Foreword and Acknowledgements

In the early summer of 2006, the Forum on Democracy & Trade was contracted to prepare an Assessment of international trade in relation to the work of the Maine Citizen Trade Policy Commission. Forum on Democracy & Trade Executive Director Peter Riggs presented a draft plan for review and comment at a May 11th meeting of the Commission. In June, the workplan was finalized in consultation with the Commission's co-chairs Senator Peggy Rotundo and Representative John Patrick, with assistance from Legislative Council Executive Director David Boulter and Legislative Analyst Curtis Bentley.

To complete the assessment, the Forum conducted visits to Maine and interviewed Commission members, state leaders, and citizens; attended (or watch videos of) the Commission's Public Hearings around the state; met with staff members of Maine's federal representatives in Washington D.C.; and reviewed documents pertaining to issues raised by Commission members and the sub-committees. The Forum submitted its final report to the Maine Citizen Trade Policy Commission on November 30th. Commission members discussed the report at their 5 January 2007 meeting, with Peter Riggs joining by conference call. Since then, a modest few amendments and updates have been incorporated into this final, published version of the Assessment.

We would like to thank all those Commission members, other leaders and citizens of Maine, and Maine's Congressional staffers in Washington DC who answered our questions, provided us with useful documents or background reading materials, and in general assisted with the preparation of this Assessment. Of course, the Forum is responsible for the final product presented here.

The Assessment is comprised of the following:

1. **Report to the Maine Citizen Trade Policy Commission**
    a. **Executive Summary**
    b. **Assessment of the Commission's work**
    c. **Options for Future Engagement on Trade**
    d. **Sub-Committee Report Recommendations**
2. **Report to the Labor and Economic Development Subcommittee**
3. **Report to the Natural Resources and Environment Subcommittee**
   Special Report: Water in International Trade and Investment Agreements
4. **Report to the Health Care Subcommittee**

It has been a great pleasure to work with all members of the Commission, and especially the Commission's co-chairs, Senator Peggy Rotundo and Representative John Patrick. Their guidance, enthusiasm, and hard work have helped to make the Commission a "model for state oversight and communication on international trade issues."

We would also like to give heartfelt thanks to Curtis Bentley, who helped the Commission to function as was intended in statute, and for his unfailing good humor in responding to our needs. Curtis took on the work of the Commission "above and beyond" his other committee and analytic assignments. We are very grateful for that support, and to the Legislative Council office for management of the contract.

Thanks also to staff of the Maine International Trade Center for their time and willingness to answer our questions; and Martha Spiess, whose videotapes of Public Hearings and Commission meetings made it possible for us to assess many of the events we could not attend in person.

We look forward to continued interaction with the Maine Citizen Trade Policy Commission on these key issues of economic development, trade, and federalism.

Peter Riggs
8 February 2007

Forum on democracy & trade

The Maine Citizen Trade Policy Commission: A Model for State Oversight and Communication on International Trade and Investment Issues

Executive Summary. The activities of the Maine Citizen Trade Policy Commission were evaluated with respect to five different objectives: communication between different branches of government and civil society groups in Maine; communication with national associations and with other states; communication with the Office of the United States Trade Representative (USTR) and with the members of Maine's congressional delegation; engaging Maine's citizenry on international trade and investment issues; and communicating with the media. Our assessment suggests that in the last two years the Commission has achieved most of the purposes for which it was established, and has come to be seen nationally as a successful model for state oversight and engagement on trade issues. We conclude that the following were of particular importance to the Commission's effectiveness:

1) ***High levels of inter-branch communication.*** The Office of the United States Trade Representative (USTR) has been more responsive to Maine's requests for consultation in part because Maine communicated its concerns in different ways, but kept a relatively unified set of messages. Maine's leadership in engaging USTR has also helped clarify areas where federal-state consultation on trade policy could be improved. Initially, there were concerns that the Maine CTPC would 'fragment' communications between USTR and the state of Maine, but this has not been the case. The Maine International Trade Center has played a supportive role in the Commission over the last year.

2) ***Clear communications with Maine's Congressional delegation*** on most of the major trade agreements brought before Congress in the last two years. Congressional staff in Washington report that they are very aware of the Commission, that communications from the Commission have influenced votes for/against particular trade agreements by members, and that information about the Public Hearings helped to sharpen their understanding of the issues.

3) ***Public hearings around the state.*** The statute creating the Commission called for it to "provide a mechanism for citizens and Legislators to voice their concerns and recommendations." The Commission has played an outstanding role in providing a direct link between Maine citizens and federal representatives in Washington DC. No one who has attended these public hearings or listened to transcripts can fail to be moved by the deep level of

interest and concern that Maine's citizens have regarding trade and globalization issues. They are a testament to the continued strength of democratic traditions in Maine, and also demonstrate that Maine citizens' have an international perspective on the impact of trade and investment agreements, with concerns that transcend state and national boundaries. Maine is the only state oversight committee/commission that has taken its "show on the road" through public hearings. The role of the Maine CTPC, and the open-mike approach of the public hearings, can be used or adapted to circumstances in other states. Already legislators in New Hampshire have asked for information about Maine's approach to Public Hearings.

Two areas of engagement by the Commission had more mixed success. Print media in Maine generally did report on the Commission's public hearings; but the Commission itself does not yet have a significant presence in the media. Second, the Commission does not have a strong constituency within the business community, although particular concerns and grievances from several small business owners were aired at public hearings. Given the reach and professionalism of the Maine International Trade Center, which is providing valued services to Maine's exporters, it may not be part of the Commission's mandate to develop such links. But perhaps the composition/membership of the Commission needs to be revisited, so as to give key Maine industries a seat at the table. Among those suggested were the information technology sector and the wood products industry; and more representation from the Maine Department of Economic and Community Development.

As the national conversation around trade shifts from "playing defense" to articulating a positive vision for trade—"what does a Fair Trade Agreement look like?"—Maine's business community should have a stronger voice in the Commission's communications with USTR, with the Maine Congressional delegation, and in conversations around the state regarding the future of trade.

PART I: ASSESSMENT

A. Assessing Roles/Activities of the Maine CTPC

The statute creating the Maine Citizens Trade Policy Commission noted three purposes for the Commission: *"to assess and monitor the legal and economic impacts of trade agreements on state and local laws, working conditions and the business environment; to provide a mechanism for citizens and Legislators to voice their concerns and recommendations; and to make policy recommendations designed to protect Maine's jobs, business environment and laws from any negative impact of trade agreements."*

To fulfill that first purpose, *"assess and monitor,"* the Commission took three actions. The first was to ensure that meetings of the Commission featured speakers from various backgrounds and perspectives—including members of the Commission with expertise on particular topics. In addition to reporting on key legal and economic issues, speakers at the Commission often reported on opportunities for connecting to other states, through national associations, or with other constituencies. Because the Commission does not have dedicated staff analysts, for now the Commission has mostly been reliant on outside policy support. Second was the formation of three subcommittees to look at specific issue areas; policy recommendations from each of those subcommittees are considered in a subsequent section here. Third, the Commission prepared letters to the members of Maine's Congressional delegation, and to negotiators at the Office of the United States Trade Representative that sought to clarify particular legal and economic matters pertaining to the implementation of existing or proposed agreements.

To fulfill the second purpose, *"provide a mechanism for citizens and Legislators to voice their concerns,"* this was accomplished through the Public Hearings (see below) and through letter-writing. Congressional staff in Washington reported that they frequently heard about issues raised at the public hearings, and in one case had read through the transcripts of the public hearings, stating that this was an excellent way to stay in touch with constituent concerns. One Commission member summed up the impact of the hearings very well: "we helped to educate a diverse group of people while building a shared analysis of the problems."

The Commission is now getting to a point where it can *"make policy recommendations"* regarding trade—the third purpose cited in legislation establishing the Commission. Over the past two years, USTR has been negotiating a number of regional and bilateral trade agreements, in addition to the on-going talks at the WTO in Geneva on the Doha Development Agenda. Consequently, the Commission has been in the position of making recommendations to its Maine's Congressional delegation as to votes on particular trade agreements. The Commission communicated quite forcefully to its Congressional delegation on the subject of the Central American Free Trade Agreement (CAFTA) and judging from the votes taken by Maine's delegation, that message came through loud and clear. One Congressional staffer noted that they did not hear from the Commission about some of the less well-known agreements (eg., US-Oman, "normal trading relations" status for Vietnam); she suggested it would be useful for federal representatives to know if the Commission had looked at those agreements, whether it

had a position, and why. However, given the meeting schedule of the Commission, and the unpredictability of votes on particular agreements moving to Congress' calendar, this may not be possible, and the Commission may feel comfortable only commenting on those agreements that it has had a chance to study, or learn about from other Mainers at the Public Hearings. There was a great deal of discussion around CAFTA, which, given the seemingly negative experience of NAFTA, appeared to strike an emotional chord with a number of speakers.

Recommendation. The Commission may consider adopting a basic policy stating that it would support trade agreements that include certain elements—binding labor and environmental standards, a "no preemption" mechanism, indemnification of states, etc. The present time is an important political moment for developing this "positive agenda."

The CTPC was very active on another policy recommendation, concerning whether the Governor should commit Maine to the procurement chapters of various free trade agreements. It is in this policy realm where the influence of the Commission can be seen most clearly. In April of this year, the Governor articulated a coherent and clear set of policies regarding procurement chapters and state notification:

- I cannot commit the state at this time *"because there is no way of predicting today how procurement needs and priorities will change in the future."*
- I am concerned about any approach that would appear to pit states against each other, which is *"incongruous with the USTR's mission to…encourage economic development for the nation as a whole."*
- *"State legislature and stakeholders, not just governors, must be kept informed and given the opportunity to participate in the negotiating process."*

The question of state sign-offs on procurement has, in other states, pitted legislatures against Governors, but in Maine, the Commission brokered an inclusive conversation that focused on policy outcomes (is it good for the state?) rather than political means (who gets to decide?). This example of inter-branch cooperation is a large part of the reason that Maine's concerns on trade are taken seriously in Washington. Other states grappling with the questions of political representation on trade have looked to Maine's experience.

B. Communication with national associations and with other states

In designing the roles, membership, and function of the Commission, public officials in Maine drew upon the state's own democratic traditions, the resources of a well-organized Fair Trade Campaign, and the concerns of organized labor, which had previously felt a bit stymied in getting its perspective aired. We have no evidence that Maine planned to set itself up as a "model" for other states; but indeed that's what has happened.

In the coming year, Maine CTPC members—and staff assigned to the commission—will likely receive an increasing number of requests from other states for assistance and testimony, as more and more states review plans and develop mechanisms for trade oversight. While providing such assistance has implications in terms of the Commission's time allocation, this should be viewed as a strategic opportunity for Maine to work with states with which it shares common positions, and to advance the multi-state

networking that is most likely a precondition for any significant improvement in federal-state consultation on trade.

Recommendation. Maine is well positioned to work with the Vermont International Trade Commission (established by statute last year), and with oversight committees in Massachusetts. It is possible that legislation to establish a trade oversight mechanism in New Hampshire will also be brought forward in early 2007. Two areas of strong common regional interest: health insurance and prescription drug purchasing in relation to the General Agreement on Trade in Services (GATS); and implementation of the Regional Greenhouse Gas Initiative (RGGI). The New England region also has strong common interests in the next Farm Bill reauthorization, described in the report to the Natural Resources Subcommittee.

Maine public officials have had prominent speaking roles in recent national association meetings, as exemplified recently by Linda Pistner's presentation at the National Association of Attorneys General (NAAG) Chief Deputies' meeting in May, and John Patrick's speaking role at the National Conference of State Legislatures (NCSL)'s Annual Meeting this summer in Nashville. There are several other regional and national organizations where Maine could play a leadership role on trade issues, including:

- National Governors Association—after several years in which NGA was not particularly active on this front, there is increased staff and governor interest to see trade issues addressed by the association.
- New England Governors Conference – particularly on energy issues, and addressing cross-border issues with Canada.
- Northeast Midwest Institute—this Washington DC based organization is advancing a reform agenda for the 2007 Farm Bill through its Farm and Food Policy Project. The institute has strong links to members of Congress.
- Eastern Trade Council—a program of the Council of State Governments Eastern Regional Conference, Commission member Wade Merritt sits on the Council's Board of Directors.

Finally it is worth noting that former Maine Attorney General James E. Tierney now directs the *National State Attorneys General Program* at Columbia Law School in New York, and represents another avenue for networking amongst state attorneys general and their staffs.

Recommendation. The current InterGovernmental Policy Advisory Committee (IGPAC) roster does not include a representative from Maine. This question was asked again at the most recent Commission meeting (5 January 07) and there does not appear to be an active process to get a Maine representative on IGPAC. Gaining representation on IGPAC should be a high priority for the Commission. IGPAC is the designated policy advisory committee providing state/local government input to USTR's negotiating agenda. It has also taken the lead in a multi-state Services Working Group, asking detailed questions about GATS and playing an important policy role on GATS sectoral offers and the "domestic regulation" negotiations.

The Commission is also fortunate in having access to Maine's "State Point of Contact" (SPOC), housed at the Maine International Trade Center. MITC has been very forth-coming in sharing with the Commission information that has come through the SPOC system.

USTR's utilization of the SPOC system has been inconsistent. For example, when USTR sent a notice of the new GATS request/offer process to SPOCs earlier this year, it included only a summary of new US offer, and omitted some of the key sectors under discussion, such as bulk storage of fuels, pipeline transportation of fuels, and brokering of electricity. It is unfair of USTR to ask SPOCs to be effective intermediaries if they are not given key information that is of interest to a broad range of stakeholders in the state. We have no specific recommendation on how to remedy this problem, it's been a source of frustration for "State Points of Contact," as well. It seems counterproductive for USTR to be providing some information to IGPAC, some to SPOCs, and some directly to states when asked by oversight committees and commissions. This piecemeal approach is inadequate, causes needless suspicion of USTR motives, and again makes clear the need for major changes in the way USTR communicates with states.

C. Communication with USTR and Maine's Congressional delegation

The Maine Citizen Trade Policy Commission sent a number of important letters to its Congressional delegation, and directly to USTR, in the past year. Governor Baldacci also communicated directly with USTR on several occasions—also in support of the Commission's role. The letters can be grouped into three areas of concern: procurement; new agreements (CAFTA); and on-going WTO negotiations, particularly on services.

Recommendation. Congressional staff members were invited to speak directly before the Maine CTPC. Ideally this could be made an annual event, since Congressional staff spoke positively about that experience, and found the interactions to be very fruitful. In addition, the CTPC may wish to seek support for sending a delegation / subcommittee of Commission members to Washington DC on an annual basis to meet with House members and Senators. This should be a high priority in the next six months, since Maine's Congressional delegation is likely to play important roles in the "Trade Promotion Authority" reauthorization debates.

USTR is to be commended for sending GATS negotiator Chris Melly to Maine to answer questions at a Commission meeting. The exchange with Mr. Melly was particularly useful, since the Maine CTPC was the first domestic group to learn that USTR plans to drop "necessity tests" language from its services negotiating text with Malaysia and Korea. One could speculate that this was due to the questions raised by Maine and other states regarding the language on "necessity tests" in the WTO-GATS Working Party on Domestic Regulation.

USTR staff should also be commended for indicating a willingness to speak with Commission members by telephone. However, some Commission members expressed frustration with the fact that USTR has *not* made any adjustments to its GATS offer as a

result of communications from Maine or other states—"the door is always open, but the answer is always no," is how one member characterized the interchange.

With this in mind, it is worth noting that USTR did provide a detailed response to Senator Susan Collins in her letter regarding the text of CAFTA. Senator Collins "forwarded" the questions that the Maine CTPC had raised. The Maine CTPC may wish to ask itself, and Congressional staff, whether the most politically effective way to raise questions is via a Member of Congress. Anything that can be done to regularize the contacts between the Maine CTPC, Hill staffers, and the Maine Congressional delegation is a high priority and a positive step forward.

D. The Public Hearings

Several Commission members told us that they were overwhelmed by the turnout and response to the Public Hearings. Attending a hearing or reading a transcript of these meetings should lay to rest any thought that trade and globalization issues are somehow outside the concern of ordinary American citizens. Indeed, the major impression one is left with is how articulate are the speakers who volunteered to come before the Commission to address issues of specific concern—whether it be a local issue, something that touches specifically on their business, something having to do with Maine's democratic practice, or whether the speaker is acting "in solidarity" with people in the Global South who are negatively impacted by trade and investment agreements. This last point bears repeating: Maine's citizens repeatedly expressed interest in the effect of trade agreements on other countries, which is a far cry from the usual notion of "protectionist sentiment."

At the same time, it has to be acknowledged that the public hearings were often "grievance sessions." And in many cases those frustrations were expressed in the form of powerful stories about plant closings, worker dislocations, and the continued hard times experienced by workers in Maine's manufacturing-dependent communities. But rather than dismiss these tales as one-off stories from aggrieved workers, not representative of larger trends, one has only to look at Maine Department of Labor statistics to realize that those who spoke at the CTPC public hearings were articulating a broader concern and a pervasive reality. Looking at the statistics on "Industries Projected to Gain or Lose Jobs at the Fastest Rate in Maine between 2004 and 2014," one sees that the industries expected to lose jobs are all manufacturing. Leather, down 44% in the number of jobs over the next ten years. Textile mills jobs—down 40%. Paper manufacturing—down 18%. Apparel may lose another quarter of its total jobs. Plastics, wood product manufacturing, electrical equipment—all double-digit losses. Almost 8,000 jobs expected to be lost—and this using 2004 as the baseline.

The challenge for the Commission is to acknowledge, and try to come to terms with, two distinct trends: that Maine as a state is now a "top ten" export performer, led by seafood and information technology and financial services and some specialty manufacturing, led almost entirely by small firms finding smart niches in the global economy; and on the other hand, with the rise of "global sourcing" and the ability of corporations to chase lower wages and worker standards around the globe, that industries which for decades

had provided not only good jobs but also an *identity* to many of Maine's towns and rural areas, are now vanishing.

One can imagine that this bleak testimony to the Commission was hard to respond to, because to any observer of Maine's economy, it's a well-known story; and because the trends are not going to be changed or reversed by simple remedies in one or another trade agreement. Among the most powerful pieces of testimony were from workers who had visited communities in Mexico and Central America, to where "their" jobs had been relocated. There was no anger at the people who now held those jobs—just a sorrow and a dismay that the conditions in which they were asked to work, and the wages that they were paid, were so miserable. That Maine workers lost good jobs, but that didn't result in someone else getting a job that allowed them to raise a family and send their kids to school—this was a powerful experience for many of those who testified in front of the Commission. They understood that industries were mobile and that the unemployment which a generation ago would have been seen as just cyclical, the community just needed to hold on and soon enough, folks would be called back to the mill—those days are over. This unemployment represents a structural shift in the global economy and is permanent. Still, almost none of those who testified in front of the Commission were arguing for straight-up "protectionism" (although one speaker proposed a powerful remedy: "The United States should not be allowed to run a trade deficit with any country"). Instead, speakers asked about how they could manage, how to level the playing field; they asked about labor standards, and trade adjustment assistance programs, and fairness. "This state has some of the best craftspeople in the world. We just need a fair shake."

But also important in this equation is to acknowledge where Maine has benefited from integration with the global economy. One story that should be told broadly is Maine International Trade Center's capacity-building role, and its championing of small-business interests. The Center has reached out to the small business community and 'retailed' its services to the different needs of people in Portland, Bangor and around the state. Another part of that story is the Center's role in attracting investment into Maine. The labor subcommittee's proposal to work with MITC's Board of Trustees on cross-border issues with Canada is also an important step in extending collaboration. In sum, the Commission needs to make sure that both halves of this powerful story about the global economy are being heard—and acted upon by its Congressional delegation in Washington.

E. Communicating with the media.

The Maine CTPC does not have a specific mandate to work with the media, although one could argue that such a mandate does derive from the second of three purposes of the Commission as noted in statute: *provide a mechanism for citizens and Legislators to voice their concerns and recommendations.* The media is able to amplify and frame the Commission's concerns. The CPTC made the decision to become more comfortable in its own role before aggressively seeking out connections in print and broadcast media. All of the suggestions that came out of the Commission's 20 July 2006 meeting, at which members conducted a "brain-storm" about outreach, are good ones: a brochure,

newsletter/articles to trade journals and newspapers, "one on one contacts" with business and opinion leaders, and the crafting of public service announcements.

Recommendation. The Commission has accomplished remarkable things with a very limited budget. If it wants to expand its outreach to the media, it would benefit from a conscious strategy and consistent approach—and ideally, that would come from engaging a communications specialist. Clearly this would be one of several competing priorities if the Commission had a slightly larger budget.

Based on areas of likely growth/demand, the Commission will need to balance "in-state," "multi-state" and national priorities:

a) support for developing a communication strategy, and support for Commission members to convene or attend meetings with editorial boards, etc.
b) support for travel to neighboring states (VT, NH, Mass) in order to develop a strong multi-state platform for engagement on critical issues: GATS, health care, Farm Bill/forestry, green/"sweatfree" procurement, etc.
c) support for Commission members to spend time in Washington DC, particularly in the first half of 2007, as key issues of trade promotion authority and trade adjustment assistance, etc., will come before the Congress.

Of course how the Commission allocates resources depends first and foremost on how it defines its workplan and political objectives for 2007. In the following pages, we lay out a menu of the possible work items, based on upcoming events, the restart of WTO negotiations, possible ratification of new regional agreements, and communications of interest from Commission members and those taking part in the Public Hearings.

PART II: OPTIONS FOR FUTURE ENGAGEMENT ON TRADE

A. 'Fast Track.'

Over the past several years, WTO negotiators in Geneva have treated the expiration of the US President's "Fast-Track"/ Trade Promotion Authority (TPA) as the 'drop-dead date' for conclusion of the Doha Round of trade negotiations. TPA expires at the end of June, 2007. For practical purposes having to do with the 90-day period in which Congress reviews agreements submitted to it for ratification, the actual 'drop-dead' date for completion of the Doha Development Round is April 1st, 2007. Similarly, other bilateral agreements now being negotiated with Korea and Malaysia would need to be completed by April in order to be considered under Fast-Track rules.

Prior to the November 7 election, certain voices on Capitol Hill suggested that the President might seek a "Doha-Round-only" extension of TPA negotiating authority. Now, with a change in majority control of both houses of Congress, and continued pessimism in Geneva about the completion of a Doha text, this option appears to be off the table. The more important dynamic now at work was articulated by Senator Max Baucus, incoming chair of the Senate Finance Committee, which has committee jurisdiction over trade agreements in the Senate: "As a practical matter, whatever law reauthorizes fast-track authority…will have to strengthen labor and environmental provisions in some way to win broader Democratic support."

It is not necessary for the President to have fast-track authority in order to negotiate trade agreements—President Clinton's authority from Congress expired following the special session at which the WTO "Uruguay Round" agreements were approved, and this authority was denied him in 1998. But there is perception amongst US trading partners that United States' negotiating positions carry more weight when the resulting negotiated text is seen as essentially binding on Congress, not subject to amendment. President Bush renamed Fast-Track as "Trade Promotion Authority" and received that authority from Congress in August 2002.

Early indications are that the House and Senate will each take up new approaches to "Fast Track." Senate Finance, and House Ways and Means, most likely will each come forward with their ideas regarding what would constitute a 'fair trade' agreement. Whether an actual bill will emerge from these committees—and then whether it will clear Congress and reach the President's desk for a signature or veto—remains to be seen. A new TPA bill could, however, articulate new conditions that the Office of the United States Trade Representative must observe in its negotiation of new trade and investment agreements. Consequently, the next few months will be a period of intense discussion and creativity about the content of "fast track" renewal—one in which the Maine Congressional delegation will be intensely involved, and consequently a critical opportunity for the Maine CTPC to advance some of its own reform proposals. Among the elements that are likely to be discussed:

- ***Binding labor standards.*** As Commission members heard repeatedly in the public hearings, binding labor standards in trade agreements are a key concern of Maine's citizens. There are different ideas about what would constitute a fair labor standard, but certainly rights of collective bargaining, strict rules on child labor, and stringent enforcement mechanisms would be part of the discussion. These provisions alone would be sufficient to put significant pressure on China, a country with which the United States has a large trade deficit. The United States could use International Labor Organization (ILO) Conventions as the basis for establishing what constitutes a "fair labor standard;" but, as Bjorn Claeson has pointed out, the United States has not ratified all of the ILO's core labor standards. Consequently, there is still much educational work to be done in this area. Maine's leadership in the "sweatfree" procurement campaigns, the strong support for inclusion of labor standards among Maine's citizens as evidence in the Public Hearings, and Representative Mike Michaud's dedication to this issue suggest that engaging on labor standards is a "high-leverage" opportunity for the Maine CTPC.
- ***Environmental protections.*** Again, there are a number of ways that the concern for environmental protections could condition USTR's negotiating approaches. One would be to state that trade rules "defer to" multilateral environmental agreements—such as CITES (endangered species), or the Montreal Protocol on Ozone Depletion. The United States has not signed two of the international agreements that are most often mentioned in the trade context, namely the Convention on Biological Diversity (which has significant ramifications for trade related to intellectual property) and the Kyoto Protocol on global warming. The intent of strengthening environmental protections in trade agreements is usually seen as preventing countries from undercutting American manufacturing by "externalizing" their environmental costs of production. Like labor standards, environmental protections are seen as a major component of "fair competition." A great deal of creative thought will need to go into defining what are the environmental protections that must be observed in a trade agreement, and how such a mandate can be enforced in the international sphere.
- ***Reform of the federal inter-agency process.*** Many have remarked on the "inefficiency", or even the perversity, of a Fast-Track process whereby the key decision about a trade agreement—whether it will be ratified or not—comes after considerable 'sunk costs' of negotiation and the expenditure of 'diplomatic capital' just to bring the agreement forward for Congressional consideration. Others have suggested that Fast Track was a suitable mechanism when trade dealt only with at-the-border tariffs, when Fast Track could be used to prevent members of Congress from slipping in changes to the text which favored one or another domestic industry—but that Fast Track in its present guise has long outlived its usefulness. Should trade provisions that touch upon national security—for example, critical infrastructure and port security—be reviewed up-front by the Senate Committee on Homeland Security and Government Affairs? Is it more efficient for Congressional committees with jurisdiction over particular economic matters to provide specific instructions to USTR about the content of those negotiations, so that USTR would know in advance what would or would

not be acceptable to Congress? Also, how should the voices of other federal agencies—Commerce, Justice, Labor, the Environmental Protection Agency—be accounted for in the formulation of national trade policy? All of these questions are now under consideration.

- ***Reform of federal-state consultation.*** States in particular are concerned that the new 'Uruguay Round' (1995) agreements on government procurement, services, and (in NAFTA) investment bring new concerns about U.S. federalism—but those concerns are not reflected in fast-track consideration. This issue is a major concern for the Maine CTPC. The Commission is as well-placed as any entity in the country to make recommendations about how USTR could better communicate with states, enshrine principals of federalism in their negotiating positions, etc. A quick listing of potential items for consideration:
    - Seriously implementing the "no greater rights" provision of international investment agreements, which would curtail the use of "investor-state" provisions in (for example) NAFTA Chapter 11.
    - Indemnify states against possible damage awards in investment cases brought against state laws. (USTR/State had refused to indemnify California in the *Methanex* case.)
    - No preemption of state law based on an international trade commitment; also no withholding of federal funds or permissions to compel compliance.
    - Review of existing procurement commitments for purposes of advancing "sweatfree" and sustainable development objectives.
    - Subfederal measures protected in GATS domestic regulation disciplines.
    - Establishment of a federal-state commission on trade policy.

  Note that not all of these measures constitute directions/guidance given to USTR; the TPA bill can be used to articulate broader principles of trade policy pertaining to U.S. federalism and consultation, as well.

In sum, the debate over "fast track" renewal is multi-faceted; there are many possible avenues for Maine CTPC engagement; and the Maine Congressional delegation is likely to be closely identified with some of the more creative, bipartisan reform proposals. ***This is probably the most important opportunity for advancing policy change that the Maine CTPC will see in 2007.***

B. WTO General Agreement on Trade in Services.

WTO negotiations restarted in Geneva in mid-January 2007. There is no sign that there has been any breakthrough in the negotiating arena that led to last summer's collapse of the Doha Round—that is, in agricultural tariffs and subsidies. Nonetheless, United States negotiators like Chris Melly have already been quoted as saying that talks on services should forge ahead. Those negotiations will pertain both to sector offerings (energy, health, retail distribution services, etc.) as well as Domestic Regulation, whose disciplines are likely to apply to all "committed sectors."

Because the mandate for negotiations on Domestic Regulation come out of the Uruguay Round, it is conceivable that disciplines adopted in this negotiating setting could become

binding without progress being made in other areas. USTR has been careful in answering questions about their authority to adopt such disciplines in the absence of an overall Doha agreement. One negotiator stated in front of an NCSL audience that USTR "would be crazy not to go back to Congress" to gain approval/recognition for new disciplines. This comment falls short of a commitment to actually do so, however.

There is much speculation regarding the interplay between the United States' requests of other countries to make new sectoral commitments, and USTR's negotiating position in the Working Party on Domestic Regulation (WPDR) talks. Other countries have reported receiving a strong push from the U.S. to make 'unbound' (that is, full and unconditional) commitments on "distribution services"—with implications for alcohol and tobacco trade, and potentially for the 'rights' of large retailers, as well. If the U.S. persuaded a sufficient number of trading partners to make full commitments under "distribution services – retail," would the United States then possibly make accommodations to the 'demanders' in the WPDR talks with respect to necessity tests? This is speculation, but the situation bears watching.

The Governor of Maine has already indicated his position with respect to new GATS sectoral offers, and the Maine CTPC has directly registered its concerns about the domestic regulation negotiations. Chris Melly stated that USTR did not find Maine's reasons for wanting to be carved out of new GATS offers as very compelling. It is not clear why this was so, but two thoughts come to mind. Mr. Melly did not address concerns in Maine regarding health insurance and other health-care related commitments in relation to GATS, choosing to focus on two areas where he thought it unlikely that a U.S. trading partner would mount a GATS challenge (outdoor billboards and the ban on new landfills). But it is false reasoning to suggest that the only risk involved is that a foreign trading partners would challenge these bans (although we do not share Mr. Melly's conviction that such a challenge is unlikely, particularly if it is directed at a state that appears to be in the vanguard of state-led change with respect to, for example, health care).

Given that one interpretation of WTO rules is that the United States *must* take steps to bring non-conforming measures into compliance with U.S. trade commitments, and given that the federal government has yet to articulate a clear position against preemption of state laws pertaining to international trade commitments, there are a number of scenarios in which the federal government, and U.S. trading partners, can register their "displeasure" with a law passed by Maine or an ordinance adopted by one of its towns, and bring pressure to bear to have the offending measure removed.

The other possible explanation why USTR choose to ignore Maine's request for a GATS carve-out is that it only came from one state, and it didn't come through Maine's Congressional delegation. Again, this is speculation, but it suggests two strategic actions. In fact, Governors from four different states requested some sort of carve-out or safeguard with respect to new GATS commitments. We are not aware that these states have communicated with each other. The other three states do not have oversight mechanisms like the Maine CTPC. This may suggest that the Maine CTPC, in

consultation with the Governor, may want to approach these other states (Iowa, Michigan, and Oregon) and see if a unified articulation of concern from four states is more "compelling" than just letters from individual Governors. The other approach, akin to the process used by the Maine CTPC in asking hard questions about CAFTA, would be to engage Maine's Senators, and have them ask questions of USTR about the rights of states to seek a modification of the GATS schedule so as to adhere to the wishes of that state. Certainly Maine is in the position of being able to point to considerable open and public discussion of its concerns, in public hearings and in legislative settings, to indicate that the position articulated by the Governor had been arrived at through an inclusive democratic process.

In sum, the Maine CTPC should continue to build on its very important 2006 actions with respect to the GATS negotiations. The restart of talks in Geneva means that services negotiations will be very active in the months to come. In particular, the negotiations on Domestic Regulation may not rely upon a reauthorization of Fast Track and ratification by Congress in order to become binding on states. USTR would like to fold Domestic Regulation in with the completion of the WTO 'Doha Round', and it is not clear what will happen if Doha breaks down completely. For now and into the future, ***Domestic Regulation is the trade issue with the greatest implication for state and local governing authority.***

PART III: SUB-COMMITTEE REPORT RECOMMENDATIONS

Many of the recommendations made in the Subcommittee reports can be folded into the two proposed areas of major concern/engagement for the CTPC for next year—namely the work on "fast track" renewal, and on GATS negotiations. Ideas from each subcommittee report are summarized here.

A. Natural Resources Subcommittee

We recommended that the Maine CTPC think seriously about what leverage it has, and what leverage the state of Maine will have, in the upcoming debate on renewal of the Farm Bill. Although we described several possible approaches, our contention is that Maine would have to work regionally with other New England and mid-Atlantic states if it wants to have sufficient "throw weight" on critical Farm Bill reauthorization provisions. In the absence of a multi-state, collaborative approach leading to an articulation of regional priorities, it seems unlikely that Maine's particular needs will be addressed in this Farm Bill round, unfortunately. We argued that Maine might obtain more benefit from a renewed Farm Bill, and have more traction in reauthorization discussions, if it focused on one particular Title of the Farm Bill, namely Forestry, where the Maine Congressional delegation already has considerable power and expertise.

We also conducted a broad overview of water policy and trade rules in relation to Maine, concluding that the major areas of engagement should be in GATS negotiations—both sectoral commitments on environmental services, sewage services, etc., and on domestic regulation—as well as the investment provisions of the non-WTO trade agreements. With respect to investment, the paper suggests three possible reform measures:

1. an interpretive note applying to current agreements;
2. a general exception for water policy measures in future agreements; and
3. a diplomatic review provision in future agreements.

B. Labor and Economic Development Subcommittee

In our report to the **Labor and Economic Development Subcommittee,** we focused on procurement issues. After reviewing the history and structure of the General Procurement Agreement in the WTO, and procurement chapters in other free trade agreements, we noted areas of leadership by the State of Maine, particularly in developing ideas for "sweatfree" (high-labor-standard) state procurement. We then looked at six areas of procurement that appeared relevant to Maine's current concerns:

1. ***"Anti-Sweatshop".*** Maine will continue to play a leadership role in this area. Maine's use of a Code of Conduct could become a good point of discussion/ negotiation with respect to provisions in a new approach to Fast Track, and more broadly the development of binding labor standards in future trade agreements.
2. ***Outsourcing*** is a matter of ongoing political debate in Maine. If a legislative and administrative consensus develops on this issue, it would be an appropriate area for CTPC attention. We reviewed the range of approaches other states have used to condition the outsourcing of state contract work.
3. Selective purchasing based on broad ***human rights considerations***. We briefly reviewed the history of the 'Massachusetts Burma Law' and noted that a similar

concern, and set of divestment actions by states, has arisen in relation to the Sudan, and concern for Darfur. Because Maine is one of the eight states that have passed divestiture laws—laws that are being challenged in U.S. district court by the National Foreign Trade Council—it is not inconceivable that in future Maine's law could be cited in a WTO challenge. The Maine CTPC may wish to work with Offices of Attorneys General and Treasurers in other states to develop a strategy for responding to a possible WTO complaint. This is not an immediate priority until an initial decision in the domestic court challenge is reached.

4. ***Local food procurement***—states, local governments and school districts are experimenting with "buy local" programs, and we assert there is significantly more latitude for such preferences than is commonly understood. The chance that such purchasing preferences would be challenged under WTO GPA or other international procurement agreements is extremely remote. Maine's Congressional delegation may wish to argue for a major expansion in "farm-to-school" program money in the next Farm Bill.
5. ***Renewable energy procurement***—this is an area of important multi-state work in implementing the Regional Greenhouse Gas Initiative (RGGI), and more broadly, an area where the relation between trade rules and environmental preferences has yet to be clarified. The Maine CTPC may wish to raise the issue of renewable energy purchase preferences in the context of the environmental standards debate under Fast Track.
6. ***Prescription Drug Purchasing***—The challenge to any state drug purchasing program is more likely to arise as a GATS issue or in response to non-procurement provisions in particular Free Trade Agreements.

C. Health Care Subcommittee

With colleagues at Harrison Institute, Georgetown University Law Center, we carried out a specific analysis of provisions of Dirigo health programs in relation to GATS rules. Our conclusion is that there is no immediate threat of a trade challenge to any component of the Dirigo system.

In conclusion, the "Fast Track" and GATS debates are the two most significant opportunities for engagement on trade issues by the CTPC in the coming year. The "Fast Track" debate encompasses many of the concerns raised in Public Hearings—from the need for binding labor standards in trade agreements to the need for reform of "investor-state" provisions in regional/bilateral agreements such as NAFTA, CAFTA, and the US-Panama Free Trade Agreement proposal. Maine can work to advance a "first principles" discussion of federal-state communication on trade through the Congressional hearing process regarding reauthorization of the President's Trade Promotion Authority. The Commission should continue its important engagement with USTR services (GATS) negotiators regarding "domestic regulation" and state concerns about 'necessity tests' and references solely to 'national policy objectives.'

The Commission is also encouraged to devote more attention to broader questions of federal-state communication on trade. Maine has demonstrated to other states a highly successful model for democratic discussion of trade, investment, and globalization issues.

It has demonstrated to USTR—and by extension the entire federal government—how states can, and why they should, be consulted on trade policy matters. Other states are eager to learn from your successes. Next steps would be to link more strategically with other states—through their oversight committees, through multi-state thematic working groups, and through national associations such as NCSL and NAAG. The other priority is working toward to gain Maine state representation on IGPAC, since IGPAC has also championed a set of ideas for improved communication between the federal government and the states. States seek improvements in the quality of consultation; the timeless and adequacy of information provided; the opportunity to weigh in on the scope and shape of U.S. commitments; support for creative export-promotion and small-business services administered at the state level; and better data collection to facilitate state/local economic development and investment.

As is so often true in its history, Maine is again the bellwether state advancing an important principle of U.S. federalism, and has again demonstrated the importance of grassroots democratic deliberation on the key issues we confront as a nation.

Forum on democracy & trade	**Report to the Labor and Economic Development Subcommittee of the Maine Citizen Trade Policy Commission**

December 2006. The Forum on Democracy & Trade analyzed "how Maine can effectively use state and local procurement to promote local and state economic development without conflicting with trade rules," as per instructions from the Maine Citizen Trade Policy Commission. This report contains three sections:

1) Background on the issue of Government Procurement in Global Trade Agreements
2) Notes on Maine's leadership in government procurement, and comparative notes on Maine's and other states' approaches to trade and procurement. Maine has been a national leader with respect to promoting and modeling standards for labor and human rights in its procurement practices. Increasingly, Maine is also attempting to use its procurement dollars to promote economic development in the state.
3) Notes on particular issue areas pertaining to government procurement, remedies, opportunities/risk, and possible action items for the Maine CTPC.

1) Background.

Government procurement first surfaced as an issue of international trade negotiations during the Tokyo Round (concluded 1979) and led to the establishment of the GATT "Government Procurement Code." This code, covering central government procurement, was extensively revised in the Uruguay Round of negotiations, and resulted in the establishment of the WTO "Government Procurement Agreement" (GPA). The GPA is a "plurilateral" agreement. This means that unlike most other WTO agreements, in which as a condition of WTO membership the Party (country) is automatically subject to the disciplines of that agreement, not all WTO members are parties to the GPA. They can accede to the agreement separately from their WTO membership. Partly for this reason, "cross-retaliation" between the GPA and other WTO agreements is prohibited. At present, it is primarily wealthier countries that have signed on to the GPA. For example, Canada is a signatory of the GPA; Mexico is not. Both European trade negotiators and USTR have pushed hard to see China join the GPA as a part of its WTO obligations, without success thus far.

Under WTO rules, the fundamental obligations of "covered entities"—that is, central and subfederal governments[1]--include:

- *Non-discriminatory treatment.* Goods, services, and foreign suppliers of goods/ services must be treated "no less favorably" than U.S. firms/suppliers. The WTO Secretariat and USTR have presented this "non-discrimination" standard as one simply to prevent discrimination against foreign bidders. In fact, the GPA goes

[1] U.S. local governments are not covered by the terms of the GPA, or any subsequent international trade agreements that include procurement chapters.

well beyond this. It limits the criteria for government procurement decisions to price and 'performance'—implicitly using a presumption against any social criteria for awarding contracts. This question is explored more fully below.

- *No use of offsets.* The GPA "prohibits government entities from considering, seeking, or imposing 'offsets' as a condition for award of contracts…. 'Offsets' are measures used to encourage local development or improve the balance-of-payments accounts by means of domestic content, licensing of technology, investment requirements, counter-trade, or similar requirements." (Article XVI).
- *Publishing obligations:* States that have agreed to be listed in the GPA are required to publish their tender invitations on a federal-government website.
- *Prohibits the use of technical standards* whose purpose or effect is to create unnecessary obstacles to trade. The wording of this prohibition of technical standards has been controversial, as several WTO members have argued that the use of environment and labor/human rights "process" standards as criteria in government procurement is against WTO rules.[2]

Two other considerations also apply to the General Procurement Agreement:

- *Dollar threshold:* For committed states, the threshold at which GPA rules on most goods and services come into effect is about $500,000. For construction services, the figure is about $6.8 million.[3]
- *General exceptions* include: measures necessary to protect public morals, order or safety; to protect human, animal, or plant life and health; to protect intellectual property; or which relate to the products or services of handicapped persons, of philanthropic institutions, or of prison labor. How far such exceptions extend is subject to much debate in the WTO system. Thus far, none of the general exceptions have been given an expansive reading by WTO tribunals. Maine should continue to cite moral, environmental, and social values as reasons for particular purchasing choices, while realizing that there is little certainty in international trade law regarding what constitutes a "measure necessary to protect" such values.

The most significant development concerning states and government procurement came in the Uruguay Round negotiations in the early 1990s, when the United States was pushing vigorously to make government procurement a stronger part of the WTO system.

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[2] In February/March 2000, several members of the WTO Committee on Trade and Environment (CTE) raised concerns about the use of eco-labels and their perceived inconsistency with another of the WTO agreements, the Agreement on Technical Barriers to Trade (TBT). Several members insisted that "non-product related production and processing methods" were inconsistent with WTO rules. The WTO dispute panel in the "Tuna-Dolphin" case did not provide much clarification, as it chose to interpret the eco-label provision as a mechanism intended to counter "deceptive advertising practices"—rather than a positive statement about the good in question--and was therefore allowed. In sum, the extent to which "process" standards can be used to advance environment or labor/human rights concerns has not been definitively settled through the WTO or other international bodies dealing with commerce.

[3] The actual amount is 355,000 (and for construction, five million) "Special Drawing Rights," which is an accounting unit created by the International Monetary Fund that fluctuates somewhat in dollar terms since the unit is based on a basket of international currencies. The US level of Special Drawing Rights has remained unchanged since 1996.

At that time, US Trade Representative Mickey Kantor sent letters to Governors of all fifty states, emphasizing the new trade opportunities that would materialize from an international agreement on government procurement, and asking that Governors commit their states to be bound by the disciplines of the Government Procurement Agreement. USTR's ability to deliver state participation clearly strengthened the overall U.S. offer in the Uruguay Round, since well over half of all government procurement under the U.S. system of federalism takes place at state and local levels. As a result of Kantor's letter, the governors of thirty-seven states agreed to adapt their procurement procedures to the dictates of the WTO's General Procurement Agreement.

Maine was one of the thirty-seven states committed. Some states noted specific reservations; others listed only a subset of state agencies as being covered by the terms of the GPA. Maine listed the following departments for coverage:

- Department of Administrative and Financial Services
- Bureau of General Services (covering state government agencies and school construction)
- Maine Department of Transportation

USTR apparently just copied the list of states that had agreed to be committed as part of the WTO GPA when negotiating the procurement chapter of the Chile and Singapore agreements.[4]

In September 2003, USTR sent out another letter, again asking Governors to commit their states to implementing the disciplines on government procurement then being negotiated in a range of regional and bilateral trade agreements. Maine did choose to become a signatory to the US-Australia Free Trade Agreement's procurement provisions. After initially voicing his willingness to become a signatory to such provisions in the Central American Free Trade Agreement (CAFTA), Governor Baldacci rescinded the commitment proposed under CAFTA in a May 2004 letter to USTR. In 2005, the Maine CTPC was active on issues pertaining to CAFTA and other, bilateral trade negotiations. Maine declined to make commitments under procurement in subsequent agreements, and the Governor's office communicated in some detail with USTR on these matters. Indeed, the Governor's 20 March 2006 letter to then-Ambassador Rob Portman demonstrates the care and consideration with which his office—in communication with the Maine CTPC —approached the procurement issue. This is discussed in more detail below.

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[4] We find no evidence that Governor Angus King was ever asked to weigh in on the question of whether Maine was to be committed under the procurement chapter of these two bilateral trade agreements, signed in 2003. Certainly the Maine state legislature was not consulted on the matter. NAFTA is something of an anomaly in the process of covering state procurement. Annex 1001.1a-3 to the Government Procurement chapter of NAFTA states that "Coverage under this Annex will be the subject of consultations with state and provincial governments in accordance with Article 1024." Article 1024 of NAFTA, entitled "Further Negotiations," states that negotiations intended to lead to sub-federal coverage were to start "no later than December 31, 1998." We have no evidence that such negotiations were ever undertaken. Mexico most likely was unenthusiastic about such negotiations, and under Canada's constitution, the federal government could not compel provincial participation in this international agreement. Consequently, there is no listing of US states under NAFTA's procurement chapter.

The European Commission continues to argue for the negotiation of a multilateral framework for the *procurement of services*, based on Article XIII:2 of the General Agreement on Trade in Services (GATS). The EU and the United States have taken different positions as to whether *most favored nation, national treatment*, and *market access* rules in the GATS would apply to procurement when the government purchases a utility service for purposes of supply/ selling to consumers. The EU has said that it "attaches great importance" to negotiations on GATS and procurement. While these negotiations on GATS and procurement do not appear to be moving at present, negotiations on *domestic regulation* in the GATS are moving, and such rules would apply to "qualification requirements"—including qualification for bidding on contracts. The United States has yet to state in its submissions to the Working Party on Domestic Regulation that it views *domestic regulation* rules as NOT applying to procurement. By contrast, the European Union has stated its position: namely, that *domestic regulation* disciplines DO apply to procurement.

On 7 October 2004, USTR sent out a Federal Register notice regarding procurement, "request[ing] written public comments with respect to the expansion of market access opportunities in government procurement under the World Trade Organization Agreement on Government Procurement." USTR spokespersons have asserted that the United States' main interest in the WTO GPA at present is to extend its coverage to other WTO member-countries (like China), rather than to "deepen" its coverage within the United States. On 8 December 2006 USTR released a Trade Facts sheet, "Provisional Agreement on Text of Revised WTO Government Procurement Agreement" indicating that parties to the GPA had revised its text. Some of the revisions noted by USTR are the re-ordering of provisions, removing ambiguities, and updating electronic tendering issues. It does not appear that the revisions lead to any new commitments or complications for states.

2) A comparative perspective on Maine's actions and areas of Maine's leadership on procurement.

CAFTA was the first time in which a majority of states chose *not* to bind their state purchasing programs to the rules of a trade agreement. Maine was part of that trend. Communications between the Maine CPTC and the Office of the Governor appear to have helped shape procurement policy during the past two years.

In the spring of 2004, at a time when USTR was negotiating free trade agreements on a number of regional and bilateral fronts, the United States Trade Representative sent a letter to governors asking them to bind their states' procurement practices.[5] As noted previously, the initial impulse of the Governor was to grant the assent requested by USTR. However, after discussions in the state, the Governor reversed his opinion with

[5] Because some FTA negotiations had advanced farther than others, USTR sought a blanket agreement from states: "…to be most efficient we are requesting that Maine consider coverage for all the countries with which the United States is currently negotiating."

respect to the Central American Free Trade Agreement (CAFTA).[6] Perhaps due to the fact that provisions on workers' rights were far less controversial in the US-Australia Free Trade Agreement, the Governor did sign onto the procurement chapter of that bilateral treaty. It does not appear that any formal consultation with the legislature took place regarding these decisions—although some in the state pointed out that traditionally, the legislature retains authority with respect to a range of spending and procurement decisions.

By the time that USTR made another request to governors to bind their states in a new round of FTA negotiations in early 2006, it appears that the Governor had opted for a new approach to government procurement and trade agreements. This was probably due both to legislative developments—such as LD 1015 (HP 699) designed to increase small business access to state contracts—as well as to his own leadership role in developing the Governors' Coalition for Sweatfree Procurement and Workers Rights.[7] Among the principles advanced in Governor Baldacci's 20 March 2006 letter:

- Concern that a "technical standard" designed to safeguard worker rights or the environment could be interpreted as causing an "unnecessary obstacle" to trade.
- Concern that commitment to a procurement chapter would foreclose future policy options for the state. *"I cannot jeopardize this state's ability to reevaluate its procurement policies in the future to respond to changes in social and environmental needs and priorities."*
- Concern about threats to state sovereignty. Other trade agreements assert that the federal government must "take reasonable measures" to compel states to change "non-conforming measures."[8]
- Concern about the lack of meaningful state/federal consultation. Governor Baldacci registered particular concern about the inadequacy of the "State Point of Contact" system, and the new policy of "reciprocity"[9] that is *"pitting states against each other"* on procurement matters.

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[6] A 23 March 2004 "Open Letter" to Governor Baldacci from PICA [Peace through Interamerican Community Action] and the Maine Fair Trade Campaign should also be noted in this regard. The reader is referred to this letter, which also contains a very readable summary of these organizations' concerns in relation to Maine's existing procurement laws/procedures. See also the response to PICA's "Open Letter" from the Maine International Trade Center, letter dated 5 April 2004, stating MITC's concerns.

[7] The State Division of Purchases sought to strengthen the terms and enforcement of a 2001 "sweat-free" procurement law through enhancing labor rights provisions in the State Purchasing Code of Conduct.

[8] At its most extreme, this has been interpreted to mean that the federal government is obligated to sue states in order to compel conformity with U.S. trade rules. However, the federal government might take other measures, such as withholding federal funds or federal permissions in order to compel compliance.

[9] Very briefly, this USTR policy, announced with the Andean and Panama FTA negotiations, would allow only those states that signed onto procurement chapters access to "sub-federal" procurement markets in those trade-partner countries. USTR Robert Zoellick's 2005 letter to governors announced: "This is how the new policy will work. If your state choose to participate in the new FTAs, our foreign trading partners' sub-federal entities will open their procurement to any supplier that: 1) offers goods substantially produced or services substantially performed in your state; or 2) has its principal place of business in your state." The InterGovernmental Policy Advisory Committee (IGPAC) and the National Association of State Procurement Officers (NASPO) both strongly criticized this new policy. IGPAC described it as "punitive" in a 2006 report on the Peru and Colombia FTAs, noting that the definition of "principal place of business" was so loose that essentially the new policy would discriminate only against small businesses—namely

Maine's engagement on the procurement issues is perhaps the most thorough-going and thoughtful response to the USTR request from any state. It reflects communication between nonprofit organizations, the Governor's office, the legislature, and the Maine CTPC. Issues of government procurement have also been raised at several of the Public Hearings conducted by the Maine CTPC. Maine's overall position demonstrates cooperation amongst the different branches of government, and also a level of prudence with respect to the maintenance of future decision-making powers, for both the legislature and administrative agencies, at the state level.

(In addition to Maine's oversight on procurement, this model on engagement and communication is also relevant to other trade agreements that have schedules of commitments, such as the WTO General Agreement on Trade in Services, where according to the rules parties can review and change commitments.)

Other states have taken different approaches. The state of **Maryland** has gone farthest in modifying its commitments. Maryland's legislature attempted to withdraw from the procurement chapters of *all* existing trade agreements, including those to which the state's governor had signed on. In 2005, the Maryland General Assembly passed Senate Bill 401 which "prohibits the Governor or any other State official, without explicit consent from the General Assembly, from: (1) binding the State to the government procurement rules of an international trade agreement;….The bill also declares invalid any consent previously given by the Governor or other State official to bind the State to the government procurement rules of an international trade agreement."[10] The legislature overrode the Governor's veto of this bill, but the governor did not submit a letter withdrawing its commitment, and so Maryland is still listed as committed under the WTO General Procurement Agreement. USTR staff said publicly that it would not remove Maryland from any procurement agreements unless it received a letter from the Governor explicitly instructing USTR to do so. While the outgoing Governor in Maryland did not take that step, the change of leadership there may result in such a request now being forwarded to USTR. (Obviously, USTR's public comments on this matter raise the question as to whether a request by a Governor to be carved out of an existing procurement commitment would in fact be honored by USTR in a timely manner. USTR appears to have expressed some nervousness about the possibility of facing such a request.[11])

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those with operations in just one state. In a 9 February 2005 letter to Ambassador Robert Zoellick, NASPO's President John Adler commented on Zoellick's previous letter to governors, noting that "According to your letter, a state will not be required to 'change its current government procurement practices.' However, your letter further states, 'Specifically, U.S. negotiators will be asking Panama and the Andean countries to open their sub-federal procurement markets to suppliers from U.S. states that agree to participate in the FTAs.' These are contradictory statements, in practical terms." It appears that Maine already grants reciprocity to foreign suppliers, and thus the use of the term "reciprocity" in this FTA text—suggesting that by not signing on, Maine has shut out foreign bidders—is misleading.

[10] "Fiscal and Policy Note (revised), Senate Bill 401," Department of Legislative Services, Maryland General Assembly, 2005 Session. The bill took effect 1 June 2005.

[11] See USTR Trade Facts, "State Government Procurement and Trade Agreements: Sending a Positive Signal About Welcoming International Business and Investment," 31 March 2006, www.ustr.gov. Readers are also referred to the newly-reorganized "Benefits of Trade" heading of the USTR website.

The state of **California** (and specifically its Senate Subcommittee on International Trade) has also raised concerns regarding procurement chapters of Free Trade Agreements in letters to both USTR and the state's Governor. These concerns mirror many of the issues also raised by Maine, including:

- California laws prohibiting purchasing from companies that use sweatshop labor
- recycled content procurement requirements for paper and other products
- preferences for California companies in contract bidding
- pending legislation to address outsourcing of public sector jobs.

This California legislative subcommittee also sought to remind the Governor of the legislature's traditional role in setting the state's procurement standards. Ultimately, the Governor did sign on to procurement chapters in recent FTAs.

Later, members of this legislative sub-committee were surprised by Governor Schwarzenegger's veto of another bill that the Governor himself acknowledged had substantial environmental/solid waste management benefits. The bill would have required road-building projects in California to utilize "crumb rubber" from used/ abandoned tires in the state. The Governor noted potential conflicts with NAFTA agreements—basically, that California couldn't discriminate against potential suppliers of used tires from Canada and Mexico. While the decision itself was dismaying, equally alarming to members of the California Senate Subcommittee on International Trade was the implication that a Governor felt that the mere existence of a "potential" procurement conflict was sufficient to veto legislation that the Governor himself had characterized as an example of "sound public policy." States had assumed it unlikely that the federal government would take a state to court in order to enforce provisions in the WTO General Procurement Agreement; a Governor's veto 'accomplished' essentially the same preemptive function.

The examples from Maryland and California both describe situations where the legislature and the Office of the Governor were not 'on the same page,' and where the Governor asserted the right to make decisions on procurement through use of veto powers, at the expense of the legislature's prerogatives—with very different outcomes in the two states. **Washington State** also went through a process of consultation between the legislature and the Governor, which did not result in the withdrawal of Washington state from any procurement agreements. Instead, Governor Gary Locke wrote to USTR and conditioned the state's participation in any procurement chapter on the state's continued ability to use preferences to conform to international labor and human rights standards. However, USTR did not list the Washington governor's conditions in the U.S. schedule of commitments it uses to communicate with other WTO parties.

Maine is characterized by a somewhat different situation from these three states. A primary concern of the Maine CTPC has been—and should remain—interbranch coordination and the continued ability of the state to "speak with one voice" on trade policy matters. We now turn to a consideration of "offensive" and "defensive" strategies on state procurement strategies in relation to international trade agreements.

3) Government Procurement and Maine's future options.

We will discuss six different facets of government procurement where trade rules and social/environmental justice strategies loom large, and describe a range of policy options in each of these six areas.

Before doing so, however, the basic question in relation to this report should be posed anew, namely: *can Maine effectively use state and local procurement to promote local and state economic development, and to condition state purchases on moral considerations regarding labor and human rights standards, without conflicting with trade rules?*

The answer to this statement is equivocal. Maine *can* effectively use state and local procurement to promote economic development without conflicting with trade rules. Maine has already evinced an appetite for advancing local economic development concerns through procurement strategies. Maine's approach does push into a "grey area" with respect to consistency with trade rules. The state has shown an interest in requiring that companies employ local workers when the state purchases goods and services—and doing so would appear to violate the non-discrimination principle by choosing to purchase products based on the identity of the bidder. The conscious purchase of renewable energy supplies—that is, energy purchases based on source of supply, rather than 'performance'—is also arguably a violation of WTO rules.

Maine's efforts to advance smart (and 'green') purchasing programs should be continued, while procurement officers, the attorney general, and the legislature remain aware of the fact that many points of potential conflict with trade rules—or federal preemption—have not been settled. Rather than crafting a blueprint for action, then, this report simply acknowledges the series of political 'judgment calls' that Maine public officials and the CTPC face.

A related question: If Maine were to withdraw from all its current commitments under international trade agreements (such as the WTO GPA), would this 'solve' the problem of potential conflicts? From one perspective, the answer is clear: withdrawing from the WTO GPA (for example) would clarify that Maine did not intend to be bound by the restrictions contained in that agreement. Some in the state had advocated for Maine's immediate withdrawal from the WTO GPA, and this remains 'on the table' as a policy option. USTR would likely argue that the United States is already obligated under the GPA, and it cannot withdraw a state from an existing commitment. However, USTR did make a political commitment to states during the WTO Uruguay Round negotiations that they remained free to change their minds and that USTR would renegotiate procurement commitments accordingly. It would also be instructive for the Maine CTPC to learn from Maryland's experience in this regard—noting also USTR's stated policy of only referring to the Governor's wishes with respect to coverage or non-coverage.

On the other hand, one interpretation of the federal government's responsibility vis-à-vis our trading partners is that it is *required* to force states to change laws that do not comply with the United States' international trade commitments, including under procurement. From that perspective, seeking to withdraw from an existing procurement agreement

might be needlessly provocative if no specific concern has been raised by a U.S. trading partner with respect to (for example) Maine's anti-sweatshop and recycled paper requirements, and its modest contracting preferences for in-state companies. Maine most likely does not face a situation in which the state's Governor might veto sensible procurement policies that are based on environmental or social-justice considerations, as was the case in California. At the same time, the Maine CTPC may wish to push for a "clarification," such as that advanced by Washington's governor, that the state will make reference to international labor and human rights standards as basic principles governing procurement by the state. Maine's particular concern should be captured in a footnote or some other clause in the U.S. schedule of "covered entities" for procurement agreements. As was noted in a 2005 letter from Alan Stearns to USTR Chief Procurement Negotiator Jean Grier, "…my review of Maine law has shown that Maine has no barriers to state government procurement for companies from any country….Maine law currently provides reciprocity and openness [in its procurement approaches]." Thus, Maine complies with general transparency requirements contained in the GPA. It takes advantage of some of the safeguards written into the GPA, and procurement chapters of other FTAs, for example preferences given to the disabled.[12] Maine does use a State Purchasing Code of Conduct (Title 5, §1825-L) which conflicts with provisions of the WTO GPA as interpreted by some member-countries;[13] and Maine provides some bidding preferences to domestic companies.[14] But it has *not* shut the door to foreign companies who want to bid on state contracts to supply goods and services.

It would appear that USTR has responded in a less than forthright manner regarding Maine's concerns about procurement safeguards. It remains important that those concerns be addressed. It is regrettable that failures of federal-state communication and USTR's punitive position on procurement have led to this impasse. It is suggested that, as the Maine CTPC works with the legislature and the Governor to advance a worker-friendly, "green" procurement strategy for the state, these policy initiatives are communicated to its Congressional delegation and copied to USTR's procurement negotiators. The Maine CTPC should work to keep open the possibility of meaningful dialogue regarding Maine's attempts to balance its commitments to in-state economic development, sensible use of taxpayer dollars for state procurement, and international trade obligations.

There is a practical difference between analyzing areas of potential conflict between Maine's state procurement authority and international trade rules—and as noted, such conflicts do exist—and stating the likelihood of an actual challenge being brought as a result of *x* or *y* action taken by the state. We will remain mindful of those differences in

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[12] See Maine Administrative Procedures and Services Title 5, §1826-A through §1826-D, found on-line at http://janus.state.me.us/legis/statutes/5/title5ch155sec0.html.

[13] Developing countries frequently point to the WTO Singapore Ministerial Declaration of 13 December 1996 in arguing that labor standards should not act as barriers to trade. That declaration reads in part: "We reject the use of labor standards for protectionist purposes, and agree that the comparative advantage of countries, particularly low-wage developing countries, must in no way be put into question."

[14] Specifically, Maine has a "reciprocal preference law" that applies to businesses from other states that also have a domestic ("Buy American") purchasing preference.

the analysis presented below. The general principle observed here is that Maine's trade-related concerns are taken most seriously when they:

- result from a process of in-state discussion based on democratic principles;
- reflect a consensus forged and maintained among the three branches of government;
- reflect a continued commitment to transparency and openness in public purchasing;
- proceed from analyses of specific actions that may be taken by the state or by local governments, be they legislative decisions or purchasing procedures; and
- are communicated to the state's Congressional delegation, and where appropriate directly to USTR, to the National Association of State Procurement Officials, etc., so that in each case Maine is educating a broader audience about its democratically-derived choices, while also educating itself about "best practices" in procurement.

Finally, here are notes on six areas of procurement under discussion in Maine, as elicited in interviews with interested parties in the state or raised at a CTPC public hearing. The first three areas outlined below concern broad aspects of procurement that potentially cover a range of goods and services and relate to Maine's interest in economic development and in advancing a 'public morals' approach to state purchasing guidelines. The last three areas reference particular types of procurement, and as such, overlap with the concerns raised by the two other subcommittees of the Maine CTPC (Health Care and Natural Resources).

a) **Anti-Sweatshop.** Maine has been the national leader in "anti-sweatshop" procurement through its first-in-the-nation adoption of a Code of Conduct on workers rights, and more recently with Governor Baldacci's letter to other governors inviting them to join in a "new collaborative effort to level the playing field for ethical businesses and advance justice for workers."[15]

   As more states join onto the "Governors' Coalition for Sweatfree Procurement and Workers' Rights"—and as the enforcement provisions for implementation of these purchasing preferences are strengthened—it becomes correspondingly more likely that a U.S. trading partner may register a WTO (or other FTA) complaint regarding the conditions that this effort imposes. The WTO rules state that conditions for participation in bidding are limited to "those that are essential to ensure that the supplier has the legal, technical, and financial abilities to fulfill the requirements and technical specifications of the procurement." This phrase has been interpreted to mean that suppliers cannot be disqualified because of a company's labor or human rights record. A review of WTO jurisprudence suggests that while this phrase has been subject to some interpretation with respect to environmental concerns, there has been no claim brought forward at the WTO to curb national or sub-national attempts to invoke labor standards as a reason for challenging a procurement measure.[16]

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[15] See Governor's 18 September 2006 press release on-line at www.maine.gov and www.sweatfree.org.

[16] Ironically, President Clinton did issue an Executive Order that sought to avoid the purchase of goods made with the worst forms of child labor, but that order *exempts* NAFTA and GPA member-countries because of concerns about inconsistency with U.S. trade commitments. Perhaps more relevant is Australia's national anti-sweatshop "code of conduct," which is much like that adopted by the state of Maine. To the best of our knowledge, Australia's code of conduct has not been challenged at the WTO.

At the same time, it is worth noting that the current administration has not been favorably disposed to highlighting labor concerns in its recent FTA negotiations with developing-country partners. One example concerns the labor provisions in the US-Oman Free Trade Agreement. The Senate Finance Committee offered an amendment that would have required the Bush Administration to suspend free trade benefits on imported merchandise from Oman made under 'slave labor' conditions. USTR argued *against* the inclusion of this amendment in the final bill implementing the Oman FTA, stating that the text of the FTA already required Oman to enforce its own labor laws, which include prohibitions on slave labor. Similarly, USTR vigorously defended its crafting of labor provisions in the Central American Free Trade Agreement, even issuing a "Fact Sheet" about labor and CAFTA.[17] However, leadership in the new Congress has already indicated to the administration that it may seek the renegotiation of trade pacts with Peru and Colombia to strengthen worker protections. At the same time, the administration is moving to submit these agreements to Congress for consideration.

As the anti-sweatshop movement gathers force and moves from voluntary purchases made by private actors (universities, major league baseball, etc.) into binding municipal ordinances and state law, the question becomes whether the federal government will seek to preempt such actions, or whether a U.S. trading partner might bring a claim against "codes of conduct" and related measures. The Maine CTPC may wish to consider the following actions:

- Remind Maine's Congressional delegation of the state's Code of Conduct, and its strengthened enforcement provisions, and suggest this as an applicable standard for advancing labor rights in any future Free Trade Agreements. This could be a very timely contribution to the early-2007 debate on renewal of the President's Trade Promotion Authority.
- Request that USTR state or certify that nothing in the state's Code of Conduct, or in other legislative actions, executive orders, etc. pertaining to labor standards, conflicts with Maine's obligations under the WTO GPA; ***or,*** if such certification is not forthcoming, request a specific 'carve-out' pertaining to those elements of the code that appear to be inconsistent with the WTO GPA; ***or,*** if a specific carve-out cannot be granted, requesting that the state be withdrawn from the listing of states that have committed to observing WTO GPA dictates in state purchasing. Note that even if USTR is willing to certify that the state's Code of Conduct were 'trade-rule-compliant,' this certification has no force of law. USTR would need to seek assurances from U.S. trading partners, perhaps through an exchange of Interpretive Notes or a modification of commitments, for this assurance to have any meaning internationally. The

[17] See "The Facts About CAFTA's Labor Provisions," USTR CAFTA Facts, February 2005, online at www.ustr.gov/assets/Trade_Agreements/Bilateral/CAFTA/Briefing_Book/asset_upload_file504_7188.pdf. The Maine CTPC, in its June 2005 letter to the Maine Congressional Delegation on CAFTA, noted the "overwhelming" opposition to DR-CAFTA voiced at public hearings, and in particular concerns about labor standards.

Maine CTPC may wish to inquire as to how it might seek a 'carve-out' on labor standards. It could ask USTR to describe the process for clarifying a commitment. It can work to ensure that Maine's limitations on GPA commitments are noted in legal texts.

- In cooperation with other leaders in the Governors' Coalition for Sweatfree Procurement and Workers' Rights, seek an amendment to Annex II of the United States' Schedule to the General Procurement Agreement under the WTO (which covers sub-federal entities), possibly in the form of a "General Note," indicating that U.S. states and municipalities retain the right to pursue procurement policies that require certification of goods/services suppliers with respect to labor standards.
- State a position on the use of binding labor standards in the negotiation of future Free Trade Agreements.

b) Outsourcing. Concerns about the possible offshoring of state contract work led to the proposing of a bill to prohibit "any Maine Government department, agency, or bureau from conducting business with any entity that outsources its services outside the United States." The bill was later amended to a study of contracting and out-sourcing practices.[18] Concerns regarding outsourcing may arise in future legislative sessions, depending in part on the results of the data obtained through the study provisions found in LD 471.

As with the "anti-sweatshop" legislation, constitutional and WTO GPA questions with respect to state "anti-outsourcing bills" have been raised by those opposing such legislation.[19] And again, it does not appear that either the federal government or the World Trade Organization would relish the fight that a challenge to these state laws would entail.[20] Federal "anti-outsourcing" legislation appears unlikely at this time. With this in mind, states will remain the key drivers of innovation (or, depending on one's point of view, punitive action) with respect to outsourcing and government procurement.

Aside from outright bans on outsourcing of state contract work and privatizing services performed by state employees, other states have enacted a variety of restrictions, including:

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[18] See text of LD 471, signed by the Governor 12 May 2005.

[19] See "Exporting the Law – A Legal Analysis of State and Federal Outsourcing Legislation," Shannon Klinger and M. Lynn Sykes, National Foundation for American Policy, April 2004, on-line at: www.nfap.com/researchactivities/studies/NFAPStudyExportingLaw_0404.pdf. This study summarizes why "state and federal legislation to restrict outsourcing may violate the U.S. Constitution and jeopardize U.S. obligations under international trade agreements," and argues that "prohibitions on state contract work being performed overseas are the most legally suspect category of proposed outsourcing legislation."

[20] In several states, Governors were persuaded to veto anti-outsourcing bills, and they cited potential trade conflicts as a reason why. In California, Governor Arnold Schwarzenegger vetoed three bills in 2004 that would have placed serious restrictions on outsourcing. Vetoing the bill on state contracting, AB 1829, the Governor noted that the bill would "restrict trade, invite retaliation or violate the United States constitution and our foreign trade agreements."

- **Protecting the privacy of medical or financial information.** The California legislature has passed several laws that forbid sending medical or financial information offshore to jurisdictions that do not have sufficient privacy protections. The European Union has also enacted very strict laws on the transfer of data to countries outside the EU.[21] Other states have addressed this question using a consumer "right to know" approach, which doesn't ban such work from being done offshore, but requires notification of the affected person.
- **Public reporting of the location of work performed offshore.** This type of legislation requires contractors and subcontractors to report where work on state contracts is performed. Such information is made accessible to citizens through a state website.
- **Certifying that work is done in the United States.** Requires, as part of a bid, that a contractor certify that it has the ability to perform the contract with workers located in the United States.
- **Restricts the ability of companies that send work offshore work to bid on state contracts or to receive state subsidies.** Again, this is short of a ban on offshoring, but does create economic disincentives for companies. Note that such measures may be taken with respect to *any* offshoring, not just work contracted by the state, and thus is potentially a very powerful tool.[22] Another approach is just to require companies to communicate to state authorities any outsourcing/ offshoring of jobs in a given year.
- **Designation of "critical infrastructure."** Finally, while this is primarily a federal matter, questions have been raised as to whether it is a good idea, from a national security perspective, to allow for international competitive bidding on projects that concern U.S. port, water, energy, telecommunications, or transportation infrastructure. Governors from several states affected by the "Dubai Ports" merger/takeover bid raised concerns about such contracting. Maine was not directly affected by this controversy.[23]

Issues of outsourcing in relation to state contract work/procurement in Maine, and the legislative basis for addressing such concerns, are still in flux. With state legislation a moving target, it would be premature to make recommendations or suggest a policy menu for engaging on outsourcing questions in relation to procurement and international trade. As a study item for 2007, the Maine CTPC could communicate with public officials from states that have trade oversight mechanisms and have taken up the issues pertaining to the outsourcing of state contract work. The states where

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[21] See EU Directive 95/46/EC, Articles 25 and 26. The United States subsequently concluded a "Safe Harbour Agreement" with the European Union allowing for the transfer of information to American companies, although US banks are not eligible for this scheme.

[22] It also raises a host of constitutional issues. See "Exporting the Law," *supra* Note 19.

[23] The "Dubai Ports" controversy was not an outsourcing/contracting issue *per* se; rather, it had to do with the takeover of Peninsular & Oriental, a British company that provides logistical/management services for six U.S. ports, by the company Dubai Ports World. In her role as the Chair of the Homeland Security and Governmental Affairs Committee, Senator Susan Collins introduced a resolution that called for an expanded review of this proposed deal. See press release, "Senator Collins Introduces Resolution Calling for Thorough Review, Congressional Consultation Before Dubai Ports World Deal Could Proceed," Office of Senator Susan Collins, 27 February 2006. The press release does not mention Maine.

state oversight committees have conducted oversight hearings on this topic are California, North Carolina, and Washington. Closer to home, Connecticut and New York are two states that have adopted legislation restricting state contracting and limiting development assistance to companies that outsource overseas. This remains an area of fruitful public engagement by the Maine CTPC and therefore should be a 2007 priority for the commission.

c) Selective purchasing based on broad human rights considerations. A third area of human and labor rights concern is that of "selective purchasing," in which a state or municipality chooses *not* to do business with—or, in the case of state pension funds, divests from—a corporation that also does business with countries or in countries that are known as egregious violators of human rights. Such "selective purchasing" laws were pioneered during the 'anti-apartheid' movement. Building on an in-state history of anti-apartheid activism, the Commonwealth of Massachusetts passed a law in 1996 that effectively prohibited companies that do business with the Union of Myanmar (Burma) from providing goods and services to Massachusetts state agencies. The first such selective purchasing law passed by a state in the WTO era, it resulted in a WTO challenge brought by Japan and the European Union. These WTO members argued that Massachusetts' procurement policy violated the supplier qualification rule under the WTO GPA by imposing conditions of a political nature, not essential to fulfilling the contract.[24]

The WTO challenge was suspended when a domestic plaintiff, namely the National Foreign Trade Council, sued to block Massachusetts' measure in the U.S. District Court on several grounds.[25] Eventually the U.S. Supreme Court held that the Massachusetts law was preempted by the federal sanctions on Burma; it did not rule on the other constitutional claims.[26] Consequently, the WTO dispute involving provisions of the GPA did not move forward to consideration by a dispute panel, and so the 'legality' of these GPA provisions pertaining to the use of human rights criteria in state purchasing decisions has yet to be interpreted at the WTO. Several municipalities, including entities as large as the City of Los Angeles, seem to have kept Selective Purchasing Laws in place without sustaining court challenges.

Issues of divestment and selective purchasing are back in the news, this time with respect to Sudan, a country that stands accused of genocide in Darfur. Maine's legislature passed, and Governor Baldacci signed LD 1758, which calls for Maine to

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[24] In all, the EU and Japan challenged three articles of the General Procurement Agreement. See "United States – Measures Affecting Government Procurement, Request for Consultation by the European Communities," WTO/DS**1, GPA/DS2/1, 26 June 1997. See also "Basic Human Rights Tools Eliminated by WTO Procurement Rules," fact sheet prepared by Public Citizen.

[25] The NFTC claimed that the Burma law was preempted by federal sanctions on Burma; violated the Commerce Clause; and infringed on federal foreign affairs power.

[26] This narrow verdict begs the question as to whether state-level programs of this type would be legal in the absence of federal sanctions. See "Preliminary Analysis of Supreme Court Decision: Impact on Options for Free-Burma Legislation," Robert Stumberg and Matthew Porterfield, Harrison Institute for Public Law, Georgetown University Law Center, 20 June 2000.

divest from all companies doing business in Sudan.[27] In so doing, Maine joins a number of other states that have also pursued divestment from Sudan.

In August of this year, the National Foreign Trade Council sued the State of Illinois, naming the State Treasurer and Attorney General specifically in its complaint. The complaint argues that "the Illinois Sudan Act compels financial institutions to choose between refusing to make loans to borrowers engaged in dealings with Sudan that are lawful under federal law, on the one hand, and abjuring the receipt of Illinois state funds, on the other."[28] This law has a more limited reach than the "Massachusetts-Burma" law. However, NFTC has made arguments similar to those advanced in the Massachusetts-Burma law case, namely that the existence of federal government sanctions "pre-empts" any state or local sanctions.

There are federal sanctions in place against the government of Sudan. Those sanctions were reauthorized in September of this year. Versions of the bill that include provisions that supported state divestment issues passed *both* the House and the Senate—but in conference, this language was removed, at the request of the Bush administration.[29]

The National Foreign Trade Council, in lobbying against the inclusion of state divestment language, argued that the lawsuit in Illinois should be allowed to run its course. Should the NFTC prevail in that case, Maine's law would likely also come under attack. However, should Illinois prevail in the case, there is the possibility that the sort of case that was shelved at the World Trade Organization concerning the "Massachusetts-Burma law" might be brought forward with respect to the case of Sudan.

Issues of divestment and Sudan were raised at one of the Maine CTPC's public hearings, and this is of clear concern to Maine's citizenry. Options open to the Maine CTPC include:

- Urging the new Congress to take up the question of sanctions against Sudan, and revisiting the question of support for state divestment actions. While this would not prevent a possible WTO challenge to state actions, the inclusion of such support into the federal program of sanctions would certainly "raise the bar" on any such challenge being brought forward from a U.S. trading partner.
- Analyzing the legal differences between the state's divestiture law on Sudan and the "Massachusetts Burma Law" from the perspective of a potential WTO challenge. Specifically, is it possible that a challenge could be made through the General Procurement Agreement? Or through WTO-GATS provisions on "non-discrimination," given U.S. scheduling of commitments under "Financial

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[27] "…Baldacci said the order would require the Maine State Retirement System to divest itself of more than $50 million in holdings from companies doing business in Sudan." Bangor Daily News, 19 April 06.
[28] See complaint registered in the United States District Court, Northern District of Illinois Eastern Division; on-line at www.nftc.org/default/sudan%20lawsuit/NFCT%20v.%20Topinka%20compliant.pdf.
[29] "Divesters lose skirmish in Sudan battle," **The Hill,** 27 September 2006; on-line at www.thehill.com/thehill/export/TheHill/Business/092706_biz3.html.

Services"? Could companies or financial institutions domiciled in a NAFTA or CAFTA country bring an investment claim against US state divestiture laws?

- Working with the divestiture movement, and with Offices of Attorneys General and Treasurers in other states with divestment laws on the books, to develop a joint letter to Congress and/or USTR outlining concerns that Maine's LD 1758, and similar legislation in other states, could become the subject of a WTO challenge. A multi-state strategy which sought to clarify the relation between human rights concerns and the extent of "non-discrimination" provisions in WTO agreements would raise the profile of human rights concerns in relation to trade.

d) Local food procurement. In this section we expand on questions raised in the Forum on Democracy & Trade's report to the Natural Resources Subcommittee of the CTPC, which analyzes international trade commitments/negotiations in relation to Maine's agriculture and forestry sectors. Maine is not a major beneficiary of the federal system of crop supports—a system which has been challenged at the WTO by Brazil with respect to one crop (cotton), and which has been under attack generally by US trading partners in the WTO Doha Round of negotiations. We have suggested that shifting federal rural-sector spending to more trade-compliant forms of support might help alleviate these trade tensions, and most importantly, shifts to "Green Box" and other non-distorting forms of support could provide much greater economic benefits to Maine's rural sector in a revamped Farm Bill.

Among the non-trade-distorting strategies considered was greater support for "farm to school" and other local food purchasing programs, connecting Maine farmers with local markets and institutional food buyers. In this section we briefly consider the procurement issues surrounding local food purchasing.[30] We believe that the prospect of a "trade conflict" arising with respect to the way that local food procurement is practiced in Maine—now or for the foreseeable future—is extremely remote:

- Maine does not have a central entity coordinating statewide local food procurement efforts. To date, procurement appears to have been carried out by individual school districts and local governments, with assistance from the State Departments of Agriculture and of Education. As noted above, local governments are not subject to the rules of the WTO GPA or other procurement agreements.
- Even if the Maine Department of Agriculture became the "procuring entity" for local food purchases, the dollar thresholds at which GPA rules come into play are generally beyond the dollar amount used for most local food purchases.
- Even if the state of the Maine became the "procuring entity," and contracts were large enough to trigger WTO GPA disciplines, bid contracts are likely to specify "freshness" as a performance criteria relevant to the goods concerned.[31]

While not a question specific to trade rules on procurement, it is worth clearing up a common misperception that states cannot use USDA funds to implement local

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[30] We would like to thank Heather Albert-Knopp for her assistance in understanding "Farm to School" purchasing issues in Maine.

[31] A conflict is marginally more likely if Maine were to use local-preference criteria for the purchase of substantial quantities of processed foods for use in Maine's schools and correctional facilities.

purchasing preferences. The 2002 Farm Bill did create a program for local purchases.[32] Congress noted that institutions can craft purchasing preferences for local foods, "to the maximum extent practicable and appropriate." Given that Congressional "green light" in the 2002 Farm Bill, the Maine CPTC may wish to argue for dramatic increases in federal support of "farm to school programs" as part of its advocacy around 2007 Farm Bill reauthorization. A new "farm to school" listserve coordinated by representatives from the Maine state departments of education and agriculture should assist in informational exchange about the important economic development issues pertaining to "Farm to School" efforts at the local level. For purposes of this report, we simply note that, with respect to trade rules, Maine faces few 'downside risks' in aggressively expanding local food purchasing preferences. If the State of Maine became a significant "procuring entity" of foodstuffs in future, and vigorously pursued local preference programs in its procurement, then trade rules might become an issue at that future time.

Renewable energy procurement. In 2003, the Maine legislature asked the Department of Environmental Protection to develop an "action plan" for reducing greenhouse gas (GHG) emissions contributing to global warming. This resulted in the release of the Climate Action Plan in 2004.[33] Maine is part of the Regional Greenhouse Gas Initiative (RGGI), a plan involving eight states that will reduce the "carbon footprint" of New England and other eastern-seaboard states.
Maine has also:

- Adopted GHG emissions targets of 1990 levels by 2010, and 10% below 1990 levels by 2020
- Adopted California's vehicle greenhouse gas emissions standard
- Developed a voluntary public benefits fund dedicated to supporting energy efficiency projects
- Developed a renewable energy portfolio standard.

This set of programs/mandates suggests that Maine takes seriously its efforts to combat climate change. Among the "Recommended Options" found in the Maine

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[32] Found in the 2002 Farm Bill at Section 4303, "PURCHASES OF LOCALLY PRODUCED FOODS": *"Section 9 of the Richard B. Russell National School Lunch Act (42 U.S.C. 1758) is amended by adding at the end the following:*
``(j) Purchases of Locally Produced Foods.--
``(1) In general.--The Secretary shall--
``(A) encourage institutions participating in the school lunch program under this Act and the school breakfast program established by section 4 of the Child Nutrition Act of 1966 (42 U.S.C. 1773) to purchase, in addition to other food purchases, locally produced foods
for school meal programs, to the maximum extent practicable and appropriate;
``(B) advise institutions participating in a program described in subparagraph (A) of the policy described in that subparagraph and post information concerning the policy on the website maintained by the Secretary;…"
The 2002 Farm Bill Conference Committee report noted that *"The Senate amendment requires the Secretary to: encourage institutions participating in the School Lunch and Breakfast programs to purchase locally produced foods, to the maximum extent practicable and appropriate and in addition to other food purchases;….The Conference…adopts the Senate provision."*

[33] For an overview of the plan and link to documents, see http://www.state.me.us/dep/air/greenhouse.

Climate Action Plan are such items as carbon offset requirements, renewable energy benefit charges, energy efficiency measures for state buildings, and low GHG preferences for fuels used by the state vehicle fleet. If these GHG abatement options were aggressively implemented; if Maine made state purchasing decisions based on the Climate Action Plan; and if, through adopting a renewable energy portfolio standard, Maine showed a clear "process" preference for some technologies based on their low-emission characteristics, this would suggest that Maine was making procurement choices that incorporated specific performance characteristics. Consequently, it could be argued that these measures conflict with Maine's undertakings as part of the WTO GPA.[34]

Here again is a situation where a particular reading of the WTO rules suggests that Maine's aggressive action on climate change—including the use of GHG emissions as an evaluative lens for state procurement choices—could lead to a trade conflict. However, we feel that a trade challenge based on the WTO-GPA or the procurement chapter of another FTA is unlikely.

To begin with, most of the signatory countries of the WTO GPA are also signatories of the Kyoto Protocol, and have evinced a level of alarm on climate change similar to that shown by the New England states. Generally, the countries that have committed to substantial GHG emission reductions have also applauded the actions of U.S. state and local governments to come to grips with climate change, and appreciate the role played by sub-federal governments in pushing a national discussion on this issue within the United States. Consequently, it is unlikely that they would instigate any action designed to dissuade states from taking this issue seriously.

As a practical matter, Canada is the only country affected by Maine's choices with respect to electricity procurement, since it shares grid interconnections with Maine and because utilities in the Atlantic provinces of Canada do sell electricity to Maine. Maine's Renewable Portfolio Standard is constructed in such a way so as to exclude power from most major Canadian hydropower installations (only hydropower from facilities less than 100MW in size 'count' under RPS definitions). Consequently, it is at least theoretically possible that HydroQuebec or other suppliers might persuade the federal government of Canada to bring a claim under the WTO GPS (or GATS, or NAFTA's Services Chapter), arguing that Maine's laws are "discriminatory" with respect to its purchase of electricity (including purchase for resale to consumers). However, these Canadian utilities are working to bring more renewable energy options on-line; there are regional processes to deepen the integration of New England's electricity markets with those of eastern Canada; and Governor Baldacci has stated an interest in exploring greater power purchases and grid interconnection

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[34] The use of criteria that may not be "necessary to ensure the quality of the service" with respect to electricity services, for example, may also run afoul of proposed rules now under discussion in the WTO General Agreement on Trade in Services' "Working Party on Domestic Regulation." This issue is extensively discussed in the Working Group on Trade and Energy Policy's "Interim Report on GATS and Electricity," and will not be discussed further here. See the report, released 15 April 2005, on-line at: http://www.forumdemocracy.net/public_leadership/documents/gatsandelectricity0405.pdf.

from Quebec and the Canadian Maritime provinces.[35] Under such circumstances, the filing of a WTO claim on government procurement of energy would be disruptive. Of course, circumstances could change, and the situation bears monitoring by the Maine CTPC. It is also conceivable that a Canadian corporation could "freelance" and bring a 'minimum treatment' or expropriation claim against the United States under NAFTA's Chapter 11, if it felt that its access to the American market was hampered by the actions of states to give contracting and purchasing preferences to suppliers of low-emission fuels and electricity services.

Beyond the monitoring of possible threats, however, lies a much broader question, having to do with the "general exceptions" allowed under the WTO GPS and other FTA procurement chapters. Would a procurement strategy that evinced a major concern for combating climate change be considered as a set of "measures necessary to protect human, animal, or plant life and health"? To what extent can the rules of the international trading system be made to respond to, or at least not impede responses to, the threat of climate change? Is carbon accounting an example of a disallowed "offset" under the GPA? While several institutions have attempted to come to grips with the conflicts and compatibilities between international trade rules and international GHG abatement regimes, for the most part debates about the rules governing trade and climate change have run on parallel tracks.[36] As the Regional Greenhouse Gas Initiative gathers momentum, and as states that have adopted an aggressive stance on combating climate change increase their mutual interaction and sharing of information, there are two possible actions to consider:

- Work with other states, and possibly with the International Trade Commission (ITC) in Washington DC, to address the ways in which trade rules may or may not "defer to" policies designed to combat global climate change. In particular, examine whether procurement strategies and domestic regulations that do not specifically discriminate against foreign suppliers of goods and services, but nonetheless change the conditions of competition to disadvantage those suppliers, would nonetheless be safe from challenge. Clarify the scope and extent of coverage under the WTO GPA's "General Exceptions" protecting human, animal, and plant life. Understand the set of policy responses—safeguards, interpretive

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[35] Maine's Public Utility Commission recently appealed a Federal Energy Regulatory Commission decision to raise rates in the state. Maine feels that these rate increases respond primarily to demand increases in southern New England. Governor Baldacci suggested that Maine might even wish to reevaluate the state's continued participation in ISO-New England. See "FERC raises electricity rates," Mal Leary, Bangor Daily News, 3 November 2006.

[36] See for example "International Trade and Climate Change Policies," Duncan Brack et al., Royal Institute for International Affairs, 1999; "Project on Sustainable Energy Transition, Climate Change, and International Trade," International Center for Trade & Sustainable Development, Geneva, project description at http://www.trade-environment.org/page/ictsd/projects/energy_desc.htm. Note that the European Commission recently commissioned a paper that suggests levying border tariffs on goods produced in countries that do not use a CO_2 cap on their industries, as a way to make the EU carbon offset scheme more competitive: http://www.euractiv.com/en/sustainability/eu-moots-border-tax-offset-costs-climate-action/article-158641; and still more provocatively, the political stance of the New Zealand Green Party, which argued last month at global climate talks that nations that have not signed onto the Kyoto Protocol should have their rights of WTO membership revoked.

notes, etc.—that could be used to clarify that government procurement decisions reflecting a concern for climate change are 'protected.' The United States could shape its commitments in the WTO GPA, GATS, and FTAs in ways that reflect concerns about climate change, and states need to play a role in defining those actions and commitments.

- Work with other states to develop cooperative purchasing mechanisms designed specifically to address climate change and advance renewable energy usage. Smaller states have used cooperative purchasing arrangements to maximize economies of scale for particular purposes. Such sharing of information could reduce costs, accelerate the growth of renewable energy businesses, and create a "best practice" set of responses to climate change.[37]

f) Pharmaceutical purchases. Maine is a recognized national leader in managing prescription drug costs and expanding access to medicines for low-income and disabled citizens. Some of its cost-control measures have already been extensively litigated, for example in the landmark case *PhRMA v. Walsh.* One major concern with respect to drug purchasing is the relevance of the "government authority exclusion"—whether programs in which the state purchases drugs for resale would be deemed as a "service provided in the exercise of government authority" or not, and consequently *excluded from* GATS disciplines on distribution services. Also relevant are negotiations on GATS and services procurement mentioned in the first section of this report—*if* such negotiations move forward. Negotiations in this part of the GATS could lead to new trade rules for procurement and subsidization of services, affecting Preferred Drug Lists, the regulation of Prescription Benefit Managers, and in general how the state purchases medicines on behalf of its citizens.

The Forum's report to the Health Care Subcommittee of the Maine CTPC looks at GATS in relation to health insurances services. Since a pharmaceutical benefit is usually part and parcel of an insurance service, issues pertaining to drug benefits within health insurance are relevant here. The potential conflict between trade rules and prescription drug purchasing by states and towns is not usually framed as one of procurement. Analysis of potential conflicts between trade rules and drug purchasing programs such as Maine Rx should probably draw from the GATS analysis already completed for the Health Care Subcommittee. Further, the new federal Congress may substantially change how various drug benefits are handled and how prices are negotiated, with significant impact on state programs, as well. As the Maine CTPC deepens its analysis of GATS and health programs generally, issues pertaining to pharmaceutical purchasing will arise. The recommendations found in the Health Care Subcommittee report are suggested as ideas for possible further research and action with respect to pharmaceutical purchasing by the state.

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[37] See "Strength in Numbers: An Introduction to Cooperative Procurements," National Association of State Procurement Officials, February 2006.

Report to the Natural Resources and Environment Subcommittee of the Maine Citizen Trade Policy Commission

December 2006 – January 2007. The Natural Resources/Environment Subcommittee of the Maine Citizen Trade Policy Commission asked the Forum on Democracy & Trade to look at agricultural strategies and policies favorable to Maine in light of current WTO and Farm Bill discussions. This paper first discusses why international trade is important to Maine's agriculture and how trade agreements impact three of the state's most important resource sectors. The second section of this report focuses on policy responses that may help Maine benefit from changes in Farm Bill legislation, with reference to dairy, forest products, and "specialty crops." We focus on how enhanced spending in the conservation and rural development titles, and changes to spending approaches used in the nutrition title, might yield substantial benefits for all Mainers. We briefly note the existence of significant organizing efforts on Farm Bill reform already taking place in Maine. Leaders in these efforts would be appropriate speakers to the Commission, and could collaborate further on state-based advocacy.

1. Why is international trade an issue for Maine's agriculture sector?

Agricultural exports—particularly of apples and berry crops, vegetables, seafood/aquaculture products, and specialty preparations (jams and jellies, etc.)—form an important part of Maine's overall international trade in goods. By value, dairy products and potatoes have each accounted for about 20% of commodity receipts in the state. Continued tariff barriers in Canada, plus increasing competition from imports, have made it more difficult for Maine farmers to market these primary commodities abroad. In potatoes and to some extent dairy, the average size of operations has increased: "get big or get out" has been the watchword in these sectors. Consolidation throughout the food production and retail chain has accelerated dramatically in the last decade—some of the changes facilitated by provisions in international trade agreements[1], and some due to overall processes of globalization and structural changes in the U.S. economy. There has also been considerable consolidation in the forest products industry—some of it driven by policy instability and international disputes.

International trade is also an issue for Maine's agriculture sector because commitments made by the United States as part of the WTO Agreement on Agriculture are now putting considerable pressure on current U.S. farm programs contained in Farm Bill legislation.[2] The existing Farm Bill is scheduled to be reauthorized in 2007. In the five years since

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[1] Note in particular the United States broad commitment in its WTO General Agreement on Trade in Services (GATS) schedule, in the category of Distribution Services, defined as "wholesaling, retailing, and franchising services."

[2] The Forum on Democracy & Trade, with colleagues at Harrison Institute, Georgetown University, has analyzed the potential impact of WTO commitments—and the dynamics of current "Doha Round" negotiations—for the Farm Bill reauthorization process as a whole. See "The Implications of the Expiration of the WTO's Peace Clause for U.S. Farm Subsidy Programs," Matthew Porterfield, manuscript in press and available from the Forum on Democracy & Trade.

the last Farm Bill was passed by Congress, three important events have occurred to increase the significance of international trade for discussion of domestic farm policy:

1. **Expiration of the "Peace Clause."** In 1995, at the conclusion of the WTO Uruguay Round of trade talks, the European Union and the United States negotiated a nine-year "phase-in" period for new commitments intended to discipline their use of trade-distorting agricultural subsidies (called "Amber Box" domestic supports in the jargon of the WTO). During this phase-in period, at the end of which EU and US subsidies were supposed to be reduced to a level where they did not have distorting effects on international trade, the subsidies were shielded from attack through the WTO dispute resolution system. This compromise became known as the "Peace Clause." However, neither the United States nor the European Union could overcome domestic political resistance to making those changes in the nine-year "Peace Clause" period—indeed, the 2002 Farm Bill *increased* total trade-distorting subsidies in the United States by more than 70%. Consequently, there is a mismatch between U.S. trade commitments and the content of domestic farm support programs. After the expiration of the Peace Clause in 2004, all domestic supports are now "actionable" under WTO rules.
2. **Brazil brings a trade dispute on cotton to the WTO—and wins.** Brazil argued that several domestic programs used by the United States to support cotton crops, including export subsidies and various direct payment programs, were illegal under its 1995 WTO commitments. Brazil won this case and last year the WTO Appellate Body fully affirmed Brazil's arguments. Congress and the administration did make some changes to existing programs, including the repeal of an export subsidy program. In September 2006, the WTO Dispute Settlement Body agreed to Brazil's request to establish a Compliance Panel to review whether the United States has in fact complied with the WTO ruling.[3] Brazil has already floated the idea of targeting non-agricultural goods and services—as well as intellectual property rights—as part of its retaliatory action against the United States.[4]
3. **Collapse of Doha Round negotiations.** A failure to agree on agricultural tariffs and subsidy disciplines sunk the most recent round of international trade negotiations.[5] While no one single country or negotiating bloc is to be blamed for the lack of progress in the trade talks, it is clear that there will be no movement in the Doha Round unless the United States and the European Union table more "ambitious" proposals to cut domestic supports (and in the case of Europe, to cut more of its agricultural tariffs, as well).

These three factors mean that the demands of the international trading system will be a new and critical driver in domestic discussions of Farm Bill reauthorization.

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[3] See www.wto.org/english/news_e/news06_e/dsb_28sept06_e.htm, viewed 11 November 2006.
[4] Ken Cook and Chris Campbell from the organization Environmental Working Group explore this issue in an on-line essay at www.ewg.org/issues/agriculture/20050609/index.php.
[5] See www.forumdemocracy.net/trade_negotiations/WTO_Doha_Round_trade_talks_suspended.html.

Changes in current Farm Bill programs present both threats to and opportunities for Maine's rural producers. If spending in Farm Bill Title I (the "commodity title") were to be slashed, and not restored in other Farm Bill titles, dairying operations in the State of Maine would suffer. If Farm Bill Title VI (forestry) were eliminated, this could also present hardships to a number of Maine's woodlot operators and wood product industries. These threats are described in the following sections.

Understanding Dairy in the WTO context.

There are continued pressures on all U.S. crop-support programs in the current round of WTO trade talks, and dairy is no exception. As is the case with most dairy producers globally, the United States has used a variety of policy instruments to provide assistance to dairy operators and to bolster prices. These include limits on the import side through use of tariffs, as well as price supports and direct payments to domestic producers.[6] These two mechanisms have generally kept dairy prices in the U.S. at or above the world market price. Still, a marked increase in the price of inputs as compared to the guaranteed market price for Class I and Class II milk has meant that dairy producers in Maine continue to struggle, and the long-run viability of the industry is very much in question.[7]

As noted above, the policy environment for dairy could become more complicated in the next Farm Bill:

- **End to the Export Incentive Program.** At the Hong Kong WTO Ministerial in December 2005, the United States joined with the European Union and others in agreeing to a full phase-out of all export subsidies by the year 2013. This will necessitate an end to the Dairy Export Incentive Program, which was designed to subsidize U.S. exports.
- **Market-access concessions to trade partners**. As part of the United States' WTO commitments, and through its bilateral Free Trade Agreement (FTA) with Australia, foreign milk and dairy product suppliers have received expanded access to the U.S. market. Commitments in the Uruguay Round mean that the United States must gradually expand the volume of dairy products that can be imported duty-free through the Tariff Rate Quota (TRQ) scheme. Dairy producers in Australia received additional market access equal to about $41 million, according to the Office of the U.S. Trade Representative. That duty-free TRQ for imports from Australia expands between 3 and 6% annually, depending on the category of dairy product.
- **No increases in access to the Canadian market.** Unfortunately, the North American Free Trade Agreement (NAFTA) did not do much to create market-

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[6] Under Uruguay-Round WTO rules, the United States set up "tariff rate quotas" (TRQs) that allowed a certain volume of imports of dairy products at a very low or zero-tariff rate. Imports beyond those TRQ amounts were subject to very high tariffs. Price supports have come through federal milk marketing orders, price supports, and dairy market loss payments. See "ERS Analysis: Dairy Programs," and "2002 Farm Bill: Commodity Programs," **ERS Features—Farm Bill 2002**; and the **Dairy Policy Briefs** of the Dairy Policy Analysis Alliance, Food and Agricultural Policy Research Institute (FAPRI), University of Wisconsin-Madison, for a complete overview of U.S. dairy-sector support programs.

[7] See for example "Issues in Maine's Natural Resources Industries: Maine Dairy Industry**," College of Natural Sciences, Forestry, and Agriculture White Papers #4,** University of Maine, March 2003.

access opportunities for Maine dairy producers, as Canada continues to provide substantial protections to its dairy industry.[8] Currently, the United States and Canada provide approximately equal levels of subsidization to their national dairy herds.[9] A breakout for the regional fluid milk market meaningful to Maine producers is not available.

- **Dairy is a big part of United States' Aggregate Measure of Support (AMS).** Price-support programs are not prohibited under the WTO rules, but their use is limited. The amount of trade-distorting spending is strictly calculated. The United States negotiated a total of $19.1 billion in trade-distorting spending under the Uruguay Round agreement. This figure is known as the "Aggregate Measure of Support" (AMS). Price supports for other 'program crops,' including corn, wheat, rice, and cotton, are also included under that AMS cap of $19.1 billion.[10] USDA researchers have calculated that support to dairy producers has comprised 55% of total AMS spending since 1995—more than the amount for corn, cotton, or other program crops.[11] In October 2005, the United States Trade Representative put forward a proposal to the WTO that would have further reduced U.S. "Amber Box" spending. In sum, if the AMS cap is taken seriously (and Brazil's successful challenge to certain subsidy programs suggest that it must be), and if the U.S. proposes a lower AMS limit in order to get the Doha Round talks moving again, then other commodities will be competing vigorously with dairy for a larger slice of a dwindling subsidy "pie." The strategic compromise that resulted in the continuation of key dairy programs in the 2002 Farm Bill may not materialize in the new legislation.

A further negotiating dynamic in Doha Round talks on agriculture is the extent to which countries can designate particular tariff lines as "sensitive products," which could allow these products to be excluded from further *tariff* reductions. One can thus imagine a "food fight" similar to the fight over subsidies, but this time with different commodity groups seeking to have their product designated as "sensitive," which would enable the U.S. to maintain TRQs and other market-access restrictions for that particular tariff line.

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[8] For a more detail discussion of NAFTA and dairy, see "Free Trade Agreements and the Doha Round of WTO Negotiations—Implications for the U.S. Dairy Industry," W.D. Dobson; **Babcock Institute Discussion Paper No. 2005-2,** University of Wisconsin-Madison.

[9] The United States won a WTO case against Canada on its past export subsidies for dairy products in 2003. Canada promised to end such practices. www.usinfo.state.gov/ei/Archive/2003/Dec/31-635626.html.

[10] In fact, it is likely that the United States has exceeded this $19.1 billion level in recent years. See "Boxed In: Conflicts between U.S. Farm Policies and WTO Obligations," Daniel A. Sumner, **Cato Institute Center for Trade Policy Studies,** December 2005. The United States has not reported its subsidy levels to the WTO since 2001, even though Uruguay Round disciplines call for "timely notifications" to the WTO of all trade-distorting supports. Some nations have cited the lack of timely reporting of subsidies as one obstacle in the current round of trade talks.

[11] **Trade Liberalization in International Dairy Markets: Estimated Impacts**, Suchada Langley, Agapi Somwaru, and Mary Anne Normile; Economic Research Report 16, USDA, February 2006. Proposed Doha Round rules do call for countries to adopt *product-specific spending caps*, which could impact the dairy sector—since those products that are most heavily subsidized would be subject to larger proportional cuts.

Understanding Forest Products in the WTO and NAFTA contexts. Unlike the Agreement on Agriculture, there exists no WTO agreement specific to forestry. Prior to the 1999 Seattle ministerial of the WTO, there was an attempt to negotiate a "forest practices agreement" to govern worldwide trade in wood products. This portion of the Seattle agenda was controversial, insofar as it included no accompanying environmental protections; and because modeling of the proposed agreement's impacts suggested it would result in a four percent increase in global deforestation. Negotiation of this agreement collapsed along with other items on the Seattle agenda, and there does not seem to have been any serious attempt to revive it for the current round of trade talks. Consequently, forest products trade remains primarily regulated by the GATT, the major WTO agreement covering all goods.

The signing of NAFTA had greater impact on forestry trade between Mexico and the United States than between the US and Canada, because the United States and Canada had previously negotiated a set of agreements outlining trade and tariff duties between the two countries.[12] These agreements, however, did not lead to orderly trade in wood products, and disputes on softwood lumber tariffs between the United States and Canada have been brought forward in both NAFTA and GATT/ WTO settings. After twenty years of conflict, this dispute is headed toward resolution. A 12 October 2006 Press Release from the Office of the United States Trade Representative described the outcomes of the last round of negotiations, and the coming into force of the U.S. – Canada Softwood Lumber Agreement:

> For Canada, based on current market prices for softwood lumber, this will require the immediate collection of an export tax. With respect to the United States, this will result in revocation of the antidumping and countervailing duty orders on softwood lumber from Canada, an end to the collection of duty deposits on imports of Canadian softwood lumber, and the initiation of the process to refund duty deposits currently held by the U.S. Customs and Border Protection.[13]

While this has been a major issue in overall US-Canada trade relations, the softwood lumber dispute has been of less importance to Maine, because of provisions stating that logs originating in the Canadian Maritime provinces or in Maine are exempt from its conditions.

Farm Bills since 1990 have contained programs on forestry, and the 2002 Farm Bill included a separate forestry title. Both Senate and House versions of the 2002 Bill

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[12] The North America Commission for Environmental Cooperation—which was set up because of concerns about the environmental impacts of NAFTA—has never released a comprehensive study of the impacts of North American forest trade on the environment. This may be due to the sensitive nature of the topic, given the long history of disputes between the United States and Canada on softwood lumber tariffs.

[13] "U.S. Trade Representative Susan C. Schwab Announces Entry into Force of U.S.-Canada Softwood Lumber Agreement," USTR press release 12 October 2006. The original 1996 text of the Softwood Lumber Agreement can be found at www.dbtrade.com/casework/softwood/175976w.htm.

contained more provisions on forestry than were included in the final version produced by conference committee.[14] One of the most important programs included in this title, the Forest Land Enhancement Program (FLEP), was eventually provided with just 35% of the $100 million "guaranteed" in the Farm Bill. It expires at the end of FY2007, and there is speculation that FLEP might not be renewed in a subsequent Farm Bill.

The Maine Forest Service has been a regional leader in drawing attention to the particular needs of Northern Forest states in relation to the Farm Bill, and has participated in a number of the USDA Farm Bill "listening sessions." A 5 September 2006 letter to Senator Olympia Snowe, co-signed by state officials from Maine, New Hampshire, Vermont, and New York, as well as several important forest conservation groups in Maine, laid out a "consensus policy agenda" for the 2007 Farm Bill, including:

- Increased support for state forest stewardship and research programs;
- Increased funding for cost-share and incentive programs that support good forest stewardship and that slow the parcelization of forest land;
- Support for the Forest Legacy Program;
- Grant support for value-added production and marketing.

In sum, there has been considerable work done at a regional level, as well as within Maine, to think about forestry components in the next Farm Bill.

Understanding Specialty Crops in the WTO Context.

Unlike the European Union, which has spread out support payments to a huge range of crops and farm enterprises, US Farm Bill Title I subsidies are concentrated in a handful of "program crops"—grains, dairy, and cotton. Because the threshold for whether or not such subsidies are "actionable" under WTO rules is whether the subsidies have an impact on market prices or displace another country's product from domestic or third-country markets, the concentrated nature of U.S. subsidies is of particular concern, as has already been seen in cotton. Because of the value of these subsidies, commodity groups representing "program crops" have been particularly vociferous in Farm Bill reauthorization debates.

Recognizing the increased importance of specialty crops in the overall US agricultural economy, and in particular the increasing contribution of specialty crops to export performance, specialty crop producers—including potato growers, as well as growers of fruits and vegetables—have recently become much more active in advancing their interests through legislation. Earlier this year, a "Specialty Crop Farm Bill Alliance" was formed,[15] and other legislation passed in the 108th Congress created special programs to increase the competitiveness of specialty crops. These programs would appear to be "Green Box," non-trade distorting supports.

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[14] **Forestry in the Farm Bill**, Ross Gorte, CRS Report to Congress, Congressional Research Service; 22 November 2005. Some forestry programs were included in a controversial 2003 bill, the "Healthy Forests Restoration Act" (HFRA). A voluntary conservation program of the HFRA allowed for registration of acreage with respect to a range of biodiversity objectives. A June 2006 "fact sheet" from the Natural Resource Conservation Service states that "the primary focus of the Healthy Forests Restoration Program in Maine is to manage boreal forest to promote the recovery of Canada lynx."

[15] For an example of the Alliance's engagement on recent legislative proposals, see the press release at http://www.competitiveagriculture.org/news/supportslegislation.html.

It is quite clear, however, that there is no chance that Title I-style subsidies will be extended to specialty crop growers. (To do so would in fact be "illegal" under WTO Uruguay Round rules.) Secretary of Agriculture Mike Johanns noted as much in a recent speech:

> the specialty crop farmers…are not coming to me and saying they want to be treated the same as the program crop producers. They are arguing instead that we should address needs that they have by strengthening our support for research, voting resources to sanitary and phytosanitary issues, and boosting market promotion dollars.[16]

Specialty crop growers also have a defensive interest. In the 1996 and 2002 Farm Bills, Congress included a provision stating that recipients of "program crop" supports are restricted from growing fruits and vegetables on land counted in the "base acreage" for calculating support payments. However, in the US-Brazil WTO cotton case, it was precisely these planting restrictions which led the Dispute Panel and Appellate Body to conclude that subsidies that the United States had argued were "Green Box," non-trade-distorting, were in fact actionable "Amber Box" subsidies. Naturally, specialty crop producers are strenuously opposed to the removal of such planting restrictions, fearing that acreage currently devoted to cotton, rice and other "program crops" may be shifted into fruits and vegetables. This is of particular concern to Maine, where fruits and vegetables and other specialty crops are amongst the highest-dollar components of agricultural exports.

2. Suggestions for the Maine Citizens Trade Policy Commission and the Natural Resources and Environment Subcommittee

The climate in which renegotiation of the Farm Bill will take place in 2007 differs dramatically from that prevailing in 2002. Three major factors are different in this round:

1. **The Deficit.** Probably the best that rural America can hope for in the 2007 Farm Bill is to preserve current spending levels. Increases are extremely unlikely. Urban legislators and "deficit hawks" argue that the new Farm Bill should be much smaller, and should therefore contribute to paying down the overall national deficit. The possible use of "PAYGO" rules—which mandate that any new spending or tax changes not add to the federal deficit—may further sharpen the conflict between spending levels in different titles of the Farm Bill.
2. **Trade Pressures.** The 2004 expiration of the "Peace Clause," the collapse of the Doha Round, and the prospect of retaliation from Brazil on cotton subsidies would suggest, at a minimum, that the need for the U.S. to comply with its existing WTO commitments will play a more prominent role in Farm Bill debates. Subsidy cuts become even more relevant should there prove to be enthusiasm in Congress for U.S. leadership in reviving the Doha talks.

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[16] "Transcript of Remarks by Agriculture Secretary Mike Johanns at the National Milk Producers Federation," USDA Press Release 0443.06, 2 November 2006.

3. **Increased public awareness of current inequities in subsidy programs.** The availability of an on-line database detailing subsidy payments (www.ewg.org), combined with multi-part articles over the past few months in many metropolitan dailies (New York Times, Washington Post, Atlanta Constitution-Journal, etc.) has increased public awareness of the market distortions that subsidies cause (or exacerbate). Public attention has also focused on the ways in which subsidies can spur agribusiness consolidation, and subsidies' inequitable geographic distribution.[17]

Maine at present does not have a member of its federal Congressional delegation on either a House or Senate Agriculture Committee, where the Farm Bills are written. Historically, delegations from New England have been under-represented on these committees—although Senator Patrick Leahy of Vermont played a very active role in the 2002 negotiations to broker a deal on dairy that provided benefits to smaller-scale milk producers in this region (the MILC program).

Maine benefits comparatively little from the current structure of the Farm Bill—because of its diverse cropping base, low acreage levels of "program crops" and because of the insignificant amounts of money contained in the Forestry Title. To be sure, Maine dairy farmers, and (to a lesser extent) potato growers who are rotating acreage with grain crops, have benefited from federal supports,[18] and Maine farmers and woodlot owners received $34.2 million in conservation program payments over the past decade. But it is also clear that Maine could derive more benefit if the current Farm Bill was restructured to focus on rural development, on building regional food and nutrition systems, on sustainable forestry, and on biofuels development.

More generally, it is probably in Maine's best interest to focus on developing regional economies of scale and in-state areas of economic comparative advantage. To date, a broader focus on rural development concerns has not driven US negotiating strategy at the WTO. By contrast, in past WTO negotiating rounds, the European Union and Japan focused on a concept called "multi-functionality," which the WTO defines on its website as the "[i]dea that agriculture has many functions in addition to producing food and fibre, e.g. environmental protection, landscape preservation, rural employment, food security, etc." The United States and the "Cairns Group" of major agricultural product exporting countries have resisted this negotiating concept. For states such as Maine, however—where the health of farm and forest landscapes are taken as important quality of life indicators, and also contributes to tourism and other non-agricultural sectors—a negotiating approach emphasizing "multi-functionality" as a key value might speak more directly to Maine's particular interests for its rural sector.

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[17] As the Environmental Working Group notes on their website, "Over the past decade, U.S. taxpayers have spent over $112 billion on commodity subsidies, but just seven states took in half of the money. Why? Because four commodities—corn, wheat, rice and cotton—account for 78 percent of the subsidies, and a handful of states produce most of the subsidized crops."

[18] Environmental Working Group's database shows that Maine producers received $41.9 million in subsidies between 1995-2004, with dairy programs accounting for about $15 million of that total.

The Maine CTPC (and in particular its Natural Resources Subcommittee) could, as part of its 2007 Workplan, devote attention to working with Maine state agencies, rural-sector businesses, producer associations, local governments, and nonprofit groups to identify and advance a set of priorities for a reformed Farm Bill:

Continue payments to dairy producers through a combination of "Green Box" and capped "Amber Box" supports. As noted above, dairy occupies much of the United States' trade-distorting "Amber Box" spending. Other commodity groups, which understand that they are now competing for a limited volume of "Amber Box" spending, may attempt to eliminate USDA's price- support programs for milk. From another direction, there may be a strong push from producers in other parts of the country, where average herd sizes are much larger than in New England, to remove the current cap on MILC payments (in which producers receive supports up to a maximum of 2.4 million pounds of milk produced per year[19]). Either of those outcomes would be disadvantageous to Maine's producers. Ironically, it can be argued that MILC is an example of a less-trade-distorting subsidy, precisely because of the cap; nonetheless, because of the way subsidies are calculated at the WTO, dairy price supports occupy a particularly large proportion of U.S. Amber Box spending as compared to what it "costs" the federal treasury in terms of actual outlays.[20]

The Maine CTPC may wish to address the following strategic questions regarding dairy and the Farm Bill, arranged from "minimalist" to "maximum" reform approaches:

a) *Argue for replication of the 2002 Farm bill status quo on dairy, including retention of the current MILC cap (and a reevaluation of benchmark prices).*

Pro: relatively predictable, understood by producers, and modestly responsive to the particularities of Maine's dairy sector (i.e., smaller average herd size).

Con: liable to be 'at risk' due to attacks from other 'program crop' commodity groups in the Farm Bill reauthorization process; vulnerable to WTO challenge; does not directly assist producers with income diversification.

b) *Argue for the continuation of some price-support mechanism (still "Amber Box"), with any reductions in overall supports made up for with other types of support through non-trade-distorting ("Green Box") payments.* This could include payments to assist with environment/nutrient-management compliance costs. This could be achieved through use of a state (or regional) "community capital displacement fund," perhaps funded through the rural development title, whereby communities/counties/states that have a particular reliance on dairy as part of their economic base have decreased funding for commodity-specific production made up to them through different "Green Box"

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[19] Rates for MILC payments are established on a monthly basis based on the difference between a "trigger price" and the actual price for Class I milk in Boston. Producers receive a payment equal to 45% of the difference between those two prices—up to 2.4 million pounds of milk per producer.

[20] To simplify somewhat, this is because WTO subsidies are to be calculated and notified in relation to the global price for milk during the years 1986-88, whereas the MILC program is calculated with reference to the price of milk in Boston, which is a higher price, because it reflects the existing tariff and U.S. market-access restrictions.

mechanisms. Funding made available through the Rural Development Title provides one avenue for administering such an approach.

Pro: indicates flexibility by the dairy sector in responding to the Amber Box caps proposed in the United States' October 2005 proposal to the WTO; provides a mechanism for "subsidy conversion" toward conformity with existing trade commitments while strengthening environmental compliance incentives; less likely to be challenged through the WTO dispute resolution system.

Con: subject to the vagaries of the appropriations process; will inevitably create new winners and losers, and increase compliance costs; possibility of greater price volatility for milk; probably increased administrative costs at the state level.

c) *Argue for across-the-board cuts in* ***all*** *commodity programs, freeing up significant resources that can be used in other Farm Bill titles, including (for example):*

- conservation—major increases in Environmental Quality Incentives Program (EQIP), Conservation Reserve, and working lands programs, and possibly the introduction of new "Ecosystem Services" payments;
- nutrition—aggressive implementation of "Farm to School" and other purchasing programs to guarantee supply and minimum prices for Maine dairy products in local markets; ensuring that producers capture more of the "per-food-dollar" spent in federal/state procurement programs; ensuring that families qualifying for food stamp programs can get vouchers to farmers' markets; etc.
- energy—major investments/tax credits etc. to advance installation, and integration into the electricity grid, of methane biodigesters and other emerging technologies that utilize poultry, cattle and mill wastes for electricity and biodiesel.
- rural development—block grants, or other funding mechanisms, to states and local governments for a variety of economic development activities. These might include: small/medium scale processing facilities and other specialty-product value-added supports; infrastructure development assistance for on-farm operations, or improvements in rural-urban food-system linkages; support to rural health treatment and insurance services; promoting organic certification, etc.;
- farm credit; and
- trade—increased funding to enable small/ medium businesses with particular specialty food/nursery products to participate in international trade and marketing activities.

Pro: WTO compliant; embraces the concept of 'multifunctionality' that foregrounds regional rural innovation strategies for economic development while assisting in the diversification of income streams and improving risk management for producers; helps move Maine and other states in the direction of more sustainable food systems, which many organizations and individuals have expressed as a very high priority for the state.

Con: runs counter to the current direction of discussions on Farm Bill reauthorization.[21] Maine's lack of representation on Congressional agriculture committees makes this a

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[21] At the time of this writing, it is not decided who will chair the House and Senate Agriculture Committees in the 110th Congress, but the likely candidates are Rep. Collin Peterson of Minnesota and Senator Tom Harkin of Iowa. Peterson has already expressed his enthusiasm for, essentially, a continuation of the 2002 Farm Bill; his Congressional district is the 7th-largest recipient of agricultural

much greater challenge for the Commission than would be the case if Maine had a voice on one or both of the Congressional committees responsible for writing the Farm Bill.

On the other hand, there are a number of vehicles for discussing multi-state strategies on Farm Bill reform, including several in which Mainers play a very prominent role. These include the Northeast States Association for Agricultural Stewardship (NSAAS); the National Campaign for Sustainable Agriculture; the Northeast Sustainable Agriculture Working Group; and others.

Focus attention on the Forestry title of the Farm Bill, since this is arguably where Maine can achieve greatest gains within the most-likely structure for the 2007 bill. Perhaps because it is a smaller and thus far less contentious Farm Bill title, a number of important consensus documents on forestry have already been produced that outline a set of principles and strategies for the 2007 Farm Bill. And whereas the term "sustainable agriculture" is still contentious in the overall Farm Bill, there appears to be agreement about the use of the term "sustainable forestry" in describing the appropriate goals of a Farm Bill title.[22] Further, a "Northern Forest Farm Bill Summit" convened earlier this year resulted in an excellent letter to Senator Olympia Snowe, dated 5 September 2006, and signed by numerous state forest associations and nonprofits, which described this region's set of priorities.[23]

As noted above, a majority of the "mandatory" spending in the 2002 Farm Bill Forestry Title never reached intended recipients; and current Forest Land Enhancement Program (FLEP) grants to Maine are beginning to expire. Maine's Congressional delegation arguably enjoys a higher profile on forestry issues than is the case for agriculture as a whole.[24] It may therefore be easier for the Commission to connect to its Congressional delegation on issues specific to forestry.

A further consideration is the fact that Maine has been a state leader in the area of "forest certification," responding to the demand for timber that has been grown according to specific "sustainability" and labor rights criteria.[25] The Maine Forest Service and the

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subsidies. Iowa ranked second among states (behind Texas) in overall subsidy supports. Data are from Environmental Working Group, based on 1995 – 2004 numbers.

[22] See, for example, the "National Association of State Foresters Principles for Sustainable Forestry in the 2007 Farm Bill," on-line at: http://www.stateforesters.org/reports/2007FarmBillPrinciples.pdf. The statement's first principle is "Meeting the goal of sustainable forestry is best achieved through a Forestry Title."

[23] Copy of letter provided by Jad Daley, Campaign Director of the Northern Forest Alliance. The lead signature on this letter is R. Alec Griffin, Director of the Maine Forest Service.

[24] Representative Mike Michaud is a member of the U.S. House of Representatives Forestry Task Force; Representative Tom Allen spearheaded a Congressional sign-on letter intended to increase funding for various forest land conservation programs; and Senator Susan Collins has sponsored legislation to amend the Cooperative Forestry Assistance Act of 1978, "to establish a program to provide assistance to States and nonprofit organizations to preserve suburban forest land and open space and contain suburban sprawl."

[25] See www.mainegov-images.informe.org/doc/mfs/certification/pubs/forest_cert_brochure.pdf and final report of "The Maine Forest Certification Initiative" dated 28 January 2005. The brochure provides examples of economic development and contracts won/retained as a result of the state's push on sustainable forestry. An analysis of the different forest certification schemes used in Maine is beyond the scope of this

Maine Technology Institute also looked at this product "branding" issue as part of its Maine Future Forest Economy Project, with one consultant's report concluding that "the [Maine] brand should be positioned to highlight the principles of sustainability and local economic development as well as accomplishments in these areas."[26]

In sum, Maine is in a position to show leadership in developing a stronger and better-funded Forestry Title in the 2007 Farm Bill, with possible attention to:

- market linkages for building a sustainable wood products industry through certification and branding;
- arguing for the importance of developing new markets for Ecosystem Services;
- "Cooperative Conservation," including methods/programs for bringing together groups of private landowners to achieve "economies of scale" with respect to watershed values, biodiversity conservation, *and* working lands approaches; and
- utilization of forest biomass for renewable energy production.

The Commission is well-placed to support such arguments and connect to Maine's Congressional delegation on these matters.

Focus attention on increasing "Green Box" supports to Specialty Crops to U.S. agriculture, through the nutrition, trade, and rural development titles. Maine is primarily a "specialty crop" state, with production and export of brown eggs, fruits, vegetables, syrups, and potatoes making the major contribution to the state's agricultural economy. As noted above, specialty crop associations nationally are organizing to be "players" in the 2007 Farm Bill in ways that have not been seen before.[27] At the same time, specialty crop producers have a defensive interest—a concern that planting restrictions on fruits and vegetables may be removed as part of the Brazil cotton dispute settlement.

Various legislative proposals—some in the Farm Bill, some in other legislation[28]—have sought to address the concerns of Specialty Crop producers and increase funding levels. Among the approaches that have been considered for block grant funding, and which arguably could benefit from expanded support:

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report. In the past, eco-labels have been controversial at the WTO because of the perception among some member-states that they constitute disguised protectionist barriers to trade. However, no challenges to forest certification schemes have been brought forward through the WTO dispute resolution system. Nonetheless, this is an aspect of international trade that the Maine CTPC may wish to monitor closely—also because certification issues are very much at play in debates on government procurement.

[26] "Branding Maine Forest Products," pp. 288-290 of the report, **Maine Future Forest Economy Project – Current Conditions and Factors Influencing the Future of Maine's Forest Product Industry,** prepared by Innovative Natural Resources Solutions, March 2005. "Brand" commentary by Robert Bush.

[27] "[Stakeholders]…point out that specialty crop producers are not beneficiaries of the $23 billion in USDA spending (in FY 2005) on price and income support programs for grains, oilseeds, peanuts, sugar, upland cotton, and dairy, although the value of specialty crop sales accounts for roughly 50% of all U.S. farm crop cash receipts." **Specialty Crops: 2007 Farm Bill Issues**, CRS Report to Congress, by Jean Rawson; 6 July 2006.

[28] These include the Specialty Crop Competitiveness Act of 2004, and three bills introduced in the 109th Congress that will inform the 2007 Farm Bill debate. Provisions of the 2004 Act are subject to the vagaries of the annual appropriations cycle, and were never fully funded. The recently-introduced bills seek as much as a ten-fold increase in funding for specialty crop block grants.

- Product market development and expansion, including support for value-added programs
- Pest and disease prevention, including support to University of Maine programs
- Organic certification programs
- "Farm to School" programs, increasing the amount of fresh fruits and vegetables supplied by local farmers to school districts, as well as to other state/local institutions (hospitals and nursing homes, prisons, etc.)
- Conservation programs to assist with specialty crop soil/water management and environmental compliance.

As can be seen, this list overlaps with many of the elements described in a previous section regarding "Green Box" and the shifting of payment types out of trade-distorting "Amber Box" programs. The nutrition, rural development, and conservation titles are all relevant to this effort. While some WTO member countries have raised concerns about use of the green payments, none of the types of programs outlined here have led to specific objections.[29]

In sum, the problem of current U.S. non-compliance with its WTO commitments on agriculture can be addressed in several ways that can be grouped under three main headings. All of these should be seen as *partial* solutions rather than panaceas:

1. Payment Caps—of which the MILC dairy program provides one possible model;
2. "Box shifting"—moving payments from current "Amber Box" to "Green Box" categories of spending. It will be incumbent on the United States for reasons of its trade commitments—as well as for the success of such programs at the local level—to identify specific environmental, local-food-system/nutritional, or economic development objectives associated with these payments; and
3. Transforming subsidies—through greater attention to the Rural Development title[30] in the Farm Bill. The states should work with USDA to develop program implementation partnerships, and create flexibilities in funding and implementation that will allow local institutions to experiment.

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[29] The G-20 group of advanced developing countries, led by Brazil and India, has expressed concerns about a range of developed-country subsidy payments in its public statements. Current WTO rules in the Subsidies and Countervailing Measures (SCM) Agreement, however, only preclude domestic support subsidies that cause significant price suppression or displace another country's market share. None of the measures proposed here would like lead to significant price distortion of markets at regional or international levels. In fact, there appears to be a rather significant "North-South" consensus regarding the importance of local food security. In many ways, the current WTO negotiating dynamic on subsidies and tariffs cuts across the grain of this tacit consensus. Members of the Maine CTPC, and speakers at public hearings, have expressed concerns about the impacts of U.S. negotiating actions with respect to local, national, and global food security. Attention to issues of food sovereignty could be part of the CTPC's future work plan.

[30] The transcript of the USDA "Listening Session" in Maine, in which Undersecretary for Rural Development Tom Dorr and Congressman Mike Michaud were both involved, provides further insights into the interests and priorities of Maine farmers in relation to the Farm Bill and rural development. This fifty-page document is on-line at www.usda.gov/documents/FBFME101105.pdf.

As part of its workplan, the Maine CTPC will decide how much attention it may devote to assisting with the process of organizing and communicating Maine's priorities for the 2007 Farm Bill and other legislation that deals with specialty crops. Specialty producers have their own perspective on the mechanics of, and potentials for, writing a "WTO-consistent" Farm Bill.

Support the ability of Maine's Specialty Food Product Producers to take part in national and international trade fairs/shows. Finally, the Farm Bill includes a title on Trade that funds a variety of marketing initiatives. The Maine Department of Agriculture and the Maine International Trade Center (MITC) have devoted substantial resources to assisting seafood and specialty food producers to take part in trade fairs where Maine products can become better known. Maine is home to a "Gourmet and Specialty Foods Producers Association," which was strengthened through a $38,000 Federal-State Marketing Improvement Program grant in 2002.[31] Conversations with producers in Maine suggest that this assistance has been extremely useful, as has been outreach to the tourism industry, restaurant associations, and specialty-food publications.[32] The Maine Citizens Trade Policy Commission may wish to engage specialists from MITC, from specialty food firms, from seafood exporting businesses, and from the University of Maine to better understand the regional, national, and international marketing and "awareness" barriers that these producers continue to face, and how the Maine CTPC might assist in this area of rapid growth and development. MITC reports that a big part of any such push should be to assist in making as many companies as possible "export-ready."

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[31] "Strengthening the Organization of Maine's Value-Added Food Producers," Jane Auidi, November 2003, final report on this USDA-FSMIP grant at www.ams.usda.gov/tmd/FSMIP/FY2002/ME0357.pdf.

[32] The Forum is grateful to Mary Ellen Johnson from the Commission for her assistance in connecting Forum staff to state officials who could speak knowledgeably on these topics.

Water in International Trade and Investment Agreements:

Report to the Natural Resources Subcommittee, Maine Citizen Trade Policy Commission

December 2006. The Maine Citizen's Trade Policy Commission has asked the Forum on Democracy and Trade to analyze the effect of international trade and investment agreements on Maine's capacity to manage its water resources and water services, and to suggest options for the Commission's future activity in this issue area.

What is the scope of Maine's interest in water policy?

Water is essential to life and necessary for economic well-being. Maine and other states regulate and manage water resources in order to protect the public health and the health of the environment, as well as to ensure adequate and sustainable supplies of water at a reasonable and fair price for individual consumption and for industrial, commercial, and agricultural use. Maine is blessed with an abundance of water, but if its water resources are not managed carefully, the ecological system may be irreparably harmed and the private interests of commercial users and distributors may trump the public interest of all the people of Maine.

The debate in Maine about how to appropriately regulate (if at all) the drinking water bottling industry illustrates the difficulties inherent in seeking the right balance between private and public interests and between commercial and environmental interests in water policy.

For example, the producer of Poland Springs bottled water, Nestle Waters North America, Inc.— a subsidiary of an Italian company[1] —was recognized by Governor John Baldacci at the Maine International Trade Day in 2006, and given the "Foreign Direct Investor of the Year" Award.

Nonetheless, Nestle Waters' practices have been challenged as not always in the public interest, and perhaps not environmentally sustainable. U.S. bottled water companies have sued Nestle Waters alleging false labeling, i.e. that Poland Springs bottled water is not always spring water and it is not always pure. Nestle Waters also has been sued by landowners of lots adjacent to its properties or its suppliers' properties. Most significant of all, in response to concerns about the sustainability of water pumping and belief that Mainers are not being fairly compensated for depletion of a valuable natural resource, a group called ***H_2O for Maine*** is proposing a 20 cent per gallon tax on water pumped by drinking water bottlers like Nestle Waters. This tax would fund a trust for investing in Maine's economic development.[2]

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[1] While Nestle's parent company is Swiss, research conducted by the Forum suggests that it was Nestle's Italian affiliate that was the locus of investment into Nestle Waters North America. See "Poland Springs Issues," by Craig Waugh, unpublished document on file with the Forum on Democracy and Trade.

[2] For more information, see the Maine International Trade Council and Nestle websites, www.mitc.com/PDF;www.waterdividendtrust.com; and www. nestle-watersna.com/PressCenter.html

Why should the Maine Citizen Trade Policy Commission monitor WTO negotiations on water services?

Of greatest concern to state and local management of water resources is the WTO's agreement on services, the General Agreement on Trade in Services. The GATS covers a wide range of economic activities. The GATS uses a "positive list" approach for *sector-specific commitments*; that is, countries make offers on individual sectors that they agree to include within the scope of GATS rules. The United States has not made a commitment under "drinking water services" to GATS disciplines, and the United States Trade Representative (USTR) has assured states that the United States has no plans to make such a commitment. But the United States has other types of commitments under water services. The United States made sector-specific commitments such as sewage treatment "contracted by private industry," and also to water-related sectors such as "other environmental services," plus engineering and construction services (which include waterworks).[3]

European water companies have targeted the United States as an important market for expansion**.** European multinationals account for more than 50% of the private water market globally. The three major multinationals are Veolia (formerly Vivendi), RWE, and Suez. Each has grown through aggressive acquisition campaigns in the United States, in Europe, as well as in Central and South America.[4]

The private water industry based in Europe in the past has been keen to see the United States commit water services under the GATS. The European water industry has specifically urged the European Community to make this request of U.S. negotiators. But to the surprise of many observers, the EU has declined at present to renew this request of the United States—perhaps an acknowledgement that commitments on drinking water services are extremely unlikely. Thus for the near term, drinking water services ("water for human use") appear to be off the table at GATS negotiations in Geneva.

Nonetheless, the United States has made sectoral commitments for "distribution services," "wastewater services," and "environmental services" that might allow a WTO challenge to the United States based on water policy in Maine. Bottled water operations in particular might be regarded as a "distribution service." The Maine Citizen Trade Policy Commission, therefore, may still want to closely monitor GATS negotiations in

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[3] A good discussion of the number of GATS sectors where water usage might be implicated is found in "The GATS and Regulatory Autonomy: A Case Study of Social Regulation of the Water Industry," Andrew Lang, ***Journal of International Economic Law,*** Vol. 7 No. 4; 2004; at pages 812-816.

[4] Keeping track of mergers and acquisitions in this sector is practically a full-time job itself. Bloomberg.com notes that in the last three years, its index of U.S. water stocks has surged by 150%--three times faster than companies on the S&P 500 overall.

Geneva related to sectoral commitments, and to seek clarification with respect to "distribution services" at both wholesale and retail levels.[5]

Of even greater concern to the Maine Commission should be the recent resumption of WTO negotiations on general GATS obligations related to "domestic regulation."

If WTO negotiations on GATS and domestic regulation are successful, the disciplines thus adopted under the GATS could become substantially more intrusive for Maine and other jurisdictions, not only in the area of water policy but across the board.

The potential intrusiveness of the general obligations covering domestic regulations will depend on the test used for determining if they constitute a barrier to trade. It was originally proposed that these standards, requirements and procedures should be "not more burdensome than necessary to ensure the quality of a service." Such a "necessity test" could put a range of water policy measures and a range of other regulatory measures in the State of Maine and in other jurisdictions at considerable risk of conflict with GATS obligations. Further, these domestic regulation negotiations are intended to ensure that state and local measures do not create trade barriers with respect to "qualification requirements and procedures, technical standards, and licensing requirements."[6]

Parties to the domestic regulation negotiations in Geneva are now looking for a compromise—a less intrusive formulation than the necessity test—for identifying a domestic regulation violation. However, one WTO member-state was quoted recently as saying that "any deal on services must include strong linkages between market access commitments and a domestic regulation component."[7] The outcome of these negotiations will be vital for Maine and all other U.S. states and localities.

Should a necessity test or something equivalent to it be agreed upon in Geneva, the Center for International Environmental Law has identified several areas where water policy could be threatened:

- qualifications of water service providers;
- the use of licenses, permits, and technical regulations and standards related to pollution discharges, operating permits, and other water policy measures;
- the use of environmental criteria related to water services in awarding concession contracts or assessing licensing fees; and
- requirements for water sustainability impact assessments before issuing licenses.[8]

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[5] For more information see the discussion of "Water Services" on the Forum on Democracy & Trade website at http://www.forumdemocracy.net/trade_topics/water_services; for more on the EU's recent actions also see Christina Deckwirth, "Water almost out of GATS," A Corporate Europe Observatory Briefing, March 2006, available at http://www.corporateeurope.org/water/gatswater2006.pdf.

[6] Center on International Environmental Law (CIEL), "GATS, Water, and the Environment," October 2003, p.17, available at http://www.ciel.org/Publications/GATS_WaterEnv_Nov03.pdf.

[7] "A 'Green Light' to Restart DDA [Doha Development Agenda]", Washington Trade Daily, 17 November 2006, Vol. 15 No. 229.

[8] CIEL, *supra*, p.2.

As noted above, a number of other GATS sectors may implicate Maine's water services and management of water resources, particular with respect to, for example, water treatment plants and sewer systems (construction, architecture, engineering, project management services, technical testing services, etc.).

How can Maine raise concerns about GATS and water services? [9]

- The Maine CTPC has already communicated to USTR and Maine's congressional delegation its concerns about the domestic regulation negotiations in Geneva—negotiations suspended in July 2006 but recently restarted. Continued dialogue with USTR about the status of negotiations, and US proposals to the Working Party on Domestic Regulation, should be a priority for the Maine CPTC. Maine has sought to ensure that no 'necessity tests,' including operational necessity tests, are included in domestic regulation disciplines.
- The resumption of WTO negotiations on GATS and domestic regulation and the already-existing U.S. commitments on distribution services and on sewage services and environmental services bear very close watching and in the long run may threaten Maine's authority over water policy more generally. Maine regulates a number of professions that pertain to water and environmental health. The qualification requirements used for service suppliers could be challenged as "more burdensome than necessary"; also possibly at risk are fees charged in order to obtain a license to practice a professional services in the state.
- Governor Baldacci's April 2006 letter regarding GATS negotiations mentioned a number of sectors of concern to Maine, but did not mention water, as this was not seen as being part of a new GATS offer. The Maine CTPC may wish to again seek assurances that USTR does not intend to make further sectoral commitments on water services.
- Maine may wish to argue that a number of its water and sanitation projects are excepted from GATS disciplines because they "supplied in the exercise of government authority."[10] To date, there is no WTO jurisprudence, or any clear international consensus, regarding the scope and extent of the "government authority exception." How this term is interpreted is crucial to the degree of regulatory flexibility that governments will be accorded in the water sector.
- Finally, Maine may wish to raise the issue of taxation as a limitation to specific articles of the GATS. In 1995, the United States Trade Representative assured states that he would seek a "carve-out" in the GATS to protect state taxing authority. Other WTO members rejected that carve-out, arguing that the use of different tax treatment in different states amounted to a violation of GATS 'non-discrimination' principles. While no cases have been brought forward in the GATS to challenge US tax measures, the possibility that Maine will adopt a tax

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[9] The Forum on Democracy & Trade has not undertaken an in-depth study of Maine's water laws and regulations as part of this assessment. For more detail on water services in relation to the GATS, the reader is referred to www.forumdemocracy.net, under "Trade Topics: Water."

[10] See GATS Article I 3:(b) and (c).

on bottled water exports suggests that the Maine CTPC may want to ask USTR about the status of state taxation measures vis-à-vis the GATS.

Why should Maine be concerned about the effect of international investment agreements on its capacity to manage water resources?

While GATS water issues should be monitored closely, recent developments such as the European Union's decision not to seek inclusion of "water for human use" as a sector of economic activity that should come under the scope of GATS regulation suggest that a conflict between GATS rules and Maine's authority to regulate drinking water services is unlikely in the near term.[11] The possibility of a challenge under an international investment agreement to Maine's authority to regulate its water resources, however, cannot be discounted—even in the short term.

Two major NAFTA chapter 11 cases challenging the capacity of state and local government regulation to protect the safety of drinking water have already been adjudicated. The NAFTA tribunal in *Methanex v. United States* soundly rejected Vancouver-based Methanex Corporation's claim for nearly a billion dollars in compensatory damages for California's phase-out of the gasoline additive MTBE, which was polluting lakes and groundwater and endangering the public health. But in an equally important case, *Metalclad v. Mexico*, an international tribunal found a violation of NAFTA's Chapter 11 on investment when state and local governments took regulatory action to stop operation by U.S.-based Metalclad corporation of a hazardous waste disposal facility that was believed to be a threat to drinking water safety and the environment. Neither the *Methanex* or *Metalclad* cases are formally precedential in NAFTA or other international investment litigation; future panels may cite the reasoning used in either case, or not refer to them at all.[12] But the existence of such litigation suggests that there is some risk that

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[11] However, the European Union (for example) could challenge the regulation and taxation of bottled drinking water enterprises based on the current U.S. commitment under "distribution services," and not as part of the service category "water for human use."

[12] One encouraging trend in international investment litigation can be seen in the "Counter-Memorial" recently filed by the U.S. State Department in another NAFTA case, this one brought by the Glamis Gold Corporation of Canada. The Counter-Memorial sought to remind the tribunal that "United States law on the whole provides a high level of protection for investment, consistent with or greater than the level required by international law," and directed the United States to negotiate agreements that: "[do] not accord greater substantive rights [to foreign investors] with respect to investment protections than United States investors in the United States [are accorded under U.S. law]…..United States law does not compensate plaintiffs solely upon a showing that regulations interfered with their expectations, as such a showing is insufficient to support a regulatory takings claim. Tellingly, despite Glamis's heavy reliance on domestic jurisprudence throughout its Memorial, Glamis nowhere cites U.S. legal authority to support its proposition that an interference with one's expectations alone is compensable. **It is inconceivable that the minimum standard of treatment required by international law would proscribe action commonly undertaken by States pursuant to national law."** (emphasis added; internal footnotes omitted) Glamis is seeking compensation for expropriation of investment and a violation of minimum treatment through a NAFTA tribunal because of a California law whose purpose is environmental protection and the protection of sites of cultural significance. The *Glamis* case is still working its way through the dispute resolution process.

new international investment claims may be brought seeking compensation for regulation of water resources by Maine or other U.S. states or localities.[13]

It also suggests that the Maine Citizen's Trade Policy Commission may want to work with the U.S. Trade Representative's office and with the Maine congressional delegation to seek an official interpretation of NAFTA Chapter 11 and to clarify language in future agreements regarding investment agreements. This could include the codification of parts of the *Methanex* decision to protect bona fide government regulations, including water regulations, from any *Metalclad*-type claim that might be based on the actions of the State of Maine or one of its subdivisions (i.e., a county, town, or water service territory). As noted in note 12 above, it would appear that the U.S. State Department has taken a line of argument suggesting that non-discriminatory environmental regulations cannot be judged as a violation of the "minimum standard of treatment"—at least with respect to the facts in the *Glamis Gold* case. Thus far, however, the *NAFTA countries have not agreed to any interpretive statement clarifying the rights of states and provinces to take actions to protect natural resources*, or to codify parts of the *Methanex* decision.

What are the options for reform of international investment agreements?

The Maine Citizens Trade Policy Commission may want to consider the options for reforming U.S. policy related to international trade and investment litigation to preclude a challenge to state or local water policy. The primary options are:

- Renewed consultations with USTR to seek interpretive notes for current agreements and to carve coverage of water policy and regulation out of future agreements;

- Congressional action to carve out water policy from existing and future agreements, or at least prevent the enforcement of adverse tribunal decisions against states and localities under U.S. implementing legislation.

Renewed consultations with USTR. Such consultations might focus on three possible reform measures:

(1) an interpretive note applying to current agreements;
(2) a general exception for water policy measures in future agreements; and
(3) a diplomatic review provision in future agreements.

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[13] The risk of international investment litigation is not limited to challenges to state and local anti-pollution or drinking water safety measures; hypothetically it might extend to other water policy measures such as production limits, siting regulation, or taxation of bottled water pumping operations, for example. Although the United States does not have bilateral or regional investment agreements or treaties with Italy, France, Germany, or Britain (the home base for most multinational water corporations), Nestle, Violia, RWE, and Suez do have in some cases foreign subsidiaries or could quickly create them in countries that do have such agreements with the United States. This phenomenon was observed in the case of a U.S. company, Bechtel, reorganizing its investment in Cochabamba, Bolivia, through its subsidiary in the Netherlands, in order to take advantage of an existing Bilateral Investment Agreement between Bolivia and the Netherlands.

(1) *An interpretive note*: NAFTA article 1131(2) provides that an interpretation of a provision of Chapter 11 on investment by the Free Trade Commission (consisting of the three parties to the NAFTA agreement) "shall be binding on a Tribunal established under this section." CAFTA and some other agreements incorporate similar language allowing the parties to officially interpret the text of investment agreements. Therefore, the Maine Commission may want to consider the pros and cons of supporting an official interpretation of international investment agreements in order to incorporate and expand upon the central holdings of the *Methanex* case, i.e.:

- a non-discriminatory regulation for a public purpose, which is enacted with due process, cannot constitute an expropriation or a violation of minimum treatment under international law; and
- the "in like circumstances" test for discovering a national treatment violation must be read narrowly. The test does not encompass a comparison between two different products that are only generally in economic competition.

(*2) A general exception.* Another potential starting point for consultations with USTR might be to discuss including in future international investment agreements and treaties a general exception for water policy and land use measures.

There is considerable precedent for including such as exception in future investment agreements and treaties. NAFTA article 2102, for example, provides a general exception for national security measures. In addition, the WTO agreements including the GATS provide a long list of general exceptions, including measures protecting human and animal health and life, protection of consumers and workers, protection of national treasures of artistic, historic, or archeological value, and maintenance of capacity to collect income and property taxes, among others.[14]

(3) Diplomatic review. Diplomatic review of investor claims would allow either country connected to an investment dispute to stop a claim from proceeding. There is precedent for a diplomatic review provision. Claims involving tax measures are currently subject to diplomatic review under NAFTA article 2103.6.

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[14] One prominent Canadian trade lawyer, Steve Shrybman, has noted that "while the GATS does allow government measures to protect human, animal, or plant life,…it does not allow the other critical WTO environmental exception for measures relating to the 'conservation of exhaustible natural resources.'" Shrybman argues therefore that "no government can use conservation to justify interfering with the rights of foreign service providers." Crafting a general exception for conservation in the GATS might be one approach to addressing this. See "The Impact of International Services and Investment Agreements on Public Policy and Law Concerning Water," Steven Shrybman, January 2002, originally published by the Council of Canadians. www.canadians.org.

A diplomatic review article in a future international investment agreement could simply state that no investor could bring a claim, until such time as the competent authorities (e.g., the Attorney General) in both countries agree to allow the claim to proceed.

Congressional action. As an adjunct to renewed consultations with USTR, the Maine Commission may want to consider calling for congressional action to carve out water policy and land use measures from existing and future agreements, or at least to prevent the enforcement of adverse tribunal decisions against states and localities under U.S. implementing legislation. Three types of congressional action might be considered: (1) an anti-preemption/cost shifting bill; (2) an appropriations rider; and (3) a comprehensive, "stand-alone" bill that addresses the relationship between natural resource management at state/local levels and international trade rules.

Beyond water policy issues, should Maine be concerned about international investment agreements?

International investment agreements, such as Chapter 11 of the North American Free Trade Agreement (NAFTA), establish systems of investor-to-state dispute resolution:

- which allow foreign investors to circumvent domestic courts, and
- which allow foreign investors to file claims against national governments seeking money damages in compensation for economic regulation by state and local governments, including water-policy regulation.[15]

In addition to the unusual rules with respect to who has standing to bring and defend international investment cases[16], consider these characteristics of the arbitrators who sit on the tribunals:

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[15] These tribunals operate on the model of international arbitration of commercial contracts. Each of the two parties to the dispute picks one arbitrator, and the third is either mutually agreed upon by both parties or appointed by a World Bank official. International investment agreements are unique in providing a private right of action for foreign corporations to initiate claims for economic damages against a national government. Multinational corporations and other investors are placed on an equal footing with nation-states in a process for resolving an issue of public policy. Investors no longer have to work through trade ministries to pursue a claim. As a result, the volume of cases increases, and the claims themselves may be brought without the restraint that nation-states exercise when dealing with issues of international relations.

[16] In contrast to the standing afforded foreign transnational corporations, U.S. state and local governments, although consulted, have no direct right to represent themselves before these international investment tribunals when a state or local law is alleged to be in violation of the United States' international obligations, even in cases where the state/local policy conflicts with the interests of the federal government or the Administration's political position. The inability of states and localities to represent themselves is a particular concern because international investment tribunals can effectively enforce their decisions by ordering the federal government to pay money damages to the foreign investor. The federal government has refused, so far, to assure states and localities that it will not seek reimbursement of any monies paid from the U.S. treasury to satisfy international tribunal judgments. Moreover, the federal government is authorized to sue to preempt any state or local measure that is a violation of a tribunal decision or that is otherwise inconsistent with an executive-legislative investment agreement.

- Arbitrators are appointed by executive branch officials to hear one case, and thus do not enjoy tenure and are not subject to confirmation by the legislative branch.
- Arbitrators are typically international commercial lawyers who may alternately serve as arbitrators in one case and plaintiff's counsel in the next, thus raising questions of conflict of interest.
- Arbitrators may have little or no familiarity with the U.S. constitutional principles of federalism and separation of powers, and are in any case forbidden to apply U.S. constitutional principles in rendering an opinion.
- Arbitrators make their decisions based on the text of an international investment agreement and customary international law, both of which are to be interpreted in light of the purpose of the agreement: to promote international investment.

Fortunately, the international rules for resolving international investment disputes about water policy and other state economic regulations are at an early stage of development. If state and local officials are passive, those rules are likely to expand at the expense of state autonomy. But if Maine continues its active engagement with USTR and Congress and if other states follow Maine's lead:

- new official interpretations of NAFTA, CAFTA, and other existing agreements can be adopted;
- new provisions could be negotiated as part of international investment agreements to protect the sovereignty of Maine and the 49 other states; and
- Congress can pass new legislation to protect the states' authority over water and other regulatory policies.

Appendix A: What was the Metalclad case about?

The possibility exists that under a bilateral or regional investment agreement like NAFTA's Chapter 11, Maine's authority to regulate its water resources could be challenged. The decision in *Metalclad v. Mexico* suggests this is a real possibility.[17]

This dispute arose over the use of a plot of land originally owned by a Mexican company (COTERIN), located near the municipality of Guadalcazar, in the state of San Luis Potosi, Mexico. In 1990, the Mexican federal government granted COTERIN a permit to build and operate a hazardous waste landfill on the land. But, in 1991 and 1992, the municipality denied COTERIN such a building permit. In 1993 the U.S. corporation Metalclad bought COTERIN and its permits, after receiving assurances from Mexican federal government officials that the project could go ahead.

In October, 1994, the City of Guadalcazar ordered a halt to construction of the Metalclad landfill because Metalclad had not obtained proper municipal building permits. Metalclad applied again for a municipal permit and immediately resumed construction, completing the project in March 1995. That same month, Metalclad attempted to open its new facility for operations. But angry local protestors, allegedly with the aid of state troopers, blocked the opening of the new facility. The landfill remained closed until November 1995. In November 1995, Metalclad entered into an agreement with two federal agencies, and the facility began to operate. The Guadalcazar city council responded in December 1995 by denying Metalclad's last petition for a municipal building permit and shortly thereafter obtained an injunction barring Metalclad from operating the facility.[18] Finally, in September 1997, the Governor of San Luis Potosi issued a state-level decree which established the landfill site as a protected natural area. Thus, without any reference to the lack of a municipal building permit, the state government entirely prevented the landfill from operating.

Earlier on January 2, 1997, Metalclad had already demanded arbitration under NAFTA's Chapter 11. In its claim against the Mexican federal government, Metalclad argued that the nation of Mexico was responsible under international law for the conduct of its governmental subdivisions, and that both the state of San Luis Potosi and the municipality of Guadalcazar had violated NAFTA section 1105's " minimum treatment" standard, and NAFTA section 1110's "expropriation" prohibition.

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[17] Metalclad v. United Mexican States, ICSID Case No. ARB(AF)/97/1, Award (Aug. 30, 2000), available at http://www.worldbank.org/icsid/cases/mm-award-e.pdf (also available at www.naftalaw.com). For a full version of this analysis of the *Metalclad* case, see the Forum on Democracy & Trade website at: http://www.forumdemocracy.net/disputes/nafta_cases/metalclad_v_mexico.

[18] Guadalcazar brought action against the federal government in Mexican court to challenge the agreement the federal agencies entered into with Metalclad. Pending resolution of this suit, Guadalcazar successfully obtained a preliminary injunction barring further operations at the landfill site. While the action was pending, the same federal agencies granted Metalclad a further permit which authorized a substantial expansion of the landfill site.

In August 2000 the NAFTA tribunal issued a decision and found that Metalclad was entitled to monetary relief in the amount of $16.9 million from the nation of Mexico. The Metalclad tribunal found that Mexican state and local authorities—in seeking to assure the safety of drinking water supplies—had violated two important investor rights protected by NAFTA: Article 1110 on expropriation and Article 1105 on minimum treatment under international law.

- ***Compensation for expropriation***. NAFTA requires member nations to compensate investors if national or subnational governments "directly or indirectly nationalize or expropriate" an investment of the other countries' investors in its territory. Expropriation includes measures "tantamount to nationalization or expropriation." The Metalclad tribunal had to decide not only the scope of expropriation, but also what the open-ended references to "tantamount to expropriation" and "indirect" expropriation meant. The Metalclad tribunal broadly read the term "tantamount to expropriation" and "indirect expropriation" in NAFTA's article on expropriation. This broad reading granted to investors a set of property-right protections that extend beyond the protections granted to property owners under the Fifth Amendment to the U.S. Constitution.

  In interpreting the Fifth Amendment "takings" clause, the U.S. Supreme Court "usually has applied the regulatory takings analysis only to regulations of specific interests in property." Expected or future economic benefits are not considered property under the Takings Clause. By way of contrast, the Metalclad tribunal read NAFTA's expropriation article to include not merely the seizure of property or its regulation to the point that its economic value is extinguished, but also "covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or significant part, of the use or reasonably-to-be-expected economic benefit of property…" In its Metalclad opinion, the " tribunal made it clear…that the relevant 'investment' for purposes of its expropriation analysis was Metalclad's broader interest in operating a particular type of business, not merely its interest in its real property."
- ***Minimum treatment under international law***. NAFTA article 1105(1) requires member nations to provide other members' investors with treatment in accordance with customary international law, including fair and equitable treatment and full protection and security. Article 1105 is intended to serve roughly the same purpose as "due process" norms in U.S. constitutional law, but because article 1105's terms are largely undefined, especially when compared with the extensive U.S. case law on procedural and substantive due process, international investment tribunals exercise great discretion when they make inherently subjective judgments about when government action violates fundamental principles of procedural or substantive justice.

  According to the Metalclad tribunal, Mexico breached article 1105(1) because it "failed to ensure a transparent and predictable framework for Metalclad's business planning and investment."

Appendix B: What was the Methanex case about?

Methanex v United States was one of the first cases brought against the United States under the investment chapter of NAFTA.[19] NAFTA's investment chapter provided the Methanex corporation, a Vancouver-based multinational firm, with a private right of action before an international tribunal to seek an award of economic damages against the U.S. federal government in compensation for California's phase-out of the gasoline additive MTBE that was poisoning the groundwater and lakes of California.

The Methanex case drew wide public attention because the Canadian plaintiff was seeking nearly $1 billion in compensation for lost "future profits." Methanex claims that billion-dollar loss resulted from California's regulation of MTBE. California argued that it was responding to a clear, scientifically-documented threat to public health and the environment.

- *MTBE — a fuel additive.* MTBE belongs to a group of chemicals called oxygenates. According to the U.S. Environmental Protection Agency (EPA), when oxygenates like MTBE are added to gasoline, they produce a cleaner burning fuel, thereby reducing tailpipe emissions and air pollution. The 1990 Clean Air Act Amendments require oxygenates to be blended into reformulated gasoline that is used in high-smog areas and in areas with high carbon monoxide levels in winter months. The act does not stipulate the use of MTBE, but most refiners chose to use MTBE rather than other oxygenates because of its price. About 26 percent of the gasoline sold in the United States in 2000 was blended with MTBE. Ethanol is the other widely-used oxygenate.

- *MTBE — a public health threat.* Although it helps improve air quality, MTBE unfortunately presents a serious risk to drinking water supplies. MTBE is hydrophilic, meaning it is chemically attracted to water molecules. As a result, it spreads quickly over great distances into groundwater and will persist there. Once it is in the water supply, MTBE is very difficult to clean up. It does not readily bind to particles of soil. It does not degrade easily. MTBE may persist in the groundwater for decades. No inexpensive technology now exists to remove MTBE from drinking water.

  MTBE has a foul taste, and smells like turpentine. Even in low concentrations, it is easy to smell and taste MTBE in drinking water. MTBE has been shown to be carcinogenic in rats and mice. MTBE is also a potential cause of cancer in humans, and may be associated with memory loss, asthma, and skin irritation.

  MTBE contamination of ground and surface water has been widely reported in California and across the nation. Leaking underground storage tanks are by far the most significant source of MTBE pollution. Pipeline leaks, spills at gas stations, and car accidents also contaminate the groundwater with MTBE. One study

[19] For the unabridged and fully footnoted version of this analysis of the *Methanex* case, see the Forum's website at http://www.forumdemocracy.net/disputes/nafta_cases/methanex_v_united_states.

estimates that MTBE has polluted 10,000 shallow groundwater wells in California. Another report, by a research team at the University of California at Davis (UC Davis), estimated that 3,486 groundwater sites in California are contaminated with MTBE. California reported detecting MTBE in 30 public water systems. In Santa Monica, the city shut seven of its wells because of MTBE contamination, thus losing half its water supply. In South Lake Tahoe, 12 of 34 wells were closed. MTBE was found in northern California lakes such as Tahoe, Donner, and Shasta. To the south, MTBE was detected in lakes and reservoirs including Castaic, Pyramid and Perris.

- *California phases out the use of MTBE***.** Responding to complaints about MTBE contamination of groundwater, lakes and reservoirs across the state, the California legislature passed S.B. 521 (Mountjoy), the MTBE Public Health and Environmental Protection Act of 1997. The act authorized a comprehensive study of the health effects of MTBE. It also authorized the governor to act by regulation to phase out the use of MTBE as a gasoline additive, if the study proved were to prove the chemical as harmful. Governor Gray Davis acted in 1999 to phase out MTBE, based on the UC Davis report. The report showed that the cost of using MTBE as a gasoline additive outweighed its benefits.

  Importantly, other states—and then the federal government—followed California's lead in curbing MTBE use.

After lengthy proceedings and deliberations, a NAFTA tribunal ruled that all of Methanex corporation's claims had failed. The tribunal then assessed the corporation for substantial litigation costs incurred by the United States.[20] *Methanex* is a landmark decision because of two key holdings:

- with some caveats, a non-discriminatory regulation for a public purpose, which is enacted with due process, cannot constitute an expropriation; and
- the "in like circumstances" test for discovering a national treatment violation must be read narrowly. The test does not encompass a comparison between two different products that are only generally in economic competition.

[20] *Methanex v. United States,* Final Award, available at http://www.state.gov/s/l/c5818.html. (also available at www.naftalaw.com).

Forum on democracy & trade

Report to the Health Care Subcommittee Maine Citizen Trade Policy Commission

I. Introduction

December 2006. The Health Care Subcommittee of the Maine Citizen Trade Policy Commission asked the Forum on Democracy & Trade to analyze insurance elements of Maine's Dirigo Health Program with respect to provisions of the WTO General Agreement on Trade in Services (GATS). This report is primarily based on analysis carried out by specialists at the Harrison Institute for Public Law, Georgetown University Law Center. These specialists note the complexity of the GATS commitments, particularly as it pertains to a multi-faceted public policy issue like "health care," since health care programs may fall into a number of categories in the United States' GATS schedule. Here we focus specifically on Dirigo and GATS in order to enable the Maine CTPC to:

- Understand potential trade conflicts serious enough to bring to the attention of U.S. trade negotiators and the Congress
- Raise questions about the meaning of vague GATS provisions on coverage
- Make suggestions for improving state-federal consultation on health and trade policy
- Identify potential safeguards for Dirigo and similar state-level health programs. Safeguards could take the form of:
  - avoiding implementation of new GATS disciplines on domestic regulation, or
  - avoiding coverage through limits on U.S. sector commitments in the GATS.

At the outset here, we note that there do not appear to be any foreign service providers active in Maine's health insurance market today. Only foreign governments, on behalf of their service companies, can instigate a GATS challenge, and so there are absolutely no imminent trade-law threats to Dirigo Health.

The potential for future GATS conflicts will depend on whether foreign service providers will seek to enter U.S. health insurance markets, and whether existing U.S. companies might reorganize their corporate domicile in order to take advantage of particular trade-law provisions. Certainly the U.S. market is attractive. Compared to other wealthy countries in the Organization for Economic Cooperation and Development (OECD), the United States is a "statistical outlier" with respect to the provision of health services for its population. According to the OECD, only 44% of total health expenditures in the United States comes from public sources, and the 35% share of total health costs accounted for by private health insurance programs is more than double the figure for that of the closest OECD country (Netherlands, at 15% provided by private suppliers).[1] Most OECD countries have aging populations, and health care is taking up a larger share of

[1] Francesca Colombo and Nicolas Topay ,"Private Health Insurance in OECD Countries: The Benefits and Costs for Individuals and Health Systems," OECD Health Working Paper #15, 2004. The OECD average is 6% for total health expenditures paid by private health insurers.

government spending. This has led to a proliferation of new supplementary health insurance products in the European Union in recent years. Will foreign suppliers seek to move aggressively into US markets? Here are the scenarios under which GATS and other trade rules become increasingly important with respect to state health care choices:

- Foreign firms might enter the market to take advantage of new government programs (subsidies and stable administrative payments).
- Domestic firms might change their corporate domicile to take advantage of evolving trade rules. This scenario might also involve countries that have Free Trade Agreements (FTAs) with the United States, which include chapters on services or investment that constrain government authority more than GATS.

These scenarios would depend on how much of a legal advantage the trade rules would provide to a foreign firm, as well as whether another country would threaten a trade dispute in order to support such a firm. It should be borne in mind that domestic insurance and pharmaceutical companies have shown they are willing to spend resources to try and invalidate Dirigo services in the U.S. courts.

Still, by itself, Maine is unlikely to provoke an international trade dispute. But if Maine continues to be a leader in state-level health policy innovation, and if other states begin to emulate innovations in Maine's insurance market, the threat of a trade dispute involving Maine's policy (along with others) would grow.

Another possible scenario is that the federal government might use its unilateral powers to enforce trade rules through preemption; or exercising a coercive option such as withholding federal funds through the Medicaid waiver process in order to limit the options available to Maine in experimenting with different types of health care coverage.

Finally, the trade rules are changing. The most likely source of GATS conflict that was identified involves ***proposed disciplines on domestic regulation that are presently being negotiated at the WTO.*** The Maine CTPC has already communicated with services negotiators at the Office of the United States Trade Representative regarding the Working Party on Domestic Regulations, and indeed Chief Services Negotiator Chris Melly has appeared before the commission. It is recommended that in addition to asking questions about new GATS *health-sector commitments*, the Maine CTPC also continue to monitor the *domestic regulation* negotiations very carefully.

It was recently announced that services negotiations are starting up again at the WTO, after the five-month suspension following the collapse of the Doha Round. A recent article in the Washington trade press[2] notes that

> During a 'Friends of Services' meeting..., lead US negotiator Chris Melly pressed for a clear strategy – starting with ambassadors first and ministers later – that would get to the nitty-gritty of bargaining."

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[2] "A 'Green Light' to Re-start DDA [Doha Development Agenda]," Washington Trade Daily, 17 November 2006.

Mr. Melly's statement might be evaluated in light of two comments he made in front of the Maine CTPC at the commission's 18 September 2006 meeting: first, that USTR considered the Working Party on Domestic Regulation's Chairman's Text to be "horrible"; and second, that he doubted there would be any serious negotiations on services "before the end of the year. One would assume that the Chairman's Text is the basis for the "nitty-gritty of bargaining." Has Mr. Melly (and by extension USTR) shifted from the previous assertion that there would not be significant negotiations on services before the end of 2006?

In response to CTPC questions, Mr. Melly stated again that USTR was not willing to honor the Governor's letter/request carving the State of Maine out of new GATS sector commitments. He stated that USTR did not see such carve-outs as necessary because Maine laws on roadside billboards or library services were unlikely to be challenged. Mr. Melly did *not* mention health care in his remarks before the Commission. And yet in the case of health care and pharmaceuticals, the recent history of domestic lawsuits suggests that it would be prudent to carve out health and pharmaceutical policies from coverage under GATS in order to reduce the risk of trade conflicts in the future. The fact that there are no foreign service suppliers in the market suggests that the negotiating cost of such a carve-out is low at the present time.

The expansion and growth of private health care programs in Europe and other major trade-partner countries does suggest that foreign suppliers might seek to enter Maine's health insurance market in the future. Under these conditions, the cautions noted by Maine CTPC, as well as Governor Baldacci in his 5 April 2006 letter, seem very reasonable**. Maine is fully justified in seeking further clarification from USTR with respect to that part of the U.S. GATS schedule where domestic legal challenges have already been brought by domestic actors. Maine is identified as a national leader in health care reform, and has been targeted accordingly. Maine's concerns are appropriate insofar as the rapid growth of private health care provides in Europe who may wish to enter the U.S. market makes a challenge to Maine law more likely.**

The remainder of this report follows the format and analysis provided by the Harrison Institute for Public Law. It is divided into four parts:

- Part II provides an overview of the relevant Dirigo elements.
- Part III addresses general GATS coverage of Dirigo Health.
- Part IV outlines the risk of conflict between Dirigo and GATS.
- Part V presents the potential safeguards that CTPC could recommend to protect Dirigo from conflict.

II. Brief Introduction to Dirigo

Before detailing specific GATS questions, this section provides (1) an overview of Dirigo terms, (2) a summary of how the program operates, and (3) a mention of three specific Dirigo provisions that are most likely to conflict with GATS obligations.

a) *Dirigo Terms*

The Dirigo program is a bundle of services that include insurance coverage provided by Dirigo to individuals, sole proprietors and small businesses. Employers and employees both pay Dirigo for the package. Dirigo, in turn, uses these and other funds available to it to cover its obligations for health care and prescription drug coverage through a group contract with Anthem. The Dirigo statute and its website describe the related services, which include prevention and wellness programs.[3] Three Dirigo terms could easily be confused if not explained. The relevant terms are:

- Dirigo Health Act (the "Act")—the actual statute that created Dirigo Health, which is codified at ME. REV. STAT. ANN. tit. 24-A, § 6901 et seq. (2006).

- Dirigo Health (the "Agency")—an independent executive agency created by the Act "to arrange for the provision of comprehensive, affordable health care coverage."[4] The Act creates the framework for the Agency to provide health services to Maine residents and minimize health care costs.

- Dirigo Health Program (the "Program") and DirigoChoice—The Act authorizes the Agency to create and manage a specific kind of health insurance within the Dirigo Health Program. The Dirigo web site refers to the insurance element as DirigoChoice.

DirigoChoice is available to:

- Small Business Employees (2-50 employees);
- Sole Proprietors (self employed / business of 1); and
- Individuals who:
    - Are unemployed
    - Work for a Small Business that does not offer insurance
    - Own a Small Business but cannot get enough employees to join a Small Group plan
    - Work less than 20 hours a week for any single employer

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[3] *See* <http://www.dirigohealth.maine.gov/index.html>, viewed January 12, 2007.

[4] ME. REV. STAT. ANN. tit. 24-A, § 6902.

- Are early retirees whose employer does not contribute to health benefits.[5]

Dirigo Health operates under a board of directors and an executive director.[6] The Act delegates rulemaking power to the Agency[7] and requires the Agency to arrange for the provision of Dirigo Health Program coverage.[8]

Section 6910 outlines requirements for Dirigo Health to create DirigoChoice. In short, Dirigo Health contracts with insurance carriers to provide coverage and with eligible businesses to arrange for coverage under the Program. The Agency may also permit eligible individuals to purchase coverage for themselves and their dependents.[9]

The Act authorizes the Agency to establish subsidies for "eligible individuals or employees whose income is under 300% of the federal poverty level,"[10] The subsidies are funded by savings offset payments, which are the amount saved by insurance carriers and third-party administrators as a result of the operation of the Dirigo Health Program. The Act authorizes the Agency to calculate this amount and collect it from non-Dirigo carriers.[11]

In sum, the Act creates a new Dirigo service and subsidizes its consumers. The Act also imposes some regulatory requirements (including a medical loss ratio for the first time on small group policies and some reporting requirements), but it does not place any restrictions on the type or amount of health insurance that may be offered by non-Dirigo

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[5] *See Dirigo Fact Sheet: Agency Presentation to the Governor's Blue Ribbon Commission*, at 6 (2006) [hereinafter *Dirigo Fact Sheet*], *available at* < http://www.dirigohealth.maine.gov/agency_Fact_Sheet_Final_091506.pdf>.

[6] *See id.* §§ 6904, 6909.

[7] *See id.* § 6908.

[8] *See id.* § 6910. The Act authorized Dirigo Health to create a nonprofit health care plan if health insurance carriers did not apply to offer Program coverage. *See* ME. REV. STAT. ANN. tit. 24-A, § 6910(2). Anthem Blue Cross and Blue Shield prevented the nonprofit option by becoming the first company to negotiate for business under Dirigo Health. *See Healthcare Coverage; Survey shows businesses shunning state health plan*, HEALTH & MED. WK., Aug. 2, 2004, at 549. Anthem is the only provider offering Dirigo Health Program coverage and recently renewed its contract for one more year. *See Dirigo Health Agency Reaches Agreement with Anthem on DirigoChoice* (2006), on-line at: http://www.maine.gov/governor/baldacci/healthpolicy/news/9_22_06.htm.

[9] *See* ME. REV. STAT. ANN. tit. 24-A, § 6910(4).

[10] *Id.* § 6912.

[11] The constitutionality of the savings offset payments of the Act and the validity of the methodology employed to determine savings in 2005 were recently upheld by the Cumberland County Superior Court. *See Maine Assoc. of Health Plans v. State*, No. Civ.A. AP-05-090, 2006 WL 2959744 (Me. Super. Ct. Aug. 4, 2006); *Dirigo Health Wins Court Case: Savings Confirmed* (2006), *at* http://www.maine.gov/governor/baldacci/healthpolicy/news/8_7_06.htm. The petitioners have filed a notice of appeal, which is limited to the statutory interpretation question of which savings can be counted in calculating the savings offset. On December 28, 2006, the Dirigo Health board imposed a savings offset payment for the second year of the program. Dirigo Health Agency, Minutes of Board of Directors Meeting (December 28, 2006) 4.

carriers.[12] The Act's most direct impact on the private market is that it requires carriers to pay back their savings attributable to the Dirigo program, and it may lead to a the shift of some customers to the Dirigo supplier.

b) Specific Dirigo Provisions

This section highlights the specific Dirigo provisions that are most likely to risk conflict with GATS.

1. Savings Offset Payments

The Act authorizes Dirigo Health to analyze the total savings in the health insurance market attributable to the presence of the Program and seek to recover these savings from private carriers.[13] In authorizing the Agency to determine the total savings to private carriers the Act provides standards but also arguably delegates the authority to the Agency to determine standards not listed in the statute. A Maine trial court recently upheld this statutory delegation to the Agency as not being unconstitutionally vague.[14]

While the statute is silent, the DirigoChoice carrier is required to make the savings offset payment.[15] The Dirigo board recently voted to impose a savings offset payment for the second year of the program. Meanwhile, a Governor's Blue Ribbon Commission continues to seek an alternative source of funding for the Dirigo Health Program.[16]

2. Subsidies

The Agency arranges for subsidies for those "eligible individuals or employees whose income is under 300% of the federal poverty level."[17] The Act either brings new

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[12] *See* Public Laws 2003, chapter 469, available at http://janus.state.me.us/legis/ros/lom/LOM121st/10Pub451-500/Pub451-500-108.htm#P7772_816250, viewed January 12, 2007.

[13] *See* ME. REV. STAT. ANN. tit. 24-A, § 6913.

[14] *See Maine Assoc. of Health Plans*, 2006 WL 2959744, at *3 n.4.

[15] The Act also exempts certain other carriers from making the payments. The relevant portion of the Act states:

> The board shall determine annually a savings offset amount to be paid by health insurance carriers, employee benefit excess insurance carriers and 3rd-party administrators, not including carriers and 3rd-party administrators with respect to accidental injury, specified disease, hospital indemnity, dental, vision, disability income, long-term care, Medicare supplement or other limited benefit health insurance.

ME. REV. STAT. ANN. tit. 24-A, § 6913(2).

[16] *See supra* note 11. S*ee also*, Governor Applauds Decision to Table Dirigo Savings Offset Payment, available at http://www.maine.gov/governor/baldacci/healthpolicy/news/8_8_06.htm, viewed January 12, 2007.

[17] *Id.* § 6912.

consumers to the market—those who might not otherwise consume health insurance—or pulls those on the margin over to the Dirigo supplier. The subsidies increase the base of possible consumers for Dirigo Health Program coverage—and decrease consumers of non-Dirigo services.

Approximately 40% of DirigoChoice members were uninsured prior to enrolling,[18] which means that 60% of DirigoChoice consumers were insured by a private market company before switching to Dirigo coverage. DirigoChoice is attracting more than half of its consumers away from private market providers. With 19,352 members in enrolled in DirigoChoice in August 2006, DirigoChoice attracted 11,000 consumers away other service suppliers.[19]

3. Contracting Authority (Qualification Requirements)

The Act outlines the manner in which Dirigo Health may exercise its contracting authority and powers to administer Dirigo Health services. The contracting authority provisions include the qualification requirements for carriers who wish to offer Dirigo coverage.[20] Some relevant provisions are:

- Dirigo Health is required to issue bid proposals.[21]
- Dirigo Health may include cost-containment provisions in contracts with insurance carriers.[22]
- Dirigo Health may set the allowable rates for administration and underwriting gains for the Program.[23]
- Dirigo Health may limit the number of eligible individuals who enroll in the Program.[24]

III. General GATS Coverage of Dirigo Health

The Dirigo Health program is covered by GATS. Under Article I, GATS covers measures that affect trade in services. Clearly, Dirigo affects trade in health insurance services. The one exclusion from general GATS coverage is for "a service supplied in the exercise of government authority." This "government authority" exclusion takes a measure *out* of GATS coverage *only if both* of two tests are satisfied. The measure must

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[18] *See Agency Fact Sheet*, *supra* note 5, at 14.

[19] *See id.* at 12.

[20] The Contracting Authority provisions cover contracts with insurance carriers, contracts with eligible businesses to cover employees, and authority to permit individuals to purchase DirigoChoice for themselves and their dependents. *See* ME. REV. STAT. ANN. tit. 24-A, § 6910(4)(A)–(C).

[21] 24-A MRSA Section 6910(4)(A)(1).

[22] *Id.* § 6910(4)(A)(2).

[23] *Id.* § 6910(4)(A)(5).

[24] *Id.* § 6910(4)(C)(6).

be (a) not supplied on a commercial basis and (b) not in competition with one or more service suppliers.[25]

As noted below, over 60% of Dirigo consumers are drawn from unsubsidized competitors of Dirigo. While it may seem obvious that Dirigo provides a commercial product and competes with commercial providers of health insurance, we raise this question about GATS coverage for one important reason. U.S. trade negotiators have repeatedly said to state officials that *any* government service is excluded as an exercise of government authority.

This is the line taken in a 13 April 2005 letter from Assistant USTR for Congressional Affairs Matt Niemeyer to Senator Susan M. Collins. Unfortunately, Mr. Niemeyer's interpretation would appear to misapprehend the nature of Dirigo, and relies on a very expansive notion of the "government authority exclusion."
In response to questions raised by Senator Collins, Niemeyer writes:

> Based on the description of Maine's Dirigo Health Plan, we understand that the plan operates under the auspices of the Maine government and receives some state funding for the first year as well as public funds through Medicaid. We understand that the plan has several objectives, including working with insurance companies and hospitals to find voluntary means of reducing the cost of insurance and health care and ensuring that poor citizens are able to obtain insurance. *Dirigo appears to have a unique governmental role and is not intended to compete directly with private sector suppliers of insurance* and related services or health care services (italics added).

The Dirigo customer statistics suggest that Dirigo competes on the margin with private insurance suppliers, and indeed, ***some degree of competition is unavoidable given Dirigo's objectives***. The Maine CTPC may therefore wish to pursue further this issue with USTR. Knowing whether or not USTR misunderstood or misrepresented the purposes of Dirigo in its letter to Senator Collins is less important than obtaining a written clarification of USTR's understanding of general GATS coverage of state-initiative health care pro-grams, with respect to this question: ***Does USTR believe that GATS does not cover a government-subsidized program, even when it takes customers away from commercial companies?***

IV. Dirigo's Risk of GATS Conflict

For each measure, this section comments on potential conflicts and raises questions about interpretation of GATS. Any potential conflict assumes the existence of a foreign service supplier in the market: either a domestic supplier incorporating abroad, or a foreign supplier attempting to enter the market.

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[25] General Agreement on Trade in Services art. I:3(c), Apr. 15, 1994, 33 I.L.M. 44 (1994) [hereinafter GATS], on-line at: http://www.wto.org/English/docs_e/legal_e/legal_e.htm#services.

a) *Savings Offset Payments*

The Act only requires non-Dirigo providers to make the savings offset payments and leaves calculation of the payments to the discretion of the Agency. These provisions implicate the domestic regulation and national treatment obligations.

1. National Treatment

In service sectors a Member has specifically scheduled, the national treatment obligation requires the Member to treat domestic and foreign service suppliers equally.[26] A measure conflicts with the obligation if it "modifies the conditions of competition in favour of services or service suppliers" of domestic firms compared to foreign firms.[27] Nevertheless, the national treatment obligation is limited in that equal treatment only needs to be extended to "like" services and services suppliers; thus, if suppliers are not "like," a measure treating them differently does not violate national treatment.

A "likeness" test has yet to be fully flushed out by WTO dispute resolution, though two panels have taken the general approach that service suppliers that offer the same services are "like."[28] More complex service sectors or situations may require comparison of a number of relevant criteria and "greater attention may need to be paid to external factors such as competitive relationships and the circumstances in which services are being supplied."[29]

? **Likeness.** *What is the meaning of "likeness" in this Dirigo market? Are non-Dirigo insurance providers "like" Anthem, which is the sole Dirigo provider?*

Following the test from one WTO decision, the Dirigo and non-Dirigo providers could be "like" to the extent that they all offer the same service. However, looking at the circumstances in which the services are offered illuminates external factors that distinguish the two providers. A dispute panel determining likeness will probably ask:

- Is a Dirigo provider different because it offers services to a low-income population?

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[26] *See* GATS art. XVII:1(a) ("In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.")

[27] *See id.* art. XVII:3.

[28] *See European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Panel Report, WT/DS27/R/USA ¶7.322 (May 22, 1997) (declining to find banana distributors with different origins of the bananas to be different service suppliers and stating "to the extent that entities provide these like services, they are like service suppliers"); *Canada – Autos*, Panel Report, WT/DS142/R ¶10.248 (Feb. 11, 2000) (same).

[29] Eric H. Leroux, *From Periodicals to Gambling: A Review of Systemic Issues Addressed by WTO Adjudicatory Bodies under the GATS*, at 29 (Paper presented at the World Trade Forum 2006, Bern, Switzerland).

- Is a Dirigo provider different because it is directly accountable to a government agency?
- Is a Dirigo provider different because it actually saves the market money and is subsidized by those savings?

If non-Dirigo suppliers do not supply a "like" service as Dirigo suppliers, or if the two are not "like suppliers," then the two provisions may be safe from conflict with national treatment.

2. Domestic Regulation

There may also be a risk of conflict between the savings offset payments provisions and the requirements of the domestic regulation obligation. GATS requires measures that relate to "qualification requirements and procedures, technical standards and licensing requirements" to be "based on objective and transparent criteria . . . [and] . . . not more burdensome than necessary to ensure the quality of the service"[30]

A Maine trial court recently rejected an argument that the savings offset payment was unconstitutionally vague.[31] The plaintiffs—the Maine Association of Health Plans, the Maine Automobile Dealers, and the Maine State Chamber of Commerce—argued that the Act did not provide clear direction for the Agency to determine the savings offset amount and that the Agency measured savings using factors not enumerated in the statute. The Act requires that:

> [T]he board shall determine annually . . . the aggregate measurable cost savings, <u>including</u> any reduction or avoidance of bad debt and charity care costs to health care providers in this state as a result of the operation of Dirigo Health and any increased MaineCare enrollment due to an expansion in MaineCare eligibility occurring after June 30, 2004.[32]

The plaintiffs argued that defining cost savings with the term "including" was ambiguous, allowing the Agency to limit the factors to those stated or alternatively adding factors not enumerated in the statute. The Agency board of directors originally calculated $136.8 million in cost savings, though the superintendent reduced that amount to $43.7 million, disapproving several factors used by the board.[33] The plaintiffs challenged the superintendent's calculation, but the trial court upheld the $43.7 million, stating "that the Superintendent's determination is supported by substantial evidence in the record."[34]

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[30] GATS art. VI:5(a)(i).

[31] *See Maine Assoc. of Health Plans*, 2006 WL 2959744, at *3 n.4.

[32] ME. REV. STAT. ANN. tit. 24-A, § 6913(1)(A) (emphasis added).

[33] *See Maine Assoc. of Health Plans*, 2006 WL 2959744, at *4.

[34] *Id.*

While dismissing the argument because it had not been originally raised at the agency level, the trial court also rejected its merits, stating that "[a]lthough, the legislative scheme is complex, a person of general intelligence would understand that a number of factors determine these kind of savings, such as hospital savings, uninsured savings, health care provider fee savings, certificate of need and capital investment fund savings, and insurance carrier savings."[35]

Domestic causes of action are often analogous to GATS claims. A trade conflict could arise if the domestic regulation requirement used in the GATS is stricter than the one applied under Maine law. That is to say:

- if the application of non-statutory standards by the agency may not be "objective and transparent" as required by GATS;
- the use of the payments may not be the least "burdensome" means to ensure the quality of Dirigo insurance; and
- if there is a less burdensome alternative to fund the program—for instance, through the general tax base—

then the saving payments could violate the domestic regulation obligation in the GATS. Consequently, two domestic regulation questions arise:

? **Transparent and Objective Delegation**. *How strict is the transparent and objective requirement of domestic regulation? Can statutory delegation to an administrative agency be considered objective? In the "domestic regulation" negotiations, will USTR argue for a softer standard, one that is more in line with the kind of analysis used by the Maine trial court?*

The domestic insurance industry has already shown that it is willing to spend resources to litigate against Dirigo, making the argument that the Dirigo Act is unconstitutional because it vaguely delegated authority to the Agency to determine how to calculate the savings payments. The industry argued the statute was ambiguous because the Agency was able to consider factors not enumerated in the statute in making its calculation. The Maine trial court determined the statute was not void for vagueness because "a person of general intelligence would understand that a number of factors determine these kind of savings."[36] In conclusion, then: would the GATS standard be as lenient as the Maine trial court's "general intelligence" test? Or, will the GATS require more specificity in the terms of the authority/cost calculation powers delegated to an administrative agency?

? **Transparent and Objective Regulations.** *If the agency promulgates clear regulations, do those regulations cure any objectivity problem with the statute?*

One further issue should be raised with respect to the Savings Offset Payments. The Maine trial court described the savings offset payment as a *licensing fee* rather than a tax.[37] However, in the WTO negotiations on domestic regulation, several nations have

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[35] *Id.* at *3 n.4.

[36] *See id.*

[37] *Id.* at *3.

proposed a new discipline to ensure that licensing fees are *not more burdensome than necessary to pay for costs of administering licensing requirements*.[38] In fact, the Dirigo statute excludes the cost of administration from the savings offset, and charges licensed carriers the much larger cost of calculation of savings generated by the existence of Dirigo Health.

? **Burdensomeness of licensing fees.** *Would the Dirigo savings offset be a licensing fee under GATS? If so, would it violate proposed disciplines that limit such fees to only cover the costs of administration?*

b) Subsidies

Subject to the same "likeness" and national treatment test described above, the subsidy provisions also risk conflict with the national treatment obligation. If a subsidy for Dirigo consumers "modifies the conditions of competition" in favor of the domestic Dirigo provider—and subject to the same "likeness" analysis above—there may be a risk of conflict between the subsidies provisions and the national treatment obligation.

It is clear that the Maine legislature intended for Dirigo subsidies to change the conditions of competition, at least for Dirigo consumers. These consumers are either people without health insurance before Dirigo, or consumers on the margins who are pulled away from non-Dirigo insurance providers because Dirigo is now offered at a lower price. These subsidy questions are implicitly tied to those firms that have access to this new subsidized market, which leads to the question of who can meet the requirements to qualify as a Dirigo provider.

c) Qualification Requirements

Disciplines developed in the GATS intend to limit the ability of governments to use qualification requirements for service suppliers trying to enter a market. The risk of conflict between the qualification requirements for Dirigo and GATS obligations is less clear, depending on whether or not the qualification requirements under Dirigo are deemed to be sufficiently explicit.[39] The requirements could conflict:

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[38] Most recently, the chair of those negotiations proposed:

11. Each Member shall ensure that any licensing fees have regard to the administrative costs involved and do not in themselves represent an impediment to engaging in the relevant activity. This shall not preclude the recovery of any additional costs of administering licensing requirements and any other administrative activities related to the regulation of the relevant services.

WTO, Note by the Chairman, *Disciplines on Domestic Regulation Pursuant to GATS Article VI:4 Consolidated Working Paper*, Working Party on Domestic Regulation, JOB(06)/225 ¶11 (July 2006).

[39] *See* ME. REV. STAT. ANN. tit. 24-A, § 6910(4)(a). Under the Act, the only explicit requirements of providers who wish to qualify to be Dirigo providers are that they licensed to sell health insurance in Maine and that they qualify as health plans in Medicaid. *See id.* § 6910(3),(4). There may be other requirements contained in the Request for Proposals issued by the Dirigo Health agency on May 7, 2004. *See* Dirigo Health, *Timelines & Milestones*, http://www.dirigohealth.maine.gov/dhsp01c.html.

- with **Domestic Regulation** rules if the requirements are "more burdensome that necessary." An assessment of burdensomeness would entail analysis of licensing requirements for domestic suppliers, which is beyond the scope of this report.
- with **Market Access** if there is a limit on the number of Dirigo providers. On its face, the statute does not limit the numer of Dirigo providers, and in practice, Anthem is the only company to bid for a Dirigo contract.
- with **National Treatment** if foreign health insurance providers are not eligible to become Dirigo providers. Had there been a foreign provider in the market , it would have been entitled to compete for the Dirigo contract.

V. Potential Safeguards

In addition to asking for clarification on the GATS questions posed above, the Maine CTPC could request several potential safeguards to protect Dirigo from any possible GATS conflict. These safeguards relate to two parts of the GATS and current GATS negotiations:

- the still pending negotiations on *domestic regulation disciplines*; and
- *coverage* of Dirigo under GATS and the U.S. *GATS schedule*.

Letters from the Maine CTPC and the Governor to the Office of the United States Trade Representative have already addressed aspects of each. The following ideas could be discussed with respect to the CTPC's 2007 workplan:

a) *Domestic Regulation*

☑ **Domestic Regulation.** New disciplines are currently being negotiated in the Working Party on Domestic Regulation. Less restrictive alternatives have been offered to replace the "objective and transparent" and "no more burdensome than necessary" requirements found in the Uruguay-Round GATS text. One potential safeguard is to ***avoid implementation of the objectivity and necessity tests in favor a less restrictive domestic regulation discipline.***

b) *Coverage*

☑ **Clarify that certain public health services, such as insurance, are not covered.** This would necessitate a shared interpretation at the WTO, and in particular within the GATS Council, of the scope of the "government authority exclusion." ***The government authority exclusion would be interpreted to exclude publicly funded insurance programs***.[40]

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[40] Readers interested in this question are referred to a recent article, "What is a 'Service Supplied in the Exercise of Government Authority' Under Article 1:3(b) and (c) of the General Agreement on Trade in Services?", by Eric H. Leroux; **Journal of World Trade**, 40(3): 345-385, 2006. Leroux's analytical framework is to examine whether the "modalities" of particular public services "place them outside the

- ☑ **Withdraw coverage.** Convince USTR to ***withdraw the U.S. commitment on health insurance services***. Article XXI of GATS allows a Member to modify its schedule. Of course, any Member affected by the modification may request compensation in exchange for the modification. However, if there currently there are no foreign insurance suppliers in the health insurance market in Maine, then there would be no affected Member. This should allow USTR to withdraw the commitment without objection.

- ☑ **Limit Coverage.** Limit the U.S. commitment on health insurance services in USTR's revised U.S. schedule. This can be done in two ways. First, and less preferable, limit the health insurance commitment by specifically carving out Dirigo. Second, and more preferable, horizontally carve out publicly funded programs for essential services across all health service sectors. Several states have already expressed an interest in obtaining a horizontal carve-out of publicly funded programs for essential health services.

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realm of the marketplace." Using his standards for determining what is inside or outside the market, it appears likely that Dirigo would be judged as being "inside" the realm of the marketplace, as would a plain-language reading of Article 1:3(b) and (c) of the GATS. Apparently there have been on-going discussions at the WTO GATS Council regarding the scope of the government authority exclusion, and the Maine CTPC may wish to learn more about those discussions.