

Date of Hearing: April 21, 2009

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE ECONOMY
V. Manuel Perez, Chair
AB 1276 (Skinner) – As Introduced: February 27, 2009

SUBJECT: International trade agreements and state engagements

SUMMARY: Prohibits a state official, including the Governor, from binding the state to provisions of a Proposed International Trade Agreement without specified statutory authorization. Specifically, this bill:

- 1) Provides various findings and declarations.
- 2) Defines "Proposed International Trade Agreement" as a trade agreement negotiated, or in the process of being negotiated, between the federal government and a foreign country.
- 3) Provides that a state official, including the Governor, may not bind the state, or give consent to the federal government to bind the state, to provisions of a Proposed International Trade Agreement unless a statute is enacted that explicitly allows a state official, including the Governor, to bind the state or give consent to bind the state to the provisions of that trade agreement.

EXISTING LAW:

- 1) The U.S. Constitution, Article VI, provides that treaties and international trade agreements are laws of the U.S., and as such, are supreme over the laws of the states.
- 2) The California Constitution, Article IV, vests the California Legislature, which consists of the Senate and Assembly, with the legislative power of this state.
- 3) The California Constitution, Article V, vests the Governor with the supreme executive power of the state and requires the Governor ensure that the laws of the state are faithfully executed.
- 4) The California Constitution, Article I, prohibits a person from being deprived of life, liberty, or property without due process of law or denied equal protection of the laws.
- 5) State law, recognizes the Governor as the primary state officer representing California's interest in international affairs, to the extent that representation is not in conflict with federal law or the California Constitution. Further, this recognition is declaratory of existing law and does not in and of itself confer any new authority.
- 6) State law, specifies that the state point of contact (SPOC) acts, in compliance with federal practice, as the liaison between the state and the Office of the United States Trade Representative (USTR) on trade-related matters. State law recognizes that the SPOC receives updates from the federal government on trade policies and is often provided the opportunity to review and comment on ongoing trade negotiations.
- 7) State law, requires the SPOC, in addition to any other duties assigned by the Governor, to do both of the following:

- a) Promptly disseminate information from the USTR to the appropriate state agencies, departments, and legislative committees.
- b) Work with the Legislature and appropriate state agencies to review the effects of any proposed or enacted trade agreement provisions on California environment, businesses, workers, and general lawmaking authority and communicate those findings to the USTR.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Author's Purpose: International trade agreements delve deeply into matters of state law. Past California governors have unilaterally granted their consent for the state to be bound to the rules regarding government procurement contained in trade agreements even though there is no process for this in state law and even though the California legislative branch is charged with setting the state's procurement policy. California has experienced the unintended consequences associated with trade-related preemption of state regulatory authority.

To secure the many benefits of trade for California and safeguard domestic policies we must establish transparency and open procedures that ensure inclusive decision-making with respect to whether the state should commit to the non-trade (non-tariff) regulatory policy constraints found in trade agreements. AB 1276 is needed to prevent future trade challenges against California law, and to grant the legislature a formal role in federal-state consultations regarding trade.

AB 1276 will not limit California's ability to engage in trade. The bill does not cover any traditional trade matters, such as tariff rates, quotas or customs rules. Further AB 1276 does not violate rules of prior international trade agreements. Four states addressed this problem legislatively and many more states are considering doing so.

- 2) U.S. Trade Policy: The U.S. Constitution grants the federal government the power to enter into treaties and trade agreements and provides that these treaties and agreements are laws of the U.S. and, as such, are supreme over the laws of states. By Executive Order, the Office of the U. S. Trade Representative (USTR) is created as an agency within the Executive Office of the President and is responsible for international trade negotiations.

By Congressional directive, the USTR is required to secure advice from states on trade negotiations through the Intergovernmental Policy Advisory Committee (IGPAC). IGPAC is one of six policy advisory committees established in the Trade Act of 1974. IGPAC is comprised of state and local officials, including members of state legislatures, state trade directors, and related national associations. Despite repeated requests in 2005 and 2006, no Members of the California State Legislature have been appointed to IGPAC.

The USTR also maintains a SPOC system in which the governor of each state designates a single point of contact within the state that is responsible for transmitting information to the USTR and disseminating information from the USTR to state officials. In California the SPOC serves as the official liaison between the USTR, the Administration, and the Legislature.

Under California law, the SPOC is required to "promptly disseminate correspondence or information" from the USTR to the relevant state agencies, departments, and legislative policy committees in the Senate and the Assembly. The SPOC is also required to work with the Administration and the relevant state committees to review and comment to the USTR on the effects of proposed and enacted trade agreements.

Existing California law does not specifically address the issue of this bill, that is, under what circumstances and conditions can the state bind itself to a proposed international trade agreement. As discussed later the analysis, existing law does provide for and in several cases requires joint actions between the Administration and the Legislature in order to act on international trade issues.

- 3) Representative democracies and checks and balances: The laws that govern representative democracies are full of checks and balances between the different branches of government. As an example, while the Administration negotiates international trade agreements, approval from both houses of Congress is required for the agreement to be placed in service. Treaties, which the President is empowered by the US Constitution to make, also require the advice and consent of the Senate, which must approve the treaty by a two-thirds majority for it to become law.

The National Conference of State Legislatures (NCSL) has also expressed the need for a greater voice for legislatures in developing and binding states to U.S. trade agreements. Responding to these concerns, the USTR spoke at the 2005 annual meeting of NCSL and is quoted as saying "As an executive branch agency, we are required by statute to maintain a single point of contact in each state government, generally with the Governor or a Cabinet official. We strongly encourage governors to consult with their legislatures as well. We also want to have direct contact with legislators, to help address concerns and answer questions and hope we will continue such contacts in the future." Other areas of the California international trade program also have specific checks and balances which are described in comment 8 below.

AB 1276 would seek to codify a specific role for the California Legislature, as mirrored at the federal level through the process for enacting U.S. trade agreements and as best practice as determined by the USTR. Lawmakers in Rhode Island, Hawaii, Minnesota, and Iowa have already enacted legislation to increase their role in decisions that would bind their state to certain international trade agreement provisions.

- 4) Distinct roles for legislative and executive branches of government: The California Constitution provides for three distinct powers - the legislative, executive, and judicial branches of government. The California Constitution further states that "persons charged with the exercise of one power may not exercise either of the others except as permitted by this Constitution." Legislative power is specifically vested with the California Legislature and the executive power is vested with the Governor.

The proponents of AB 1276 state that the decision to provide the federal government consent to bind the state to the rules of an international trade agreement is a legislative function as it has the potential of altering the legal rights and duties of the state, as well as setting state policies. This is because once the state is bound to an agreement, the state is constrained from implementing or enforcing legislation that falls outside of the rules set forth in the trade agreement. Further, the state is open to challenges in foreign trade tribunals of its laws and regulations brought by foreign businesses seeking preferential treatments guaranteed by the trade agreements.

As an example, California has a number of state policies and laws relating to procurement which direct state resources to small businesses, business located in enterprise zones, and disabled veteran-owned business enterprises. Potentially, these types of laws could be found to be trade barriers to foreign businesses who want to compete for state contracts.

The proponents state that the decision to commit a state to an international trade agreement involves the state evaluating its principles and priorities, weighing environmental, labor, human rights, foreign relations, business, and budget consideration against the opportunities and limitations of being bound to an agreement. While it is the role of the Governor to implement state laws, it is the role of the Legislature to set policy. Therefore, the Governor cannot unilaterally undertake a legislative function. AB 1276 seeks to put forth a more transparent review of the potential impacts of a trade agreement and limit the ability of the Governor to bind the state to an agreement without the statutory consent of the Legislature.

- 5) Undue barriers to state trade program: The California Business, Transportation and Housing Agency is opposing AB 1276, states that the bill places an unnecessary hurdle on international trade and unnecessarily complicates processes. BTH also raises concerns that the bill would defy current agreements with the WTO and existing trade agreements. A similar bill, SB 348 (Figueroa), was vetoed by the Governor in 2005. The Governor's veto message stated:

“This bill will not accomplish its intended goal because, under the Supremacy Clause of the United States Constitution, international trade agreements are treaties that preempt state law.

However, for advice from states and local entities on trade policy matters, the federal government has established the IGPAC which is comprised entirely of state and local officials. Appointed on a bipartisan basis, the Committee makes recommendations to the USTR and the Administration on trade policy matters. The IGPAC provides the appropriate venue for the Legislature to express its views on international trade agreements.”

BTH further emphasizes that given our current economic situation, international trade presents a unique economic development opportunity for California. In closing their letter of opposition, BTH stated that the Governor should continue to be the person who ensures that all the trade agreements that California signs are in the best interest of the state.

- 6) California's experience in binding its self to trade agreements: In September of 2003, the USTR sent letters to the governors of all fifty states, asking the governors to commit their states to be covered by procurement provisions in an array of pending trade agreements. According to the USTR, at that time, the U.S. was in the process of negotiating trade agreements with Morocco, Australia, five Central American countries, five nations of the South African Customs Union, and 34 countries in the Western Hemisphere.

Governor Schwarzenegger agreed on May 6, 2004, on behalf of the executive branch agencies of California to be bound by the terms of the U.S. - Australia Free Trade Agreement. As a result of the Governor's response, California was included as a covered sub-central government entity in the procurement chapter of the U.S. - Australia Free Trade Agreement, which was approved by Congress in 2004.

On May 28, 2004, twenty-one California Legislators sent a letter to Governor Schwarzenegger expressing concern over his commitment for California to be bound by the procurement chapter of

the U.S. - Australia Free Trade Agreement, and asked that the Governor not commit California to the procurement chapter of the Dominican Republic - Central America Free Trade Agreement.

In January of 2005, the USTR sent letters to state governors explaining that the U.S. is currently negotiating trade agreements with Panama and the Andean countries of Columbia, Ecuador, and Peru, and asking the governors to commit their states to those trade agreements as well. On November 10, 2005, Senators Figueroa and Perata wrote the Governor asking for his assistance to assure that California would not be committed to any trade agreement that could affect California laws or lawmaking authority. Staff understands that Governor Schwarzenegger has not agreed to bind the state to any further agreements.

7) Development of the state's new trade program: In 2003, as the result of poor economy and significant management issues within the state's international trade program, the Technology, Trade and Commerce Agency was eliminated, including all authority for the state to undertake international trade and investment activities. After years of debate, in 2006, the Legislature and the Governor began an unprecedented collaboration on the development of a new international trade and investment program. Agreements on the new program were codified in SB 1513, Chapter 663, Statutes of 2006. Development of the new trade program has five steps including:

- a) Directing BTH to prepare a comprehensive International Trade and Investment (ITI) Study on where California fits within the overall global economy and evaluates how the state could help California businesses be more competitive in the global economy.
- b) Directing BTH to prepare a preliminary ITI Strategy based on the findings of the ITI Study.
- c) Requiring the policy and fiscal committees of the Legislature to publicly review the ITI Strategy and provide comments to BTH prior to the strategy becoming final.
- d) Providing that the final ITI Strategy forms the foundation for all future international trade and investment activities of the state.
- e) Requiring the SPOC to work with the Legislature and appropriate state agencies to review the effects of any proposed or enacted trade agreement provisions on the California environment, businesses, workers, and general lawmaking authority and communicate those findings to the USTR.

In December 2007, BTH published the ITI Study, and in March 2008, BTH submitted its preliminary ITI Strategy to the Legislature for review. In March and June of 2008 the Assembly Committee on Jobs, Economic Development, and the Economy (JEDE) and the Assembly Budget Subcommittee on General Government reviewed and submitted comments on the ITI Strategy. The final Strategy was published by BTH in August 2008.

8) Checks and balances: Under the terms of the new trade program agreement, the Legislature and the Governor also agreed that the state's future activities must have certain checks and balances that seemed to have been missing during the state's first efforts in trade development. Some, but not all, of the key provisions are listed below:

- a) Requiring BTH to annually report to the Joint Budget Committee funding related to the implementation of the ITI Strategy;

- b) Requiring benchmarks and measurable objectives be included in the ITI Strategy to assist the Administration and Legislature in overseeing the program;
- c) Requiring that the SPOC promptly disseminate USTR provided trade agreement information to the Legislature and relevant agencies;
- d) Requiring approval by the Legislature before establishing any foreign trade office; and,
- e) Prohibiting further state funding to the BTH for trade- and foreign investment-related activities should certain statutorily defined oversight requirements fail to be met.

Collectively, the requirements enacted through SB 1513 for establishing state priorities and implementing the state's trade activities set forth a dual role for the Legislature and the Administration in advancing the state's trade activities. AB 1276 furthers this statutorily-defined relationship by detailing how the Legislature and the Administration should engage on the consideration of binding California communities to condition of foreign trade agreements.

- 9) Protecting California's rights under U.S. Trade agreements: As noted above, existing law requires the development of an ITI Study to help guide the development of the ITI Strategy. While the study found that California is doing a number of things right, the study also found that the state faces significant challenges from offshoring, the global redistribution of manufacturing and services, and growing talent pools in other countries.

In addition, the ITI Study raised concerns regarding the impact of global trade arrangements on California businesses. More specifically, the ITI Study identified five key shifts in U.S. and global international trade policy and practice that may affect California including that:

- a) Progress on further multilateral trade negotiations is likely to be limited with the WTO being so fractured by the three distinct interests of the U.S., the European Union, and the developing countries.
- b) The U.S. and other countries will likely accelerate efforts on bilateral and regional trade-related agreements resulting in an increase in one-off trade agreements. This stems, partly, from the lack of progress on multilateral negotiations.
- c) International trade issues will be litigated increasing in dispute settlement format with the WTO and all U.S. bilateral trade agreements containing mandatory dispute settlement mechanisms. This has already resulted, and will continue to result, in having California policies coming under attack in foreign trade tribunals.
- d) Domestic laws and regulations will increasingly be a target of negotiations and disputes. The term used to describe these policies is "behind the border" domestic regulations, which includes such things as environmental protections, labor and human rights, competition policy, investment, consumer rights and product standards.
- e) Trade "leakage" issues such as homeland security, crime, drugs, and illegal immigration will become increasingly salient and linked to trade liberalization.

In response to these issues and other global competitiveness concerns, the ITI Strategy provides several specific recommendations for advancing California's interests in international trade policies. Several recommendations include, but not limited to, sharing trade information with the Legislature, participating in IGPAC; and regularly making public reports on pending and enacted U.S. trade agreements. The ITI Strategy further recommends that California join the State International Development Organization as a means of working more closely with other states to advance states' interests in the development and implementation of U.S. trade agreements.

While these are significant actions and clearly indicate that California needs to be diligent in protecting the state's economy from trade agreements negotiated at the federal level, they do not specifically address the question of binding the state to international agreements.

- 10) California's trade-based economy: International trade is a very important component of California's \$1.8 billion economy. If California were a country, it would be the 11th largest exporter in the world. Exports from California accounted for more than 12% of total U.S. exports in goods, shipping to 222 foreign destinations in 2007.

California's land, sea, and air ports of entry serve as key international commercial gateways for products entering the country. California exported \$144.8 billion in goods in 2008, ranking only second to Texas with \$192.1 billion in export goods. Computers and electronic products were California's top exports in 2008, accounting for 29% of all state exports, or \$41.7 billion.

Manufacturing is California's most export-intensive activity. Overall, manufacturing exports represent 9.4% of California's gross domestic product, and computers and electronic products constitute 54.3% of the state's total manufacturing exports. More than one-fifth (21.9%) of all manufacturing workers in California directly depend on exports for their jobs.

Small- and medium-sized firms generated more than two-fifths (43%) of California's total exports of merchandise. This represents the seventh highest percentage among states and is well above the 29% national average export share for these firms.

Mexico is California's top trading partner, receiving \$20.5 billion in goods in 2008. The state's second and third largest trading partners are Canada and Japan with \$17.7 billion and \$13.1 billion, respectively. Other top-ranking export destinations include China, South Korea, Taiwan, the United Kingdom, Hong Kong, Germany, and Singapore.

The economic crisis has, however, had significant affects on top California trading partners. According to the International Monetary Fund's 2008 World Economic Outlook, China's gross domestic product growth is expected to fall from 11.9% in 2007 to 9.3% in 2009 – which is the first serious slowdown for China in thirty years. In Japan, the industrial output plunged 10% in January, corporate icons such as Sony and Toyota have conquered global markets but are now facing huge losses and laying-off workers, the production of automobiles plunged 41% percent in January.

Mexico has also experienced the value of the Peso drop to 12.31 per dollar, the lowest since the government eliminated currency controls in December 1994. Automakers experienced the biggest downturn, reporting a 13% decline in exports to the U.S. These economic downturns may have major adverse affects on California's economy as China accounts for \$11 billion, Japan \$13.1

billion, and Mexico \$20.5 billion of California exports. Further, as exports in these countries decline, consumption of U.S. products also decline.

- 11) Importance of foreign direct investment: The U.S. is the largest recipient of foreign direct investment (FDI) in the world. In 2007, the U.S. received \$199 billion in FDI. California receives more FDI than any other state in the U.S. with the largest share of foreign activity in California being in the non-manufacturing industries. FDI impacts the California economy in many ways, including assisting in the creation of jobs, boosting worker wages, increasing exports, bringing in new technology and skills, and generally strengthening the state's manufacturing base. Foreign-controlled companies accounted for 8.9% of total manufacturing employment in California in 2006.

California has the highest level of employment attributed to foreign-owned firms in the nation. Foreign investment in California was responsible for 4.3% (approximately 550,000 workers) of the state's total private-industry employment in 2006. Along with employment, foreign owned firms own more property, plants, and equipment in California than any other state.

As one of the 10 largest economies in the world, California plans to aggressively market itself to global investors; making the need for clarity regarding the rights and privileges of those foreign investors very important. Leading sources of California FDI include investors from the United Kingdom, Japan, Switzerland, Germany, and France. Europe, in total, is the largest source of FDI in California. Collectively, Asian Pacific countries have the second highest FDI in California with a higher proportion of manufacturing employment and commercial property holdings than Europe.

- 12) Proposed amendments to clarify implementation: The author may wish to address how this measure integrates into the existing statutory requirements.

- 13) Related legislation: Below is a list of related legislation, some of which is discussed in greater detail earlier in the analysis.

- a) AB 3021 (Nuñez): This bill establishes the six-member California-Mexico Border Relations Council (Border Council) comprised of all Agency Secretaries and the Director of the Office of Emergency Services for the purpose of coordinating activities of state agencies. The Border Council is required to report to the Legislature on its activities annually. *Status:* Signed by the Governor - Chapter 621, Statutes of 2006.
- a) AJR 14 (Jeffries): This resolution memorializes the President of the U.S. and Congress to enact legislation to ensure that a substantial increment of new revenues derived from customs duties and importation fees be dedicated to mitigating the economic, mobility, security, and environmental impacts of trade in California and other trade-affected states across the U.S. *Status:* Approved by both Houses, Resolution Chapter 73, Statutes of 2007.
- b) AJR 55 (Villines): U.S.-Colombia Trade Promotion Agreement: This resolution would have memorialized Congress that the California Legislature supports the United States-Colombia Trade Promotion Agreement as it will enhance California competitiveness, level the playing field for California exporters, and make trade with Colombia a two-way street, benefiting California's businesses, farmers, and workers. *Status:* Refused adoption in the Assembly Committee on Jobs, Economic Development, and the Economy in 2008.

- c) **SB 348 (Figueroa)**: This bill would have prohibited a state official, including the Governor, from binding the state, or giving consent to the federal government to bind the state, to provisions of a proposed International Trade Agreement, including, the government procurement rules, unless a statute is enacted that explicitly authorizes a state official to bind the state or to give consent to bind the state to that trade agreement. Status: Vetoed by the Governor in 2005.
- d) **SB 1513 (Romero)**: Final Compromise - California International Trade and Investment Act. This bill provides new authority for the BTH to undertake international trade and investment activities, and as a condition of that new authority, directs the development of a comprehensive international trade and investment policy for California. This bill reflects extended bi-partisan discussions between the Senate and the Assembly. Based on these agreements, AB 2601 was dropped to allow a single consensus bill on international trade to be sent to the Governor. More specifically, this bill:
- Provides an organizational structure for California's foreign relations.
 - Requires BTH develop an international trade and investment strategy ITI Strategy, by February 1, 2008, and submit it to the Legislature for public review.
 - Requires BTH convene a statewide business partnership, no later than March 1, 2007, to advise the Secretary of BTH on business needs and priorities for inclusion in the ITI strategy.
 - Prohibits the establishment of foreign trade and investment offices (Foreign Offices), unless certain conditions are met, including professional management of the Foreign Offices and extensive oversight by BTH and the Legislature. Failure to meet the reporting requirements will result in discontinuation of state funding to BTH for international trade purposes.
 - Requires OPR to maintain and update a comprehensive list of all state agreements made with foreign governments.
 - Requires all state employees, within 30 days of traveling outside of the U.S. on official state business, submit a memorandum to their respective administrative agencies with specified information on the purpose and outcomes of the trip.

Status: Signed by the Governor - Chapter 663, Statutes of 2006.

- e) **SB 1762 (Figueroa)**: This bill would have prohibited the Governor from binding California to provisions of international trade agreements without consent from the Legislature. Based on bi-partisan discussions with all authors of international trade related legislation, the provisions of this bill were modified and amended by JEDE into SB 1513. Status: Held in the Assembly Committee on Jobs, Economic Development and the Economy in 2006.

REGISTERED SUPPORT / OPPOSITION:

Support

International Longshore and Warehouse Union (Sponsor)
Bay Localize
California Conference Board of the Amalgamated Transit Union
California Conference of Machinists
California Fair Trade Coalition
California Farmers Union
California Labor Federation/ AFL-CIO
California Teamsters Public Affairs Council
Engineers and Scientists of California
Environmental Health Coalition
Pacific Environment
Professional & Technical Engineers, Local 21
Public Citizen California
San Diego-Imperial Counties Labor Council AFL-CIO
Sierra Club California
Strategic Committee of Public Employees, LIUNA
UNITE HERE!
United Food and Commercial Workers Union, Western States Council

Opposition

Business, Transportation and Housing Agency

Analysis Prepared by: Toni Symonds / J., E.D. & E. / (916) 319-2090