Testimony of Robert Stumberg
Professor of Law, Georgetown University Law Center[1]

Securing American Sovereignty: A Review of the United States' Relationship with the WTO

July 15, 2005

Before the U.S. Senate Committee on Homeland Security and Governmental Affairs
Subcommittee on Federal Financial Management, Government Information,
and International Security, Senator Tom Coburn, Chair

Overview

1. Trade agreements have constitutional character –
   They shift decisions on preemption and takings to the international arena.
2. The WTO's decision on gambling illustrates the threat to federalism.
3. USTR's sovereignty statements are not attentive to state and local concerns.
4. Congress can provide a forum for federal-state consultation on trade policy.

1. Trade agreements have constitutional character

The first director of the WTO described trade agreements as a constitution for the global economy. He accurately alludes to the constitutional function of limiting government authority.

a. ***Before the WTO –*** Trade agreements primarily dealt with tariffs and government measures that discriminate against foreign goods at the border.

b. ***With the WTO –*** Eighteen new agreements create trade rules that apply to laws that ***do not*** discriminate against foreign trade. Trade rules "prohibit" laws that are clearly constitutional and shift the balancing tests to determine whether a nondiscriminatory law is overly burdensome (compared to U.S. courts). The federal government has a legal obligation to enforce trade rules that apply to cities and states. One enforcement option is preemption: Congress adopted implementing legislation that authorizes the federal government to preempt state laws simply on grounds that they are "inconsistent with" a trade agreement.[1] Other enforcement options include withholding of federal funds or non-approval of state plans. If the federal government does not enforce trade rules against states, other countries may apply economic sanctions against U.S. goods, services, or property rights.

c. ***Since the WTO –*** The United States has negotiated "WTO-plus" agreements such as CAFTA and other Free Trade Agreements, which have added controversial policies such as:

(1) ***Foreign investor rights*** – in NAFTA, CAFTA and other Free Trade Agreements (FTAs). Investment chapters empower foreign investors to seek compensation for expropriation when laws have a "significant" impact on their "expectations of profit."[2] Investment agreements give greater rights to foreign investors – different procedures, a way to avoid U.S. courts, and a new book of legal rules like "expropriation" that will be defined by international tribunals.

(2) ***Principles of pharmaceutical trade*** – in CAFTA and the Australia FTA (AUSFTA). These agreements convert existing patent law into a trade obligation, which means that Congress cannot amend patent law (e.g., to authorize import of FDA-approved drugs) without risking

---

[1] This testimony does not reflect the views of Georgetown University. *Contact* – Prof. Robert Stumberg, Harrison Institute for Public Law, Georgetown University Law Center, 600 New Jersey Avenue, NW, Washington, DC 20001; *phone* 202-662-9603, *email* stumberg@law.georgetown.edu.

trade sanctions. The Australia FTA also obligates governments to subsidize "innovative" drugs without reference to the cost-effectiveness of those drugs, which all governments are working to attain.[3]

To summarize, WTO trade agreements and their cousins, the FTAs that are "WTO-plus," have constitutional character. They shift the preemption and takings debate from state capitols to Washington, and then from Washington to Geneva and other international *fora*. Rather that speak about abstract ideas in 18 different WTO agreements, I will focus on one agreement that likely has the greatest reach into the domain of state legislatures and city councils – the General Agreement on Trade in Services, the GATS.

In May of this year the WTO decided a challenge by Antigua to U.S. laws that ban Internet or remote gambling and related laws in all 50 states. The United States avoided the brunt of this challenge (except for remote betting on horse racing) for two reasons. First, the WTO dismissed the claims against state laws because Antigua simply failed to brief the state issues. Second, the WTO ruled that violation of trade rules by the federal ban on Internet gambling is excused by the "public morals" exception in the GATS. Nonetheless, this case provides substantial guidance on the meaning of trade rules that cover regulation of services.

2. The WTO's decision on gambling illustrates the threat to federalism

a. ***GATS covers all gambling laws – by mistake.*** GATS applies to sectors where countries make "specific commitments" to follow trade rules on Market Access and National Treatments. While accepting that the United States did not mean to, the WTO ruled that vague language in the U.S. schedule of commitments is a commitment on all gambling services – not just Internet gambling. Other sectors where the United States has commitments include financial services, health facilities, business and professional services, and services incidental to distribution of energy.[4]

b. ***GATS prohibits monopolies and prohibitions.*** Once a country schedules a commitment, the Market Access rule prohibits governments at all levels from operating monopolies or setting limits on the number of service providers or service operations, including quotas.[5] The WTO ruled that any ban on Internet gambling is prohibited because it amounts to a "zero quota." In its briefs, the USTR warned the WTO that the "zero quota" interpretation would significantly limit the ability of governments to regulate certain sectors.

c. ***Public morals exception.*** The USTR persuaded the WTO that the Market Access violation should be excused under the general exception for measures necessary to protect public morals. However, the threats posed by remote gambling (*e.g.*, Internet access by children) cannot be used to justify economic monopolies like state lotteries or bans on casino gambling in Hawaii and Utah, particularly when neighboring states license many forms of gambling.

d. ***Sanctions strategy.*** The USTR says that it will ask Congress to amend the Interstate Horse Racing Act to comply with the WTO decision. If Congress does not, Antigua is far too small for punitive tariffs to work as a trade sanction. The academic literature strongly suggests that Antigua will follow Brazil's lead and withdraw trade commitments to honor U.S. intellectual property rights such as copyrights, trademarks, industrial designs, patents and protection of undisclosed information.[6]

In response to these outcomes of the WTO Internet gambling case, the attorneys general from 29 states wrote the USTR on May 31, 2005:

> The prospect of [future] WTO challenges to [state-level gambling] prohibitions should alone be sufficient to give U.S. negotiators enormous motivation to use the current GATS negotiations to secure a rule change that makes explicit the right of a WTO signatory to ban undesirable activity in a GATS covered sector.[7]

3. USTR sovereignty assurances are not attentive to state and local concerns

In May 2005, the U.S. Trade Representative (USTR) recently consulted with state officials with respect to the revised U.S. offer of trade commitments under the GATS. USTR provided the following assurances that GATS would not threaten state sovereignty.

a. ***"Like any trade agreement, GATS simply says that if a state chooses to allow private competition in services, it should give U.S. and foreign firms a chance to compete on an equal footing."*** GATS is not like "any" trade agreement. It is unique in its application of Market Access rules that prohibit even nondiscriminatory quantitative limits. For example, in the U.S.-Internet Gambling case, the WTO's Appellate Body held that the Market Access rule prohibits a ban on domestically illegal trade (*e.g.,* Internet gambling) because a ban is a "zero quota." In its brief, USTR stated that this interpretation would constrain government power to regulate in a nondiscriminatory manner.

b. ***"Trade agreements such as the GATS do not automatically preempt, invalidate or overturn state laws."*** This is *literally* true, but only in the sense that the federal government must always ask a court to preempt state law. In other words, preemption is never automatic, it is manual. The WTO implementing legislation specifically authorizes the Executive Branch to sue states in federal court to enforce the GATS, and sets the burden of proof to be that a state or local law "is inconsistent with the agreement in question."[8] (emphasis added) The way in which preemption under trade agreements differs from domestic preemption is that Congress denied standing under a trade agreement to private parties.[9] In addition to the threat of preemption, federal enforcement options include withholding federal funds, approval of state plans for spending federal funds, or other kinds of federal permission that a state may need.

c. ***"Nothing in any trade agreement prevents the United States or any state from enacting, modifying, or fully enforcing domestic laws."*** Again, this is *literally* true. However:

(1) It is also true that another country may challenge federal or state laws under GATS, and if successful, may impose trade sanctions in the form of punitive tariffs on U.S. goods or services that have nothing to do with the dispute. WTO sanctions have the economic effect of a secondary or tertiary boycott. These sanctions are designed to have the maximum deterrent effect.

(2) It is also true that the federal government has a legal obligation under GATS to enforce U.S. trade commitments that apply to cities and states.[10]

d. ***"GATS does not require deregulation or privatization of any public service."*** Again, this is *literally* true in the sense that countries are free to not make GATS commitments, and the WTO has yet to implement the general GATS rules on domestic regulation. However, once the United States makes a commitment in a service sector (*e.g.*, gambling or health facilities), GATS provides that the United States *"shall not maintain or adopt"* limits on the number of service suppliers, service operations, employees or types of legal entity. In domestic policy debates regarding electricity, health care or financial services, removal of these limits are typically described as "deregulation."

4. Conclusion - Congress can provide a forum federal-state consultation on trade policy

Concerned that the WTO decision opens the door to future disputes, the USTR's advisory committee for state and local officials, IGPAC (the Intergovernmental Policy Advisory Committee), asked USTR to respond to a set of questions. These included whether the GATS commitment on gambling covers all gambling operations in the United States, including state monopolies, tribal gaming, casinos, racing, slot machines, *etc*. – all of which are regulated with limits on the number of service providers and service operations. IGPAC then asked about plans to withdraw the gambling commitment (before the gambling market grows exponentially).[11] USTR's response was that:

> Since the Appellate Body rejected Antigua's challenge to state measures, the report provides no basis for reaching conclusions about how future hypothetical cases might affect state laws or regulations.[12]

IGPAC also asked whether CAFTA would open up broader risks of a challenge based on its services chapter or the rights of foreign investors to use a CAFTA country as a base to challenge federal or state laws. USTR's non-response to these questions indicates that federal-state consultations are not presently viable, at least as a public dialogue. The WTO gave ample basis for IGPAC's concerns, and IGPAC's suggestion of withdrawing the U.S. commitment is clearly an available option under WTO rules. IGPAC has proposed broader and deeper consultation on trade negotiations. As the IGPAC reports make clear, state and local governments support expanded trade. But they feel that with greater diligence and an open forum for consultation, the United States can have expanded trade while safeguarding its tradition of federalism.

Thank you for holding this hearing and airing the need for broader and deeper consultations between U.S. trade negotiators and the state and local guardians of federalism. You have demonstrated that Congress can provide a forum to air the sovereignty debate that is so often overshadowed by the arguments over jobs and economic security.

Endnotes

[1] 19 U.S.C. § 3512(b)(2). "Inconsistent" has a range of meanings. In the sense of domestic preemption doctrine, it could mean meaning that a state law and a trade rule are in conflict: so related that both cannot be true. But "inconsistent" could also mean merely lacking in continuity of belief or purpose, synonymous with "different." Webster's Third New International Dictionary, unabridged, 1144.

[2] *See e.g.*, NAFTA ch. 11; CAFTA ch. 10.

[3] AUSFTA, Annex 2C.

[4] U.S. Schedule of Specific Commitments.

[5] GATS art. XVI:2.

[6] *See* WTO, United States – Subsidies on Upland Cotton, Recourse to Article 4.10 of the SCM Agreement and Article 22.2 of the DSU by Brazil, WT/DS/267/21 (5 July 2005) 3.

[7] Letter from Attorneys General Mark Shurtleff (Utah) and William Sorrell (Vermont) *et al.* to USTR Robert Portman (May 31, 2005) 2.

[8] 19 U.S.C. § 3512(b)(2).

[9] *Id.*

[10] GATS art. I:3(a).

[11] Intergovernmental Policy Advisory Committee, IGPAC Comments on the Updated U.S. Submission to the WTO on the General Agreement on Trade in Services (GATS) Negotiations (May 25, 2005) 4.

[12] USTR, USTR Response to IGPAC Memorandum on the Updated U.S. GATS Submission (June 30, 2005) 3.