<sup>116</sup> In *H.P. Hood & Sons v. DuMond*, 336 U.S. 525 (1949), petitioner operated three licensed milk-receiving depots in New York for milk to be distributed in Boston. New York denied petitioner a fourth depot under a law requiring that the Commissioner reject applications if it finds that issuance would tend to be destructive for local competition. Competitors opposed the license. Not surprisingly, the Commissioner concluded that a fourth depot would (1) divert milk from other distributors' depots, thus tending to reduce their volume and increase their milk handling costs, and (2) would tend to deprive local markets, like Troy, of a milk supply needed during the short season. The Court summarily rejected the second reason, citing *Milk Control Bd. v. Eisenberg Farm Products*, 306 U.S. 346 (1939), which precluded states from reserving resources for their citizens. As Justice Jackson incredulously asked, "May Michigan provide that automobiles cannot be taken out of that State until local dealers' demands are fully met?" *Hood*, 336 U.S. at 538. But the true issue in *Hood* was not the trade effects of the measure, but rather the fact that an out-of-state party desired to invest in a competing business within the state. Presumably, the state would not have prevented a domestic interest from doing the same.

In *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), the Court addressed Maryland's ability to limit investment from out of state, but the Court proceeded as if burdens on trade were the principal issue. The Court found no discrimination against interstate commerce because, "[p]lainly, the Maryland statute does not discriminate against interstate goods." *Id.* at 125. The Commerce Clause "protects the interstate market, not particular interstate firms, from prohibitive or burdensome regulations." *Id.* Even if firms were excluded from the market, there was "no reason to assume that their share of the entire supply will not be promptly replaced by other interstate refiners." *Id.* at 127 n.16.

<sup>117</sup> 437 U.S. 117 (1978).

virtually all the targeted investors were from outside Maryland, and there were few non-Maryland investors not affected by the statute.<sup>118</sup> By prohibiting producers and refiners from owning retail gasoline stations, the statute protected Maryland *investors* from non-Maryland *investors* desiring to compete in the sale of gasoline. Maryland of course argued that it had a good reason for singling out producers and refiners for special treatment, as it was concerned about predatory pricing and the inequitable allocation of petroleum products by integrated firms. However, federal statutes had already addressed those concerns.<sup>119</sup> Maryland thus had no valid reason for the measure.<sup>120</sup> On these facts a Court that focused on investment flows and the differences in the treatment between in-state and out-of-state investors clearly would have found discrimination under the Commerce Clause.

As with agreements on economic integration, the Supreme Court may have decided to prohibit discrimination against investors and their investments, but not to balance nondiscriminatory burdens on investment flows against legitimate local policy interests. However, it has not formally stated this rule. Perhaps mindful of the extensive federal regulation of interstate investment, it has simply elevated one state interest—regulating corporations—to an almost absolute standard, allowing it to overcome any burden on interstate commerce.<sup>121</sup>

Fortunately, U.S. markets are already so integrated that state investment restrictions generally do not impose significant burdens on interstate investment. In many cases what restrictions there are can be

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<sup>118</sup> Some out-of-staters (e.g., Giant Food and Sears, Roebuck & Co.) could maintain their investments in company-operated stations. Justice Blackmun, dissenting, stated that of the 233 company-operated stations, 197 belonged to out-of-state integrated producers or refiners, with 34 operated by nonintegrated companies that would not have been affected by the Maryland statute. *Id.* at 137–138.

<sup>119</sup> See *Exxon*, 437 U.S. at 144, for citations to both Maryland and federal statutes which prohibited predatory pricing and unfair allocations.

<sup>120</sup> The district court had held that the divestiture provisions were an unconstitutional taking. See *Governor of Maryland v. Exxon Corp.*, 370 A.2d 1102, 1117 (Md. 1977).

<sup>121</sup> In *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69 (1987), an Indiana statute permitted “disinterested” shareholders in a public corporation (by majority vote) to determine whether to grant voting rights to a tender offeror purchasing “control shares” (a minimum of 20 percent of total voting power). The statute applied, *inter alia*, to companies with 100 or more shareholders if incorporated in Indiana and with substantial assets in Indiana, even if as many as 90 percent of its shareholders were not Indiana residents.

In addressing that measure, the Court did not carefully examine “legitimate local interests.” Indiana in its brief had described these interests in some detail, but the Court chose not to address them. Instead it found that Indiana’s “corporate governance” legislation simply fell within a state’s prerogatives. “The very commodity that is traded ... is one that owes its existence and attributes to state law. Indiana need not define these commodities as other states do; it need only provide that residents and nonresidents have equal access to them.” *Id.* at 94. The Court simply assumed a “burden” on interstate commerce, without noting that the Indiana statute affected not only investment flows into Indiana (when the tender offeror purchased shares of Indiana residents) but also investment flows between an out-of-state investor



overcome by simply establishing a subsidiary corporation in-state. Should one of these rare state statutes be challenged, the Supreme Court could correct itself, and accept that free cross-border flow of capital is a key element in an integrated market. Agreements on economic integration suggest that the Court should first recognize that cross-border investment flows, and the activities of in-state investment owned by out-of-state investors, involve interstate commerce. The Court can accomplish this by forthrightly declaring that investment is an item of interstate commerce, thereby protecting investment flows by calling into action the principle of nondiscrimination and strict scrutiny. Second, the Court should eschew the balancing test for state actions it finds nondiscriminatory, and generally prohibit exceptions to safeguard local interests.

### **FISCAL AND INDUSTRIAL POLICIES**

Local fiscal policies can impose significant barriers to economic integration. Logically, local policymakers focus on local interests and therefore tend to discount the impact their policies may have on the country as a whole, or even on other countries. Indeed, under certain circumstances, local policies may even “impede or frustrate [national] foreign policy.”<sup>122</sup> But there are other problems, more subtle and perhaps more damaging to the country as a whole. When one state pursues a policy of offering subsidies or other incentives in order to attract investment, or perhaps to prevent it from leaving, other states feel compelled to adopt the same policy, or risk forgoing a share of the economic pie. Game theorists call this scenario a “prisoner’s dilemma.” States would likely be better off if no state participated in wasteful incentive programs, instead spending the money on competing arrays of public services or tax cuts. But when one state aggressively pursues a high-profile company looking to open a new plant, other states rightly conclude that unless they offer similar incentives, they are likely to lose out. This issue has gotten so out of hand that the Federal Reserve Bank of Minneapolis sponsored a conference on it entitled “The Economic War Between the States.”<sup>123</sup>

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and out-of-state shareholders. (The Court of Appeals had assumed that “the vast majority” of CTS’s shareholders were nonresidents. *See Dynamics Corp. v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986).)

<sup>122</sup> *See* Brenda S. Beerman, *State Involvement in the Promotion of Export Trade: Is It Time to Rethink the Concept of Federalism as It Pertains to Foreign Relations?* 21 N.C. J. INT’L L. & COM. REG. 187, 199 (1995); *see also* Richard B. Bilder, *The Role of States and Cities in Foreign Relations*, 83 AM. J. INT’L L. 821 (1989).

<sup>123</sup> Proceedings of the conference, held in Washington on May 21–22, 1996, appear in the June 1996 issue of THE REGION.

The prisoner's dilemma problem may be even more acute when states target their incentives at foreign firms.<sup>124</sup> First, it is possible that states tend to offer more generous incentive packages to foreign firms, directly raising the costs of such programs relative to those offered to domestic firms. The competition among the states for foreign firms is more intense, perhaps because they tend to represent higher-profile conquests than domestic firms. But whether or not foreign firms receive better incentive packages than domestic firms, their incentive packages represent a redistribution of economic rents away from the United States. Second, a foreign firm that is the subject of a bidding war among the states may be able to exercise undue political influence over the "winning" state. As to whether or how much this actually occurs, we can only speculate, but a growing number of scholars recommend that the federal government either regulate or ban altogether such state behavior.<sup>125</sup>

This section examines how the Supreme Court and international agreements have treated fiscal and industrial policies that distort or impede free trade. We find that, in contrast to trade in goods or services, the Supreme Court by and large lags far behind the international agreements, although both have considerable progress to make.

### **Taxes and Subsidies**

In the area of taxation, the EU follows a policy of nondiscrimination, similar in principle to the policies governing trade in goods.<sup>126</sup> In theory, imported goods are not to be taxed differently from like or competing domestic goods. One of the pitfalls to be avoided is double taxation. This problem often arises in Europe because of the value-added tax (VAT). If the host country does not properly credit the previously paid VAT, double taxation can occur. Another feature of the EU is that, upon a finding of discriminatory taxation, the host country has a choice: It can either reduce or align the offending tax so as to nullify the discriminatory effect, or it can raise the relevant domestic tax so that domestic producers are equally burdened.

The Supreme Court has treated taxation differently from the EU. A tax passes constitutional muster under the Commerce Clause if it (1) is applied to an activity with a substantial nexus within the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is

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<sup>124</sup> The discussion in this paragraph draws from EDWARD M. GRAHAM AND PAUL R. KRUGMAN, *FOREIGN DIRECT INVESTMENT IN THE UNITED STATES*, 89–90 (3d ed. 1995).

<sup>125</sup> See generally, GRAHAM & KRUGMAN, *supra* note 124, at 141; see also NORMAN GLICKMAN AND DOUGLAS WOODWARD, *THE NEW COMPETITORS: HOW FOREIGN INVESTORS ARE CHANGING THE U.S. ECONOMY* (1989); Melvin L. Burnstein and Arthur J. Rolnick, *Congress Should End the Economic War Among the States*, 9 *THE REGION* 3 (1995).

<sup>126</sup> This discussion draws mainly from 2 HAILSHAM & VAUGHAN, *supra* note 18, at ¶¶ 20.01–20.02, 20.07, and 20.13–20.14.

fairly related to the services provided by the state. Like the EU's tax policy, the Court's tax tests are strikingly similar to the trade tests under the Commerce Clause: In both there is a rule against discrimination.

International agreements and the Supreme Court deal specially with subsidies, which raise very different political and economic issues than regulatory restrictions. A first step is to be clear about their place in an integrated economy. A properly tailored subsidy can facilitate the operation of a common market by overcoming externalities and other market failures. For example, suppose junked vehicles were clogging up the highways in a given state, adversely affecting the environment and endangering traffic.<sup>127</sup> Say someone came along to haul one of the cars to a scrap dealer. He reaps the value of the car as scrap, say \$25, but he also conveys a benefit to society as a whole, say \$50, since he removed an unsightly and dangerous vehicle from the roadside. Suppose further that the cost of hauling such a car away is \$30. A problem now arises: From society's point of view, it would be economically efficient to haul the cars away, but no one would find it worthwhile to do so because the private cost (\$30) exceeds the private benefit (\$25). In these circumstances a state legislature might be willing to subsidize scrap processors, say at \$10 per vehicle. Processors would then bid the price of scrap up to some amount above \$30, making it profitable for haulers to haul the cars away. The streets would be safer and society, the haulers, and the processors would all be better off. This would clearly be a reasonable use of state resources, and it illustrates the principle behind state spending for such "public goods" as roads, education, law enforcement, and the like.<sup>128</sup> Such programs ought not to run afoul of the Commerce Clause.

However, subsidies may also undermine the goals of a common market. Governments may use subsidies for wholly protectionist reasons, favoring an inefficient producer, say, by enabling it to undersell more efficient producers both in-state and out-of-state. The sole constraint is the (un)willingness of taxpayers to foot the bill. And taxpayers may rationally opt to remain ignorant of the details of a particular program, especially if its total costs, whether in the form of direct outlays or tax expenditures, are not well publicized. Such a subsidy could have even more pernicious effects than a tariff, which

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<sup>127</sup> This scenario broadly describes the facts in *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976), discussed *infra*.

<sup>128</sup> A pure "public good" is a good possessing two distinct qualities: First, once the good is produced, the producer cannot prevent anyone who wants to from consuming it. Second, the consumption of the good by one individual has no effect on the consumption of the good by another individual. Hauling a junk car away results in a by-product—namely, a cleaner, safer environment—which is a public good because everyone benefits from it and no one person's enjoyment affects anyone else's. For a more detailed discussion of public goods, see PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, *ECONOMICS* 31–33 (15th ed. 1995).

operates only on imports. Of course, other jurisdictions may match a subsidy, thereby leveling the playing field somewhat. But that sort of behavior quickly reduces to a bidding war among the states, which is fiscally and economically unsound.

Even when confronted with major political constraints and difficult economic policy judgments, the negotiators of international agreements have agreed on specific rules for a variety of subsidies. We begin by analyzing the challenges associated with incentive packages to lure out-of-state and foreign investors into locating manufacturing or production facilities in-state.

### **Incentive Packages**

An incentive package is a combination of tax exemptions and credits, loans, and other financial devices that are targeted to a particular investor for the purpose of enticing it to locate its manufacturing or production facilities in the host state. International agreements on economic integration seldom address incentive packages, although export subsidies for industrial products are outlawed in the GATT,<sup>129</sup> the Rome Treaty,<sup>130</sup> and the NAFTA.<sup>131</sup> The GATT also prohibits subsidies to purchasers of domestic goods, while permitting states to take “countervailing” or “remedial” action, in limited circumstances, to offset subsidies by others.<sup>132</sup> At the same time the GATT condones production subsidies, obliging states only to seek to avoid them.<sup>133</sup> The NAFTA prohibits incentives given for local content and volume requirements, but allows exceptions for investment incentives linked to expand production, train workers, and carry out research and development.<sup>134</sup> Generally, however, trade agreements do not address incentive packages, nor do any of the vast network of U.S. investment treaties.

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<sup>129</sup> GATT art. XVI.

<sup>130</sup> Commission attention to export subsidies has meant “the elimination of aid for intra-Community exports—or at least overt aid.” See *Fair Competition in the Internal Market: Community State Aid Policy*, 1 EUROPEAN ECONOMY 48, 72 (1991) [hereinafter *Community State Aid Policy*].

<sup>131</sup> NAFTA art. 103 reaffirms the GATT prohibition against export subsidies (except on primary products), and in article 705 the parties have agreed to cooperate in an effort to achieve an agreement under the GATT to eliminate export subsidies for agricultural goods.

<sup>132</sup> See *The Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade*, B.I.S.D. (26th Supp.) at 56 (1978–1979).

<sup>133</sup> See *United Kingdom Complaint on Italian Discrimination against Imported Agricultural Machinery*, B.I.S.D. (7th Supp.) at 60 (1958).

<sup>134</sup> NAFTA art. 1106(3)-(4).

Against this background stands the EU. Article 92 of the Rome Treaty prohibits any aid which “distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods.”<sup>135</sup> Exceptions to this general principle permit, *inter alia*,

[ex]aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned[,] aid to promote the economic development of areas where ... there is serious unemployment[, and aid] to remedy a serious disturbance in the economy of a Member State.<sup>136</sup>

The Rome Treaty sets procedures to give substance to these rules, and the European Commission has issued interpretive guidelines.<sup>137</sup> For example, the EC has set limits on the incentives member states may offer a prospective investor. These limits were tested recently when the Brussels Regional Authority proposed a property tax exemption and an investment grant of 8 percent of the investment sum of each of six projects by Volkswagen Bruxelles SA.<sup>138</sup> The programs aimed at increasing production efficiency and restoring employment in the region. The Commission, however, did not believe that unemployment in the Brussels area was high enough to qualify under the treaty exception for “aid to promote the economic development of areas where ... there is serious unemployment.” It permitted only a portion of the grants, amounting to less than 10 percent of the original proposal.<sup>139</sup>

In the United States, as we have already discussed, the use of incentive packages has become a major policy instrument for the nation’s governors and state legislators. Few question the constitutional authority of Congress to regulate such opportunistic behavior, but the stakes have gotten so high that some question whether a majority can ever be formed at the federal level to get sound regulation under way.<sup>140</sup> A governor seeking reelection simply will not give up state subsidies. And as we pointed in subsection 4.1, some subsidies may actually lead to favorable results. It seems that, at least for the short run, the burden will fall on the Supreme Court to restore some measure of control. The Court’s instrument

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<sup>135</sup> 1 HAILSHAM & VAUGHAN, *supra* note 18, at ¶ 7.03 note that

[ex]The concept of aid is ... wider than that of a subsidy because it embraces not only positive benefits ... but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking.

<sup>136</sup> ROME TREATY art. 92.

<sup>137</sup> For example, member states must advise the Commission of state aid programs per article 93(3), which has authority to disallow it (after consultations), per article 93(2). The Commission has also set ceilings on the volume of aid in particular sectors. *See* Community State Aid Policy, *supra* note 130, at 58, 65.

<sup>138</sup> The 8 percent limit was set by Commission Decision 91/254, 1991 O.J. (L 123) 46.

<sup>139</sup> *Id.*

is the Commerce Clause, with some minor interpretive modifications inspired by international agreements.

The Court should harmonize its rules for tax exemptions and subsidies. Although they are functionally equivalent, the Court will often ban one but not the other. In addition, the Court's tax rules often mischaracterize incentive packages. Established doctrine forbids taxes that discriminate against interstate commerce. But it is not quite proper to claim that incentive packages discriminate against interstate commerce. It seems more plausible to claim that they encourage interstate commerce—creating it, so to speak. There is certainly no discrimination amounting to protectionism, as when an excise tax exemption favors an in-state over an out-of-state product. The confusion arises over the zero-sum nature of the gains from incentives. That is, given the decision by a foreigner to invest in the United States, his choice to invest in one state over another may turn on the particular incentive package offered. At worst the states that lose out will have wasted their efforts, but it is not quite accurate to claim that they forwent jobs and tax revenues. Because of the confusion and inconsistency associated with this doctrine as applied to incentive packages, we recommend that the Court consider replacing the nondiscrimination test with a non-economic-distortion test.

The Court should also establish a more consistent rule regarding subsidies. In some cases, it has given the impression that all subsidies would be upheld, while in others, it has left the issue open. At one extreme lies *Hughes v. Alexandria Scrap Corp.*, which involved a Maryland subsidy to scrap processors, whether they were located in-state or not. The Maryland legislature hoped that the subsidy would “deal with the growing aesthetic problem of abandoned automobiles [through the manipulation of] the elementary laws of economics.”<sup>141</sup> But a few years after enacting the original law, the legislature restricted the subsidy to in-state processors. The Supreme Court, acting without guidance from precedent, upheld the law by adopting a new policy: It decided that the state was acting like a “market participant,” and that like any other buyer or seller in the marketplace, it should be allowed wide discretion in its market decisions.<sup>142</sup> For this reason, some have viewed *Hughes* as putting virtually all state subsidies off-limits to judicial scrutiny.<sup>143</sup>

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<sup>140</sup> Some federal restrictions do exist. For example, the Internal Revenue Code limits deductions for interest on certain state bonds used to finance private activities. *See* I.R.C. § 141.

<sup>141</sup> *Hughes*, 426 U.S. at 794, 797 (1976) (Powell, J.).

<sup>142</sup> “Nothing in the purposes animating the Commerce Clause prohibits a State, in the absence of congressional action, from participating in the market and exercising the right to favor its own citizens over others.” *Hughes*, 426 U.S. at 810. *See also* *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980).

<sup>143</sup> This inevitability was forcefully argued by Justice Brennan in his dissent:

[ex]Clearly, if the States are to be absolutely unrestrained in their regulation of interstate markets so long as they use methods that may fairly be characterized as “purchasing” items by “artificially

Thus stated, the market participation doctrine makes little sense.<sup>144</sup> Recall that the Commerce Clause only reaches states' regulatory and taxing actions. The market participant doctrine says, in effect, that when the state purchases and sells for its own account, it is not functioning as a regulator. It does not examine the purpose of the state action or whether the measure in question is fulfilling a legitimate goal of government. More precisely, the doctrine does not differentiate between subsidies that correct a market failure (e.g., an unwillingness to remove junk cars from Maryland's landscape) and those that are purely protectionist. Note that the real goal of the discriminatory measure in *Hughes* was not to improve the environment, but to subsidize local scrap processors. But once one accepts this hands-off approach to state actions when the state acts as a market participant, the next logical step is to accept that the doctrine immunizes all state subsidies. The Court overlooked that ramification in *Hughes*. It also failed to recognize that subsidies can actually be worse than a tariff, and that like a tariff a subsidy can put out-of-state competitors at a disadvantage. That another state can match the subsidy is irrelevant; that would be good money thrown after bad and just lead to subsidy wars.

The market participant doctrine has other failings as well. It makes no distinction between tax credits, which are disciplined under the Commerce Clause, and subsidies that take the form of a cash grant. Again, the two can be functionally equivalent. The only cogent defense in the literature relies on the fact that subsidies are appropriated funds, while tax credits are forgone revenues (i.e., tax expenditures). But anyone who has seen the federal appropriations process at work knows that, without a line item veto, the appropriated funds/forgone revenues distinction is a weak reed upon which to base a subsidy.

The Court more accurately described the state of affairs in 1994, when it claimed that it has yet to pass on the validity of subsidies. That conclusion was reached in *West Lynn Creamery, Inc. v. Healy*,<sup>145</sup> where the Court may have sharply reversed direction, despite an express disclaimer that it was not passing on the constitutionality of subsidies. *West Lynn Creamery* involved a subsidy to in-state dairy farmers, financed by a charge on milk processors located both inside and outside the state. The Court basically

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enhancing" the price, then the door is open for the States to "set up what is equivalent to a rampart of customs duties designed to neutralize advantages belonging to the place of origin." *Hughes*, 426 U.S. at 829 (quoting *Polar Co. v. Andrews*, 375 U.S. 361, 377 (1964)).

<sup>144</sup> See Dan T. Coenen, *Untangling the Market-Participation Exemption to the Dormant Commerce Clause*, 88 MICH. L. REV. 395 (1989), for an excellent (and kind) analysis of the various theories used to support the "market participant" doctrine. His footnote 15, *id.* at 398, compiles relevant sources. See also Paul S. Kline, *Publicly-Owned Landfills and Local Preferences: A Study of the Market Participant Doctrine*, 96 DICK. L. REV. 331 (1992).

<sup>145</sup> 512 U.S. 186, 199 n.15.

viewed the measure as “an ordinary tariff ... imposed only on out-of-state products,”<sup>146</sup> and struck it down. Read narrowly, *West Lynn Creamery* simply restates existing law: Tax exemptions favoring in-state goods over out-of-state goods are unconstitutional, but the market participant doctrine will still immunize all other state subsidies. But under a broader reading, *West Lynn Creamery* states a new rule: Any subsidy to in-state businesses which adversely affects out-of-state businesses is unconstitutional.<sup>147</sup> Both the language in the opinion and the facts of the case support this latter reading.<sup>148</sup> And in contrast to the “tariff equivalent” cases,<sup>149</sup> the disputed charge in *West Lynn Creamery* was nondiscriminatory. Moreover, it was imposed on dairy processors, not the farmers supplying them. Thus there was no direct relation between the subsidy to farmers and the tax on the milk bottled by the processors. Milk bottled out-of-state was not disadvantaged, but out-of-state farmers were. That, however, would be true of any subsidy to in-state farmers, including one financed by general revenues. Thus it was the subsidy, and not a “tariff equivalent,” that was contrary to the Commerce Clause.<sup>150</sup> On this reading of the case, the market participant doctrine is short-lived.

The rules in international agreements provide a minimal framework which can point to the key policies and bring some order in this area. The solution may be to follow the EU example and put to rest the dubious distinction between tax rules and subsidy rules. One alternative would be to drop the nondiscrimination rule in the tax area and adopt a nondistortion rule. But it would be even easier to accept the principles underlying international agreements, in particular, article 92 of the Rome Treaty. That is, the Court should make a new policy choice: Prohibit “aid” that “distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods.” Such a rule would ban targeted incentive packages but would not affect general state measures to reduce taxes, provide

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<sup>146</sup> 512 U.S. at 194.

<sup>147</sup> Justice Scalia, in a concurring opinion joined by Justice Thomas, thought the guiding principles stated by the Court would mean that “almost all subsidies” were invalid under the Commerce Clause. 512 U.S. at 208 (Scalia, J., concurring). They would permit subsidies to domestic industry if funded from nondiscriminatory taxes included in general revenue, but hold invalid subsidies to industry members, like those in *West Lynn Creamery*, when funded by a nondiscriminatory tax on the industry. Chief Justice Rehnquist, in a dissent joined by Justice Blackmun, cited principles of federalism, and found no basis for the Court’s decision in earlier cases. 512 U.S. at 216 (Rehnquist, C.J., dissenting).

<sup>148</sup> 512 U.S. at 207 (Scalia, J., concurring, quoting Stevens, J., at 194) (“the law here is unconstitutional because it ‘neutraliz[es] the advantage possessed by lower cost out-of-state producers’”).

<sup>149</sup> See, e.g., *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984).

<sup>150</sup> An alternative view is that the Court struck down a taxing arrangement that basically required out-of-state farmers, who supplied roughly two-thirds of the milk processed in Massachusetts at the time, to finance a subsidy to in-state dairy farmers. There was no factual evidence, however, to support the view



investment tax credits, and so forth. There is no need to second-guess state tax policy on a wide range of issues. It would be up to the Court to decide whether there should be general exceptions to this principle, for example, allowing “aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned” or “aid to promote the economic development of areas where ... there is serious unemployment.”<sup>151</sup>

### **Procurement: Issues of Protectionism, Sanctions, and State Enterprises**

Procurement policies and preferences have often been used to express various unspoken agendas. For example, governments will conceal protectionist policies by embedding them in procurement preferences or by trying to express their disapproval of certain political regimes by placing sanctions on trade with companies dealing with these governments. They may also invest in and operate an enterprise in order to give preference to the state. This subsection examines how international agreements and the Supreme Court have dealt with these issues.

#### ***Procurement***

When procuring necessary goods and services, or when soliciting bids for local public projects, most governments routinely favor local suppliers. There are several reasons for this, the most obvious of which are political. Unfortunately, such procurement preferences are often inefficient, in the sense that the same goods and services may be available at lower cost from a nonlocal supplier. Perhaps because of this concern, international agreements seek to discipline procurement practices. The GATT, the EU, and the NAFTA base their procurement policies on a few fundamental principles:<sup>152</sup> (1) nondiscrimination in purchasing decisions;<sup>153</sup> (2) publication of proposed procurements over a specified amount;<sup>154</sup> and (3)

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that the out-of-state farmers “paid” the tax, which in fact was paid by the processors, and might have been borne by them (in reduced profits) or by consumers (in higher prices).

<sup>151</sup> ROME TREATY art. 92. *See also* text accompanying note 136.

<sup>152</sup> Technical aspects of these principles may differ, and the GATT AGREEMENT ON GOVERNMENT PROCUREMENT, B.I.S.D. (26th Supp.) at 33 [hereinafter GATT CODE] and the NAFTA limit their application to particular entities. U.S. state and Canadian provincial procurement rules, for example, are a subject for future negotiations in the NAFTA. *See* NAFTA annex 1001.1a-3.

<sup>153</sup> NAFTA art. 1003. GATT CODE art. II applies to procurement of goods. In the EU, the Commission first sought to discipline discrimination by identifying procurement provisions having an effect comparable to quantitative restrictions, which are prohibited under article 30. Subsequently the Council promulgated directives, *see* Council Directive 71/305, 1971 O.J. (L 185) 5, *and* Council Directive 77/62, 1977 O.J. (L 13) 1, which establish tendering procedures for public works (construction) and public supply contracts that permit disqualification of contractors or suppliers only on technical grounds (e.g., professional misconduct). The process of refining procurement rules continues. *See* Amendment to the Proposal for a Council Directive Amending Directive 90/531/EEC, 1992 O.J. (C 188) 21.

procedural and technical rules to assure competitive bidding and meritorious valuations, with the lowest bid or most advantageous offer being accepted.<sup>155</sup> These procurement principles have been rigorously applied, especially in the EU. For example, when an Italian law obliged public agencies to obtain at least 30 percent of their supplies from enterprises in southern Italy, the Court of Justice held the law contrary to the Rome Treaty:

[ex][S]uch a system, which favours goods processed in a particular region of a member state, prevents authorities and public bodies concerned from procuring some of the supplies they need from undertakings situated in other member states. Accordingly, it must be held that products originating in other member states suffer discrimination in comparison with products manufactured in the member state in question, with the result that the normal course of intra-Community trade is hindered.<sup>156</sup>

Each of the fundamental principles may be overcome by invoking the “general exceptions.” For example, a government need not make an award if the imported good would cause harm to public health.<sup>157</sup> However, apart from an exception in the GATT for developing countries, no agreement permits a government to give a procurement preference for “distressed industries,” as that would smack of protectionism.

The Supreme Court has not fully examined the constitutionality of state procurement policies. In a footnote it seemed to indicate that the market participant doctrine precludes a challenge to state procurement preferences.<sup>158</sup> But international agreements suggest that the Supreme Court should strike down state procurement preferences as contrary to principles of economic integration embodied in the Commerce Clause.<sup>159</sup> The Court of Justice is clearly correct that “percentage preference” statutes

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<sup>154</sup> NAFTA art. 1001, 1010; GATT CODE arts. I, V.3; Council Directive 71/305, art. 12(1)-(2), 1971 O.J. (L 185) 5; Council Directive 77/62, art. 9(2), 1977 O.J. (L 13) 1.

<sup>155</sup> NAFTA arts. 1007, § B, particularly 1015.4; GATT CODE arts. IV, V, particularly V.14; Council Directive 71/305, art. 16, 1971 O.J. (L 185) 5; Council Directive 77/62, art. 9, 1977 O.J. (L 13) 1.

<sup>156</sup> Case 21/88, *Du Pont de Nemours Italiana SpA v. Unita Sanitaria Locale No. 2 di Carfrara*, 1990 E.C.R. 889 (1990).

<sup>157</sup> NAFTA art. 1019; GATT CODE art. VIII.1; ROME TREATY art. 36.

<sup>158</sup> An in-state preference for goods was upheld in *American Yearbook Co v. Askew*, 339 F. Supp. 719 (M.D. Fla. 1972), *aff'd*, 409 U.S. 904 (1972). *See also* *Trojan Techs., Inc. v. Commonwealth of Pennsylvania*, 916 F.2d 903 (1990), *cert. denied*, 501 U.S. 1212 (1991). The Court has also cited with apparent approval a number of state cases upholding state preferences for in-state goods. *See, e.g.*, *Reeves, Inc. v. Stake*, 447 U.S. 429, 437 n.9 (1980), discussed *infra* in the text accompanying note 177.

<sup>159</sup> State procurement preferences appear somewhat limited in scope. Of the 37 states that have some form of “in-state” preference for goods or suppliers, perhaps 20 give a preference to in-staters when there is a tie bid. *See* 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. 1 (1992). Fourteen states offer a percentage preference to in-state goods or bidders, but the preference is usually a small percentage, the

discriminate against out-of-state products. After all, they can have the same impact as a protective tariff. Hawaii should not be free to discriminate in its procurement practices against other U.S. states while Italy is prevented from discriminating in its procurement practices against other member states in the EU. Besides, when states impose percentage requirements in their procurement policies, they can hardly be said to be acting like normal market participants.

In addition, there are compelling pragmatic reasons for holding preference statutes as contrary to the Commerce Clause. Most important, they make exceedingly poor policy instruments. When buying goods for a school system or for any other state purpose, governments have an interest in assuring that they can satisfy those goals at least cost. A blanket percentage preference, applicable to all goods and to all levels of government, necessarily raises the costs of achieving those policy goals. It also may function as a regressive transfer of revenues, making the wealthy wealthier.<sup>160</sup> The local political process cannot be expected to help, since nonlocal interests are by definition not represented. And because it involves forgone savings, it is not likely to be subject to usual budgetary discipline.

### ***Procurement and Sanctions***

Some local procurement policies are pursued not to benefit local industry, but to sanction or coerce foreign governments. Locally imposed sanctions “reflect a burgeoning movement ... across the United States, and while laudable in their goals, [they can] interfere and conflict with United States foreign policy.”<sup>161</sup> The debate over the legitimacy of locally imposed sanctions has long raged without a definite

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highest being 10 percent in Hawaii. Fifteen states have “reciprocal preferences,” which prefer an in-state bidder over an out-of-state bidder whose state provides a preference to its in-state bidders. The existence of reciprocity requirements suggests that states themselves recognize that percentage preference requirements can disrupt interstate trade. *See also* Barton B. Clark, *Give 'Em Enough Rope: States, Subdivisions, and the Market Participant Exception to the Dormant Commerce Clause*, 60 U. CHI. L. REV. 615, 618 (1993).

<sup>160</sup> A general preference for in-staters is of course not targeted to a distressed industry or to inefficient firms in that industry. Even a transfer targeted to inefficient firms may not cure an underlying problem, because there may be no relation between the “amount” of the preference and the firm’s needs. In any event, the precise amount of the preference will not usually be transparent to taxpayers or subject to budget disciplines. Subsidies, in contrast, can be more transparent, budgeted, targeted, and cost-effective.

<sup>161</sup> Daniel M. Price and John P. Hannah, *The Constitutionality of United States State and Local Sanctions*, 39 HARV. INT’L L. J. 443, 444 (1998). Today, subfederal assertiveness is back with a vengeance. China, Myanmar (formerly Burma), Nigeria, North Korea, Cuba, and Switzerland all have found themselves targeted by state and local sanctions. For a discussion of the proliferation of locally imposed sanctions, see generally Denning & McCall, *supra* note 2.

statement by the Supreme Court.<sup>162</sup> However, recently the Court agreed to review a Massachusetts case involving prohibitions against trade with Myanmar (formerly Burma).<sup>163</sup>

Massachusetts had created the Burma law to encourage free democratic elections in Burma. The law forbade state agencies from purchasing goods or services from 346 companies that did business with Burma, unless the purchase of the item was essential, there was no other bid, or if one of the listed companies bid 10 percent lower than nonlisted companies. Recently the First Circuit Court of Appeals upheld a federal district court ruling that struck down the Massachusetts law as unduly infringing “on the federal government’s exclusive authority to regulate foreign affairs.”<sup>164</sup>

In affirming the district court, the First Circuit chiefly invoked the exclusivity of the foreign affairs powers of the federal government, but it also touched upon the Commerce Clause. The First Circuit noted that in addition to providing an implied grant of authority over foreign affairs, the Constitution specifically grants Congress authority to regulate foreign commerce. The source of this authority is the Commerce Clause, which empowers Congress “to regulate Commerce with foreign Nations, and among the several States” (U.S. CONST. art. I, § 8, cl. 3). The First Circuit held that the Massachusetts Burma Law was unconstitutional not only because it infringed upon the federal government’s ability to conduct foreign policy, but also because it interfered with Congress’s ability to regulate foreign commerce.<sup>165</sup>

Massachusetts contended that in enacting the Burma Law it was only acting as a market participant, and that the First Circuit should extend the market participant exception to domestic Commerce Clause challenges to the foreign Commerce Clause (an extension the Supreme Court has never made).<sup>166</sup> Recall from section 4.2 that the market participant exception allows a state to discriminate against other states when it purchases or sells items for its own account. Massachusetts argued that the

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<sup>162</sup> See, e.g., Howard N. Fenton, III, *The Fallacy of Federalism in Foreign Affairs: State and Local Foreign Policy Trade Restrictions*, 13 J. INT’L LAW AND BUS. 563 (1993); Peter J. Spiro, *State and Local Anti-South Africa Action as an Intrusion Upon the Federal Power in Foreign Affairs*, 72 VA. L. REV. 813 (1986).

<sup>163</sup> *Natsios v. National Foreign Trade Council*, 120 S. Ct. 525 (1999).

<sup>164</sup> *National Foreign Trade Council v. Baker*, 26 F. Supp. 2d 287, 291 (D. Mass. 1998), *aff’d sub nom. National Foreign Trade Council v. Natsios*, 181 F.3d 38 (1st Cir. 1999), *cert. granted*, 120 S. Ct. 525 (1999).

<sup>165</sup> *National Foreign Trade Council v. Natsios*, 181 F.3d 38, 61 (1st Cir. 1999).

<sup>166</sup> Massachusetts relied on the Supreme Court’s Commerce Clause decisions in *White v. Massachusetts Council of Construction Employers, Inc.*, 460 U.S. 204 (1983), *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980), and *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976). These cases establish that “if a State is acting as a market participant, rather than as a market regulator, the dormant Commerce Clause places no limitation on its activities.” *Hughes*, 426 U.S. at 180. See also *supra* section 4.2.

Burma Law merely set forth certain procurement preferences, and that as with the preferences of other market participants, its preferences ought to be respected. The First Circuit refuted this argument on several grounds, all of which severely limit state actions affecting foreign commerce. To list a few points made by the Circuit Court:

[ex][T]he Supreme Court [has] held that the domestic market participant doctrine has limits. The Court [has] held that ... the market participant doctrine does not permit a state to impose extensive conditions on firms with which the state does business. ... [I]n enacting the Massachusetts Burma Law the Commonwealth has crossed over the line from market participant to market regulator. ... Massachusetts is attempting to impose on companies with which it does business conditions that apply to activities not even remotely connected to such companies' interactions with Massachusetts.<sup>167</sup>

[ex]The Supreme Court has repeatedly suggested that state regulations that touch on foreign commerce receive a greater degree of scrutiny than do regulations that affect only domestic commerce. ... [W]e believe that the risks inherent in state regulation of foreign commerce—including the risk of retaliation against the nation as a whole and the weakening of the federal government's ability to speak with one voice in foreign affairs—weigh against extending the market participation exception to the Foreign Commerce Clause.”<sup>168</sup>

The Supreme Court will hear oral arguments on the case sometime this spring and should render a decision during the summer. The Court's ruling should have an extensive impact on defining areas where state actions affect the cross-border flow of goods and services.

### *State Enterprises*

In an integrated market, the ideal state enterprise functions exactly as a private enterprise. Sales go to the highest bidder, whether or not it originates within the jurisdiction. Purchases of inputs also are based on market considerations, without preferences for local suppliers. At the other extreme, a government may accomplish virtually any trade-restricting, protectionist measure under the guise of the market by investing in and directing its own enterprise. Cognizant of this fact, negotiators of international agreements have agreed on three elementary rules for disciplining state-owned enterprises. The first rule seeks to limit monopsonistic state enterprises. When a state enterprise is the sole in-state purchaser of a given good produced abroad it can limit the import of that product (like a quota) or mark up its price on resale (like a tariff). The GATT makes a modest attempt to discipline such “markups,”<sup>169</sup> and the Rome

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<sup>167</sup> National Foreign Trade Council v. Natsios, 181 F.3d 38, 63 (1st Cir. 1999) (citations omitted).

<sup>168</sup> *Id.* at 66 (citations omitted).

<sup>169</sup> The goal is to assure that import markups are treated the same as tariffs and are subject to negotiation in GATT rounds on tariff reduction. For import monopolies, “the level of protection that [a markup] affords is limited under Art. II when the product concerned is included in the appropriate Schedule of Concession.” JACKSON, *supra* note 67, at 337. For examples of nations binding the level of “import markup,” see *id.* at 336 n.12. In the GATT, 1957 amendments set up procedures to identify import

Treaty has sought to end each state monopoly's exclusive right to import.<sup>170</sup> The second rule seeks to limit "ultra vires" actions—those actions beyond the legal scope or authority of the state enterprise. For example, under the Rome Treaty, "undertakings entrusted with the operations of services of general economic interest" must abide by the obligations of the treaty, including the rules on nondiscrimination, but only "insofar as the application of such rules does not obstruct the performance, in law or fact, of the particular tasks assigned to them."<sup>171</sup> That is, state enterprises may not discriminate in their commercial transactions except where required by their purposes.

While its jurisprudence is sparse,<sup>172</sup> the Court of Justice has construed this exception narrowly, and held monopoly state enterprises to the general rules of the Rome Treaty. Thus it has ruled that a television station with exclusive transmission rights could not discriminate against nationals of other member states by reason of their nationality,<sup>173</sup> and that Irish and British broadcasting monopolies could not prevent a foreign firm from publishing a listing of local television programs.<sup>174</sup> The NAFTA adds a wrinkle to the EU's limited rule on nondiscrimination. It obliges each party to ensure that state enterprises accord nondiscriminatory treatment in the sale of their goods and services to in-state investments owned by out-of-state investors.<sup>175</sup>

Finally, the third rule seeks to limit the ability of state enterprises to circumvent treaty provisions by claiming government authority. For example, under the NAFTA, parties are to ensure that state

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markups. *See* GATT art. XVII.4. In addition, article XVII generally prohibits discrimination contrary to the most favored nation provisions of the agreement.

<sup>170</sup> Article 37 of the Rome Treaty requires that there be no discrimination at the end of the transitional period, "regarding the conditions under which goods are procured and marketed between nationals of Member States." *See* KAPTEYN & VAN THEMATT, *supra* note 18, at 407; *see also* Case No. 59/75, *Publico Ministero v. Flavia Manghera*, 2 E.C.R. 91 [1976 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8342 (1976). A 1942 Italian law established a monopoly for the import and sales of tobacco. The Commission had submitted to the Council a proposal which treated the maintenance of these exclusive rights as unjustified, and the Council had resolved in 1970 that the exclusive right to import and market manufactured tobacco was to be abolished.

<sup>171</sup> ROME TREATY art. 90(2). Such undertakings might include public utilities, and possibly stock and commodity exchanges.

<sup>172</sup> *See* KAPTEYN & VAN THEMATT, *supra* note 18, at 579 n.520 ("all interpretations [of article 90] are to a large extent somewhat speculative").

<sup>173</sup> Case 155/73, *In re. Sacchi*, 1974 E.C.R. 409, Common Mkt. Rep. (CCH) ¶ 8267 (1974).

<sup>174</sup> Case T-69/89, *Radio Telefis Eireann v. Commission*, 1991 E.C.R. II-485 (1991).

<sup>175</sup> NAFTA art. 1503(3).

enterprises do not exercise delegated government authority in a manner inconsistent with the party's obligations in the Investment and Financial Services chapters.<sup>176</sup>

In stark contrast to international agreements, the Supreme Court has taken a totally hands-off approach to state enterprises, articulating this rule in *Reeves, Inc. v. Stake*.<sup>177</sup> In *Reeves*, the state of South Dakota owned and operated a cement plant which had sold to both in-state and out-of-state buyers for over 50 years, the latter comprising 40 percent of its sales.<sup>178</sup> A late-1970s construction boom led to a cement shortage, and the state responded by giving preferences to in-state buyers.<sup>179</sup> Plaintiff Reeves, an out-of-state buyer, had been a customer of the plant for 20 years, and was significantly damaged by the discriminatory policy.<sup>180</sup> Nevertheless, the Court upheld the policy, invoking the "market participant" doctrine introduced in *Hughes* a few years earlier.<sup>181</sup> In applying the market participant doctrine, the Court suggested that South Dakota was simply serving its taxpayers, just as it does when it provides education or police and fire protection. Justice Blackmun, in his opinion for the Court, expressed his belief that

[ex]state proprietary activities may be, and often are, burdened with the same restrictions imposed on private market participants. [Thus e]venhandedness suggests that, when acting as proprietors, States should similarly share existing freedoms from federal constraints, including the inherent limits of the Commerce Clause.<sup>182</sup>

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<sup>176</sup> NAFTA art. 1503(2).

<sup>177</sup> 447 U.S. 429 (1980).

<sup>178</sup> South Dakota created the cement plant in 1919 because of shortages in the cement market that delayed construction in-state and concerns that out-of-staters had been earning substantial profits by supplying all cement to be used in-state and would not establish a new plant in-state. *Reeves*, 447 U.S. at 431 n.1.

<sup>179</sup> In 1978, the South Dakota Cement Commission reaffirmed a policy in favor of supplying all South Dakota cement customers first. The president of the Commission had reported a dramatic increase in cement usage in the regular marketing area, a shortage of supply by all neighboring cement manufacturers as well as nationally, and the plant's inability to place a kiln on-line. *See Minutes of Meeting of the Cement Commission on June 1, 1978*, reprinted in Appendix E of Brief for Petitioner at app. 19–20, *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980) (No. 79-677).

<sup>180</sup> *See Reeves*, 447 U.S. at 453 n.4 (Powell, J., dissenting):

[ex]The consequences of South Dakota's "residents-first" policy were devastating to petitioner Reeves, Inc., a Wyoming firm. For 20 years, Reeves had purchased about 95 percent of its cement from the South Dakota plant. When the State imposed its preference for South Dakota residents in 1978, Reeves had to reduce its production by over 75%. As a result, its South Dakota competitors were in a vastly superior position to compete for work in the region.

(Citation omitted).

<sup>181</sup> 426 U.S. 794 (1976). *See supra* text accompanying note 141.

<sup>182</sup> *Reeves*, 447 U.S. at 439 (Blackmun, J.).

While it is clear that the cement plant participated in the market, it is difficult to see how the majority could conclude that state enterprises are “burdened with the same restrictions imposed on private market participants.” This point was forcefully challenged by Justice Powell in his dissent. Powell argued that “it is a pretense to equate the State with a private economic actor [since a] State frequently will respond to market conditions on the basis of political rather than economic concerns.”<sup>183</sup> Powell’s dissent echoed the principles in international agreements in many ways. For example, he alluded to the fact that state enterprises could pursue policies that mimic tariffs and quotas.<sup>184</sup> And he noted that under exceptional circumstances a state enterprise could discriminate against out-of-state buyers.<sup>185</sup>

International agreements suggest that the Supreme Court should impose at least some modest discipline on state enterprises. First, state import monopolies should not be able to discriminate against imported goods.<sup>186</sup> Second, the Court should adopt an “ultra vires” rule that would prevent state enterprises from disrupting interstate commerce beyond their authorized purposes. Third, the Court should adopt an “anti-circumvention” rule that would prevent state enterprises from undertaking activities that states themselves could not do under the Commerce Clause.<sup>187</sup> Thus state enterprises would not be allowed to discriminate against out-of-state buyers to safeguard scarce in-state resources, overruling *Reeves*. Fourth and finally, state enterprises, as in the NAFTA, should not be able to discriminate against in-state companies owned by out-of-staters.

## SUMMARY

International agreements on economic integration have much to offer a Court interested in safeguarding a common market in the United States and fostering freer trade among nations. They suggest maintaining a rule of nondiscrimination but dropping the Commerce Clause balancing test for the export of goods and the entry of foreign direct investment; a recognition that cross-border investment flows are in fact “interstate commerce”; and an end to the “market participant” doctrine, particularly with respect to state

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<sup>183</sup> *Reeves*, 447 U.S. at 450 (Powell, J., dissenting).

<sup>184</sup> “State action burdening interstate trade is no less state action because it is accomplished by a public agency authorized to participate in the private market.” *Id.* at 450.

<sup>185</sup> “In order to ensure an adequate supply of cement for public uses, the State can withhold from interstate commerce the cement needed for public projects.” *Id.* at 452.

<sup>186</sup> Such import monopolies may exist in states where a state enterprise has sole responsibility for purchasing liquor for distribution by it or a related state enterprise.

<sup>187</sup> Such a rule would meet Justice Rehnquist’s test proposed in his dissent to *Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334 (1992). He observed that Alabama could have achieved results prohibited in that case by using a state enterprise, which would be protected under the market participant doctrine.



procurement preferences. More generally, careful observation of the experience of common markets, as they evolve over time, can help to sharpen the Court’s focus on the policy bases of the Commerce Clause.

We can expect the states to become even more involved in foreign affairs, and hence the Supreme Court to be called upon more often to settle disputes related to such state actions.<sup>188</sup> The focus of this paper has mainly been to supplement current Commerce Clause jurisprudence: With regard to disputes over state actions involving interstate or foreign commerce, we recommend that federal courts utilize international agreements, such as the GATT and the NAFTA, as persuasive authority. Doing so would require courts to make an adjustment in its treatment of, *inter alia*, foreign direct investment and services, but it would lead to a more harmonious and predictable Commerce Clause jurisprudence.

We note in closing that this paper also has implicitly touched on a much larger issue: How to distribute foreign affairs powers between the states and the federal government, and between branches of the federal government. Our attention to Commerce Clause jurisprudence suggests, to say the least, that we have limited the scope of our inquiry. But within that scope, we feel that our recommendations balance the beneficial aspects of federalism with the efficiency enhancements associated with having foreign affairs directed by a single sovereign voice, taking into account the relative strengths of the federal branches in making such decisions.

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<sup>188</sup> *See, e.g.*, EARL H. FRY, THE EXPANDING ROLE OF STATE AND LOCAL GOVERNMENTS IN U.S. FOREIGN AFFAIRS, 4 (“State governments now operate almost as many permanent offices overseas[,] lead far more international trade and investment missions[, and] issue more export grants and loan guarantees [than the federal government.]”); Brenda S. Beerman, *supra* note 122, at 189 (“states are engaged in a range of international activities that include overseas offices, foreign technical and commercial exchange agreements and coordinated efforts to influence U.S. foreign policy”).