

# State Laws Take Back Seat to Trade

Global pacts are foiling California's attempts to protect public health and the environment.

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California Assemblyman Lloyd Levine thought he had found an eco-friendly way to help the state dispose of millions of scrap tires: use recycled U.S. tires in asphalt for road construction.

The Van Nuys Democrat hadn't counted on Canadian and Mexican rubber exporters crying foul. And though Gov. Arnold Schwarzenegger supported Levine's idea, he vetoed the assemblyman's bill in September, saying it would violate international trade pacts and invite retaliation against California goods.

Nobody in Sacramento was very happy with the outcome. "It's very disconcerting to think the federal government can make agreements that can compromise the state's ability to regulate for the health and welfare of its citizens," said Susan Durbin, a deputy attorney general for the state.

For state legislators, the veto highlighted the serious threat that international trade agreements pose to states' sovereignty. This is of particular concern in California, where state officials are caught between their economic dependence on trade and their concerns about the constraints on their ability to protect public health and the environment.

In the last year, the threat of conflicts with global trade pacts helped derail proposed state laws that would have beefed up screening for lead in imported candy from Mexico and created a tax on energy imports from Mexico to improve air quality at the border.

The problem arises because the U.S. is a member of the World Trade Organization and has signed such pacts as the North American Free Trade Agreement that prohibit discrimination against foreign firms or products.

A U.S. trade official in Washington, who spoke on the condition that his name not be used, said the Bush administration respected the rights of state and local officials to legislate as they saw fit. But he said trade-dependent states such as California had a lot to gain from agreements that force foreign governments to drop barriers to imports or open up their government contracts to U.S. firms.

"What we've done simply is to urge them to take into account the balance of interest as they make their individual decisions," the official said.

Under global pacts like the WTO, foreign entities can't force federal or state officials to change offending laws. But if the U.S. loses a trade case and doesn't revise the offending statute, it may face trade sanctions or large fines.

That tension has intensified as the U.S. government has expanded its trade liberalization efforts beyond lowering tariffs; Washington has moved into new areas, such as the regulation of services, investment rules and government procurement.

"California has a rich tradition in being creative in government," said Robert Stumberg, director of the Harrison Institute for Public Law at Georgetown University. "Those kinds of experiments tend to set off alarms in American trade policy."

Many sub-federal laws around the world violate global trade pacts. So far, however, foreign governments have shied away from filing costly challenges to U.S. state laws because doing so would invite retaliation and feed growing concerns that global trade agreements are weakening the power of federal or state officials.

"It seems to me the proponents of the WTO have been very cautious about picking their fights because they don't want to be seen as brazenly undermining democracy," said former state Sen. Tom Hayden, an outspoken critic of the threat posed by global trade pacts.

That could be changing. After the U.S. cracked down on Internet gambling, the Caribbean nation of Antigua and Barbuda saw its offshore gaming industry shrink by more than half. It filed a WTO complaint challenging the restrictions U.S. federal and state governments impose on Internet gambling.

Last month, the WTO announced that it had found those U.S. laws in violation of a global agreement regulating trade in services, including recreational services such as gambling. Under that pact, the U.S. had agreed not to discriminate against foreign providers or impose unnecessary restrictions on the number of service providers. Because the U.S. forbids Internet gambling within its borders, the only operators affected were foreign firms.

The Bush administration is appealing the WTO ruling, arguing that it didn't intend its commitment to the services agreement to include gambling. A U.S. trade official, speaking on background, said the ruling was "deeply flawed" and the U.S. government would "vigorously defend not only federal gambling laws but state gambling laws."

If the ruling is upheld, Stumberg said, it will open the door to foreign trading partners challenging federal or state regulation of other types of gambling, such as state-run lotteries or tribal monopolies. Here in California, voters recently voted down two initiatives that would have expanded casino-style gambling.

States such as Utah and Hawaii that ban gambling would be vulnerable, Stumberg said. Under WTO rules, a government can protect "public morals" but must use the least trade-restrictive method. With gambling, Stumberg argued, it would be difficult to prove the need for a complete ban because other states allow gambling under controlled situations.

State Sen. Liz Figueroa (D-Fremont), chairwoman of the state Senate Select Committee on International Trade Policy and State Legislation, said these potential conflicts were cropping up with greater frequency and had a chilling effect on legislators. One reason is because opponents have become more aggressive in using international trade laws to fight measures that impose tougher safety or environmental standards.

That's what happened with Levine's bill, Figueroa said. The measure was prompted by the ballooning environmental problem posed by the more than

32 million scrap tires California generates a year, which pile up in landfills or illegal dumps and are hazardous to dispose of. By encouraging the recycling of those tires into crumb rubber used in asphalt, the state could recycle scrap tires and provide more eco-friendly road construction.

Canadian and Mexican producers have been big providers of crumb rubber to California, and "we just didn't want California to be a dumping ground for Canada and Mexico," said Stuart Waldman, Levine's chief of staff. "This wasn't protectionist."

Under NAFTA, the state's efforts to clean up its groundwater and mining waste are being challenged by foreigners.

The trade pact's so-called Chapter 11 provision allows foreign investors to sue a government for taking actions that impede trade and are "tantamount to expropriation."

In 1999, Vancouver, Canada-based Methanex Corp., one of the world's leading producers of methanol, sued the U.S. for \$970 million in damage because of California's phaseout of methyl tertiary butyl ether (MTBE), a methanol-based gasoline additive. The state imposed the ban because of concerns that the additive was contaminating groundwater. That case is pending.

In a separate case, Glamis Gold Ltd. of Vancouver filed a multimillion-dollar claim alleging that state restrictions on open-pit mining have destroyed the value of a large gold mine in the California desert near sacred Indian sites. That case is also being adjudicated.

If the U.S. loses those Chapter 11 cases, the federal government will pay the penalties. But critics fear that California will be pressured to amend its laws to prevent future costly legal actions or will shy away from enacting future measures that could trigger foreign scrutiny.

States have become more aggressive in trying to head off conflicts, in part because of California's experience. Last year, the National Conference of State Legislatures and other state organizations helped persuade U.S. trade officials to remove a Chapter 11-style provision from the U.S.-Australia free trade agreement. The states argued that such a provision was unnecessary in a trade pact with a country that has a strong judicial system.

"We definitely don't want state authority or state sovereignty taken away in any shape or form," said Chris Whatley, director of international programs for the Council of State Governments.

Government procurement is another area in which states are wary of signing away their rights. When the U.S. negotiated recent trade agreements with Australia and Central America, state governments were asked to agree not to discriminate against foreign providers in their procurement of goods and services — which some states see as restricting their ability to use procurement to prevent the outsourcing of jobs or to promote socially conscious or environmentally friendly policies.

California hasn't yet committed to the procurement portion of the proposed Central American Free Trade Agreement, which is expected to face a tough battle in Congress because of concerns over labor and environmental standards. Twenty-three other states have signed up.