
**State and Local
Trade Sanctions:
A Threat to U.S. Interests**

William H. Lash, III

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State and Local Trade Sanctions: A Threat to U.S. Interests

William H. Lash, III

Understanding international trade policy and foreign policy used to be simple. The trade representative and the secretary of commerce were acknowledged as the representatives of the United States in trade matters, while the secretary of state was the voice of U.S. foreign policy. Unfortunately that is no longer the case. States, and even cities, are now entering the international arena, using the trade hammer to promote their own foreign policy.

Currently, Massachusetts' efforts to link human rights and trade policy threaten to enbroil the United States in a dispute before the World Trade Organization (WTO). Legislation now pending in Massachusetts would impose a host of trade sanctions ranging from barring investment of state pension funds to imposing barriers on government procurement on corporations doing business in Indonesia.

For Massachusetts this is purely legislative business as usual. Previously the state imposed trade sanctions in government procurement on firms engaged in trade with Burma.

Studies on the impact of sanctions imposed for political ends demonstrate that historically they are ineffective in attempting to remedy the offensive situation.¹ Moreover, the Clinton administration, no stranger to trade sanctions, has already moved away from the Massachusetts model of linking human rights and trade policy by granting most favored nation status to China.

Similarly, targeting Indonesia is contrary to the stated trade policy of the United States. Although the Department of State has identified Indonesia as a perennial violator, the Department of Commerce has repeatedly targeted that country as a Big Emerging Market for special trade attention. Additionally, the

William H. Lash, III is a Distinguished Senior Fellow of the Center for the Study of American Business at Washington University in St. Louis.

United States has been a leading advocate for Indonesian financial relief from the International Monetary Fund. The state's move towards sanctions sends a confusing message to our partners and would thwart attempts at international monetary relief in Indonesia.

Massachusetts has published an extensive list of companies ineligible for state contracts due to trade in Burma. This list is a virtual "who's who" of multinational business, including such companies as Caterpillar, Federal Express, Mobil, Texaco, Sony, Toshiba, Guinness, Unilever, and Proctor & Gamble.²

This dangerous trend of states developing trade policies has many "imitators." San Francisco has a prohibition against awarding government contracts to firms doing business in Burma. A \$40 million telecommunications contract was awarded to Motorola over rival Ericsson; Ericsson had a \$3 million contract to provide services in Burma which it would not breach to appeal to San Francisco.³ Other cities, including New York; Berkeley, Oakland and Santa Monica, California; Ann Arbor, Michigan; and Madison, Wisconsin, have adopted similar ordinances.

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Many of the state and city restrictions and trade sanctions can be traced to earlier anti-apartheid legislation. In fact, some new state laws were simply old anti-apartheid statutes with the words South Africa deleted and Burma or Indonesia inserted in their place.⁴ There is a world of difference between the United States relationships with Indonesia and South Africa. The American public was largely in agreement regarding the repressive policies of apartheid. Additionally, many of our trading partners shared this sentiment and joined in support of these sanctions. In the current round of state-imposed sanctions we lack a national consensus as well as any international support.

State sanctions against Burma are also less likely to be effective. Burma is not a major trading partner of the U.S.; an estimated 7 percent of Burmese exports reach the United States.⁵ U.S. presence in Burma can easily be replaced by investment or trade from the European Union (EU) or the Pacific Rim.

Massachusetts has placed its citizens and its corporations at a tremendous risk because both Japan and the EU are threatening cases against the sanctions. The state exports \$1.5 billion worth of goods annually to Japan and \$6 billion to the EU, representing 150,000 jobs in the state. Furthermore, the Department of Commerce reports Japanese firms employ 13,000 workers in Massachusetts. If the EU or Japan were to restrict exports from Massachusetts, these workers, their families, and communities would suffer.

State sanctions typically do not distinguish between foreign firms and subsidiaries or companies owned by foreign investors. Foreign subsidiaries are U.S. firms. They employ American workers and bring technology and opportunity. These subsidiaries account for some 5 percent of all domestic employment.⁶ In states like California, 522,400 jobs, 5 percent of state employment, are produced by subsidiaries of foreign companies.⁷

U.S. subsidiaries of foreign firms also are major forces in our export markets. An estimated 22 percent of all U.S. exports can be attributed to U.S. subsidiaries of foreign firms.⁸ States which discriminate against foreign investors and deny procurement opportunities risk loss of technology, employment, and exports. This is particularly perplexing in light of the efforts being made by states to attract foreign investment. Nearly every state has an office to promote exports. Some have multiple overseas export offices to compete for foreign investment and export opportunities in Europe, Latin America and the Pacific Rim. State-imposed sanctions fly directly in the face of these other efforts and cancel out any value of state trade offices.

Nationwide, the losses from trade sanctions in the United States are estimated at \$15-19 billion in 1996. This translates into 200,000 U.S. jobs lost because of trade sanctions. Expanding the reach of trade sanc-

tions to states and cities will only exacerbate the problem and increase job losses. Sanctions weaken the reliability of American firms in the eyes of their trading partners. With the possibility of sanctions coming from 50 states and thousands of municipalities, trading with U.S. firms raises serious issues of predictability and stability.

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The local trade sanctions also violate one of the most basic tenets of the WTO – national treatment. Under national treatment, firms which establish subsidiaries in a host state must be treated the same as domestic firms. Discriminatory sanctions against foreign-owned firms clearly violate this doctrine.

Not only do sanctions fail to influence the nations in question, but economic engagement is a much more effective technique for influencing behavior. As noted by Father Robert A. Sirico of the Acton Institute for the Study of Religion and Liberty, “[j]ust as religious freedom offers the best hope for Christian social influence, economic freedom is the best hope for spreading that influence around the world.”⁹ Similarly, Chinese dissident Li Lu observes, “[b]usiness is the ultimate force for democratic change in China.”¹⁰

Firms operating overseas also export freedom. For example, multinational Unocal, has a contract to develop an offshore natural gas field in Burma. Unocal officials have regularly advocated on behalf of political prisoner and Nobel peace laureate Aung San Suu Kyi. The firm has also sought the advice of human rights activists to assist them in advocacy efforts. Unocal has a standing policy of monitoring individuals’ human rights appeals for assistance and trying to intervene on their behalf. Efforts such as these will

be lost if firms like Unocal are forced to withdraw from Burma to comply with state sanctions. The political repression in Burma is equaled by its economic repression. According to the *1998 Index of Economic Freedom*, published by the Heritage Foundation, Myanmar (Burma) was ranked 140th in economic freedom of 154 nations.¹¹ The government employs high tariff barriers of approximately 70 percent. A majority of firms are state-owned enterprises.

The *Index* also reveals that the nations with the highest amounts of economic freedom are typically countries enjoying a high degree of political freedom. Economic engagement in Burma and other states facing sanctions may also hold the key to political freedom and the promotion of human rights globally. As Unocal President John F. Imle noted, "Economic progress, fueled by foreign investment, provides the foundation for more democratic and open societies."¹² Economist Robert Barro has similarly observed, "...improvements in a broad concept of the standard of living tend strongly to precede expansions of political freedoms."¹³

State sanctions will also fail because few states or municipalities are as attractive as nations to firms making market decisions. California and New York City are sizeable markets, but can Takoma Park, Maryland; Oakland, California; or Madison, Wisconsin wield the same type of economic power? Most firms will choose Indonesia or Switzerland over Boston or Berkeley. Local sanctions cannot succeed in the marketplace.

Furthermore, like all economic sanctions, local trade sanctions will have a negative effect on the taxpayers and the consumers of the state or city. Sanctions lead to fewer economic choices in purchasing. This loss of economic options diminishes quality and drives up costs in government procurement. Additionally, sanctions against states like Nigeria may pose serious consequences for the United States. Nigeria is a major oil-exporting nation. Current federal trade sanctions against Iraq and Libya already include an embargo on their oil exports. Expansion of oil import restrictions will only result in higher costs for American consumers.

An obvious problem with states and cities adopting international trade sanctions is the lack of experience most local legislators have in foreign affairs. We have to wonder how many city council members or state assemblymen can even name the capital of Burma or pick it out on a map. Most local officials also lack the resources or experience to assess the economic impact of their actions. Richard N. Haas of the Brookings Institution has characterized these amateur efforts in international law as "the democratization of foreign policy run amok."¹⁴

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Burma is not the only target for local and state-sanctions-happy legislators. New York City is evaluating imposing procurement bans on firms doing business in China. New York had earlier targeted Swiss banks for sanctions in connection with the banks' role in hiding assets of Holocaust victims. New York City would bar Swiss banks from underwriting municipal bond offerings, handling pension funds or doing business with the city. New York City municipal pension funds currently hold hundreds of thousands of shares in Swiss banks. The American subsidiary of Credit Suisse presently manages a portfolio of approximately \$1 billion of city pension funds. New York City joined other local and state governments and deferred imposing sanctions when Swiss banks began negotiating a global settlement with the families of Holocaust victims. Other bills imposing sanctions on Switzerland are under consideration in California and New Jersey.¹⁵

New York City also passed a resolution aimed at firms operating in Northern Ireland. This resolution, one of forty nationwide, requires city contractors doing business in Northern Ireland to sign pledges of nondiscrimination in hiring of employees.¹⁶ Nigeria,

Tibet, and China are also on the target list of some states and cities on human rights grounds. Other local sanctions are more global in nature and target states which deny religious freedom.

There have been some victories on the anti-state-sanction front. The state of Maryland rejected trade sanctions against Nigeria recently. While recognizing the violations of human rights in Nigeria, the Maryland legislature recognized that export trade created 50,000 jobs for the state. These exports jobs paid 15 percent more than non trade-related employment.¹⁷ The state legislature heeded the words of Frank Kittredge, president of the National Foreign Trade Council, that:

HB 1273 [the Nigeria sanctions bill] would disqualify, or simply discourage, capable and competitively priced companies from selling their goods and services to the state. As a center for trade, investment and cultural exchange, the state can only lose ground and lose jobs by burdening the relationships its businesses establish abroad.¹⁸

There is some evidence that, at least at the federal level, legislators are seeing the futility of using trade sanctions to promote human rights. The proposed *Enhancement of Trade, Security and Human Rights through Sanctions Reform Act*¹⁹ is designed to craft an effective framework for dealing with unilateral economic sanctions and to preserve America's reputation as a reliable supplier. Pursuant to this legislation, any bill authorizing unilateral economic sanctions would be narrowly targeted to achieve a stated national security or foreign policy objective. Most importantly, these sanctions would expire or "sunset" after two years and could be waived or adjusted by the President in the national interest.²⁰

Additionally, as part of the committee report the president would explain in another report to the Congress the likelihood that the proposed sanction will achieve the stated objective within a reasonable time. This presidential report would also include a cost benefit analysis of the sanctions. The benefits would include foreign policy, humanitarian interests, national

security, and the economy. Any possible multilateral effort or other diplomatic alternatives would also be assessed in this report. Other sanctions still in place would also be subject to annual reporting requirements.

The United States International Trade Commission (ITC) would detail the extent to which sanctions have achieved the intended goals as well as any impact on humanitarian interests and foreign relations. The ITC report would also include research on the aggregate and individual costs of all unilateral economic sanctions and the impact of the sanctions on U.S. competitiveness.

Lawsuits and Legal Challenges

States and cities engaging in international trade policy are in violation of the Constitution of the United States. Pursuant to article 6 of the Constitution, international treaties and laws of the United States are "the Supreme law of the Land."²¹ Under this legal doctrine of preemption, international treaties and federal laws trump, or preempt, state and local laws and regulations. The federal government has imposed sanctions on Burma. Pursuant to these sanctions the president is authorized to impose restrictions on new foreign investment until he is satisfied that Burma has "made measurable and substantial progress in improving human rights and implementing democratic government."²² Federal trade sanctions regarding Burma may preempt state or local sanctions against the nation.

Even though there is no federal law regarding trade relations with Switzerland, Nigeria etc, preemption may be implied. The Supreme Court of the United States has recognized "the supremacy of the national power in the general field of foreign affairs...is made clear by the Constitution, was pointed out by the authors of The Federalists in 1787, and has been given continuous recognition by this Court."

Additionally, because the U.S. is a member of the World Trade Organization and a signatory to the General Agreement on Tariffs and Trade (GATT) Agreement on Government Procurement, it may be argued that this international agreement preempts state and local government regulation regarding international

procurement regulation.

Another area of constitutional challenge to state and local trade sanctions comes from the Commerce Clause. Art. 1, section 8, clause 3 of the Constitution of the United States bars municipalities and states from engaging in regulation or taxation of commerce if these activities burden interstate or foreign commerce. The Supreme Court has ruled on several occasions that the power to regulate foreign commerce is the "exclusive" province of the federal government.

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The Court has determined that it is essential that the United States "speak with one voice" in the realm of foreign commerce. For nearly 150 years it has been accepted constitutional jurisprudence that the Commerce Clause prohibits state or local laws from discrimination against foreign nations that would be adverse to interstate commerce.²³

The Court has similarly held that "[f]oreign commerce is preeminently a matter of national concern. In international relations and with respect to foreign intercourse and trade with the people of the United States act through a single government with unified and adequate national power."²⁴

Finally, pursuant to the Supremacy Clause of the U.S. Constitution, art. 6, clause 2, the federal government has the power to conduct the foreign policy of the United States. The Supreme Court has recognized that the exclusive responsibility for foreign affairs rests only with the federal government. This federal power in the field of foreign affairs must be "left entirely free from local interference."²⁵

Under the Supremacy Clause, state efforts to impose sanctions on foreign nationals have been rejected. Thirty years ago the U.S. Supreme Court overturned an Oregon statute barring East German citizens from

inheriting property within the state as being unconstitutional and "an intrusion by the State into the field of foreign affairs which the Constitution entrusts to the President and the Congress."²⁶ Similar to current state sanctions legislation, the Oregon law was disguised as governing purely state matters such as probate.

The cities that have enacted economic sanctions policies have anticipated constitutional challenges to their ordinances. Local politicians have attempted to circumvent constitutional challenges by casting their legislation as local in nature and not subject to federal review. For example, Berkeley's Burma sanctions state:

The citizens of the City of Berkeley, believing that their quality of life is diminished when peace and justice are not fully present in the world adopted Ordinance No. 5985-N.S. to promote universal respect for human rights and fundamental freedoms, recognize the responsibility of local communities to take positive steps to support the rule of law and to help end injustices and egregious violations of human rights wherever they may occur.²⁷

The Berkeley ordinance also wraps itself in the cloak of constitutionality by stating:

The United States Supreme Court has upheld the power of a municipality to make legitimate economic decisions without being subject to the restraints of the Interstate Commerce Clause when it participates in the marketplace as a corporation or a citizen as opposed to exerting its regulatory powers.²⁸

This provision is included in legislation by Takoma Park, Maryland; Oakland and San Francisco, California; and Madison, Wisconsin.²⁹ By couching itself as a market participant rather than a regulatory body, cities can exercise "a discrete, identifiable class of economic activity in which [it] is a major participant."³⁰ However, the market participant doctrine is not without limitation. The local government "may not impose conditions, whether by statute, regulation, or contract, that have a substantial regulatory effect outside of that particular market."³¹ The impact of

these sanctions on international trade would suggest that the market participant doctrine would not apply in the local sanctions cases.

Any action by the EU or Japan challenging the state's unilateral sanctions would probably succeed. A successful World Trade Organization challenge would pave the way for reciprocal sanctions against the United States with the approval of the WTO.

Recently, USA★Engage, a 600-member coalition of U.S. corporations opposed to trade sanctions, announced that it was considering filing an action challenging the Massachusetts sanctions against Burma.³² The legal challenge would be based on the unconstitutionality of the sanctions. The European Union has also indicated that it was planning to challenge the state sanctions at the World Trade Organization. The EU petition would be based upon the violation of U.S. obligations under the GATT Agreement on Government Procurement. Japan and the European Union are both threatening cases against the sanctions in the World Trade Organization. Any action by the EU or Japan challenging the state's unilateral sanctions would probably succeed. A successful WTO challenge would pave the way for reciprocal sanctions against the United States with the approval of the WTO. Retaliatory action by the United States would be inevitable. Thus, a trade war would be born, with consumers and corporations caught in the crossfire. Should there be a trade sanction imposed on all of us so Takoma Park can feel good at night?³³

Members of the Massachusetts congressional delegation issued stern letters to both Japan and the European Union. In the letters, the House members admonished Japan on how inappropriate it would be for Japan to involve itself in the internal affairs of Massachusetts.

U.S. Rep. Barney Frank reasons:

There are a lot of things that violate the WTO; Japan and Europe are not violation-free. We are saying to the Japanese – it is wrong for you to use your discretion to press these things.

He argues that any trade compensation or sanctions imposed on the United States by the WTO "be paid for by reducing the amount of money spent on the defense of both Japan and Europe."³⁴

What Frank fails to acknowledge is that the United States is routinely before the WTO attempting to address trade barriers imposed by Japan and the EU. His argument that two wrongs make a right is simplistic and illogical. His plan for tying a future defeat at the WTO to Department of Defense spending in Europe and Japan would effectively allow the state of Massachusetts to set United States trade, defense, and foreign policy.

Past International Actions by States

States have discriminated in the past against foreign firms in government procurement by enacting "buy American" laws. However these state procurement laws discriminating against foreign buyers had to mirror federal buy American legislation³⁵ to survive legal challenges.

Emulating federal law, 35 states have enacted some form of buy American legislation, and 90 percent of those states also have adopted legislation reflecting a preference for in-state suppliers. Some of the state statutes have been challenged.

A California statute was challenged because it required that "contracts for the construction of public works or the purchase of materials for public use be awarded only to persons who will agree to use or supply materials, which have been manufactured in the United States, substantially all from materials produced in the United States."³⁶ In a 1969 case, the California Court of Appeal held that the law effectively placed an embargo on foreign products and was "an unconstitutional encroachment upon the federal government's power over foreign affairs."³⁷

In *Trojan Technologies Inc. v. Commonwealth of Pennsylvania*,³⁸ a Canadian company brought an action challenging the constitutionality of the Pennsylvania Steel Products Procurement Act. The law required government contractors supplying steel to state public works projects to use only domestic steel. Violators of the law faced a five-year debarment by the state and for forfeiture of money a contractor had received in violation of the law.

Trojan Technologies manufactured an ultra-violet-light water system that was used by several Pennsylvania municipalities. The water system had a steel content that made up less than 15 percent of the total product's value. The state's attorney general requested that Trojan Technologies certify that its system complied with the Steel Products Procurement Act.

Trojan asserted that existing U.S. agreements with other countries and federal legislation "require an inference of congressional intent to preempt state Buy-American statutes such as Pennsylvania's."³⁹ The 3rd U.S. Circuit Court of Appeals concluded that federal "agreements and statutes do not constitute a comprehensive scheme so pervasive that it must exclude all state action with respect to foreign steel."⁴⁰ Thus, the court held the Pennsylvania law was constitutional and valid.

Conclusion

States are prohibited from intruding into the field of foreign affairs, an area constitutionally reserved for Congress and the president. Furthermore, these laws were enacted prior to the WTO Agreement on Government Procurement, which substantially liberalized global procurement markets. During the negotiation of this agreement, 37 states, including Massachusetts, pledged to open their procurement markets and adhere to the agreement.⁴¹

Under Secretary of State Stuart Eizenstat stated recently, "[w]hile state and local governments should express the democratic will of their citizens, unless sanctions measures are well conceived and coordinated so that the United States is speaking with one voice and consistent with our international obligations,

such uncoordination can put the United States on the political defensive and shift attention away from the problem to the issue of the sanctions themselves."⁴² We cannot allow the folly of one state or municipality to undermine trade and national security. Nicholas Burns, State Department spokesman stated "The only question from the Japanese, I think, is, well, does Massachusetts law pertain here or does U.S. national law pertain, and we are looking into that question."⁴³ The answer is simple. The Clinton administration must challenge this pernicious policy.

Morality can have a valid role in global trade. Boycotts by consumers or resolutions by shareholders are effective in introducing market pressures to achieve political ends. These measures may be more effective than political sanctions and do not involve government action or the usurpation of foreign policy by cities or states. They also do not involuntarily weaken the global competitiveness of American firms by forcing them to pull out of lucrative export markets.

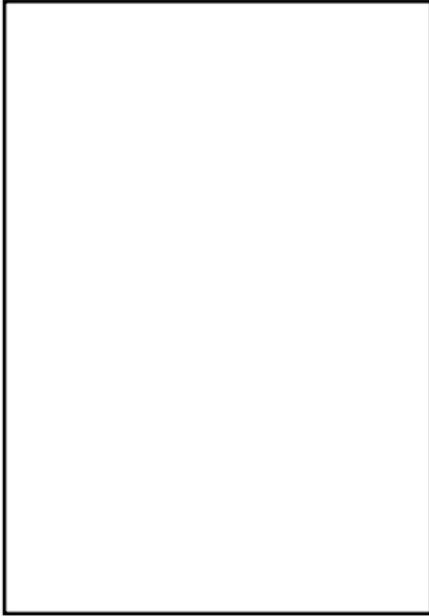
But sanctions advocates must realize that sanctions are a clumsy, two edge sword. "Sanctions are counterproductive. They hurt people not regimes."⁴⁴ A Pyrrhic moral victory with high economic and political costs for all parties will be the only result of the current sanctions explosion.

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William H. Lash, III is a Distinguished Senior Fellow of the Center for the Study of American Business at Washington University in St. Louis. He is also Professor of Law and Director of International Business Programs at George Mason University School of Law in Arlington, Virginia.

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