

## NOTE

### THE OFFSHORING OF AMERICAN GOVERNMENT

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## INTRODUCTION

In 2004, callers to the California state welfare hotline had a curious choice to make: press “one” for English and speak with a worker in India, or press “two” for Spanish and speak with a worker in Mexico.<sup>1</sup> The experience of these California callers reflects a new reality in the public sector, in which state governments are spending a large—and often untold—amount of tax dollars on offshore public contracting.<sup>2</sup> And nearly every state government does it.<sup>3</sup> Although the private sector has offshored jobs for decades,<sup>4</sup> governments have only recently become “‘part of the offshoring bandwagon.’”<sup>5</sup> The media published reports about public sector offshoring during the 2004 election,<sup>6</sup> and since then, lawmakers in virtually every state have introduced legislation to restrict state contractors from performing work outside of the United States.<sup>7</sup> Although only a few states have enacted offshoring restrictions, state lawmakers continue to introduce anti-offshoring legislation.<sup>8</sup>

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<sup>1</sup> See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-06-342, OFFSHORING IN SIX HUMAN SERVICES PROGRAMS: OFFSHORING OCCURS IN MOST STATES, PRIMARILY IN CUSTOMER SERVICE AND SOFTWARE DEVELOPMENT 17 (2006) [hereinafter GAO OFFSHORING REPORT]; Diane Lindquist, *Calls to State Agencies Go Around the World: Governments Move Toward Outsourcing*, SAN DIEGO UNION-TRIB., Aug. 22, 2004, at A1, LexisNexis Academic.

<sup>2</sup> See *infra* Part I.B.

<sup>3</sup> See GAO OFFSHORING REPORT, *supra* note 1, at 3–5; PHILIP MATTERA ET AL., GOOD JOBS FIRST, YOUR TAX DOLLARS AT WORK . . . OFFSHORE: HOW FOREIGN OUTSOURCING FIRMS ARE CAPTURING STATE GOVERNMENT CONTRACTS 2 (2004), available at <http://www.goodjobsfirst.org/pdf/offshoringtext.pdf>; see also Stella M. Hopkins, *U.S. Companies, Governments Rely on Foreign Workers to Save Money*, CHARLOTTE OBSERVER, Aug. 10, 2003, at 1A, LexisNexis Academic.

<sup>4</sup> See Alan S. Blinder, *How Many U.S. Jobs Might Be Offshorable?* 2 (Ctr. for Econ. Policy Studies, Working Paper No. 142, 2007).

<sup>5</sup> Kevin Rothstein, *Ted K Slams Mitt for Outsourcing Jobs: Mass Work Farmed Out to India, Utah*, BOSTON HERALD, Feb. 23, 2006, at 6, LexisNexis Academic (quoting U.S. Sen. Ted Kennedy).

<sup>6</sup> See GAO OFFSHORING REPORT, *supra* note 1, at 1 (“Media reports in 2004 . . . inspired proposals . . . to restrict ‘offshoring’ in public programs . . .”); N. Gregory Mankiw & Phillip Swagel, *The Politics and Economics of Offshore Outsourcing* 2 (Am. Enter. Institute, Working Paper No. 122, 2005) (“[N]o economic issue generated more heat or shed less light than the debate over offshore outsourcing.”).

<sup>7</sup> See NAT’L FOUND. FOR AM. POLICY, ANTI-OUTSOURCING EFFORTS DOWN BUT NOT OUT 2–6 (2007), <http://www.nfap.net/pdf/0407OutsourcingBrief.pdf> [hereinafter NFAP REPORT].

<sup>8</sup> See *id.* at 6.

This Note argues that state offshore contracting restrictions are unconstitutional. Part I discusses the scope of public sector offshoring and the rise of state restrictions to prevent this practice. Part II argues that state offshore contracting restrictions violate the Foreign Commerce Clause of the U.S. Constitution.<sup>9</sup> Under the Supreme Court's heightened scrutiny of state regulation of foreign commerce,<sup>10</sup> such restrictions are invalid because they facially discriminate against foreign commerce and prevent the federal government from speaking with "one voice" in international trade.<sup>11</sup> By intruding into the sensitive area of international trade, states undermine national trade policy, frustrate international trade relations, invite retaliation, and embarrass the nation. Part II also argues that states cannot take shelter in the "market participant" exception to the Interstate Commerce Clause because the exception does not (or should not) apply to the Foreign Commerce Clause. Furthermore, even if the exception does apply, state offshore contracting restrictions fail under the doctrine of foreign affairs preemption.

Part III discusses the policy implications of this outcome. States seeking to restrict offshore contracting within the bounds of the Constitution have two options: either withdraw their contracts from the stream of commerce and perform the services in-house, or seek authorization from Congress to restrict offshore contracting. Accordingly, a state seeking to privatize and keep its jobs in the United States must first seek authorization from Congress. After reviewing the costs and benefits of offshore contracting and given the potential challenges that offshoring poses for state governments, this Note concludes that the nation must engage in a serious debate about whether to permit states to restrict offshore contracting. Before this debate can occur, however, this Note calls on both the federal and state governments to make a serious commitment to identify and study the consequences of offshoring because policy solutions, if any, depend on the availability of data.

## I

### STATES JUMP ON THE "OFFSHORING BANDWAGON"

#### A. The Public Sector: From *Offsite* to *Offshore*

Outsourcing, the process of contracting with a third party to provide goods or services,<sup>12</sup> has manifested itself in the public sector

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<sup>9</sup> U.S. CONST. art. I, § 8, cl. 3.

<sup>10</sup> See *Japan Line, Ltd. v. County of L.A.*, 441 U.S. 434, 446–49 (1979).

<sup>11</sup> See *id.* at 449, 452–54.

<sup>12</sup> See RON HIRA & ANIL HIRA, *OUTSOURCING AMERICA: WHAT'S BEHIND OUR NATIONAL CRISIS AND HOW WE CAN RECLAIM AMERICAN JOBS* 199 (2005).

through privatization.<sup>13</sup> Gaining favor in the 1980s,<sup>14</sup> “the most common [form of privatization] is for governments to ‘contract-out’” public functions to the private sector.<sup>15</sup> Privatization continued to grow in the 1990s as globalization increased “demand for public services” and state budget constraints pressured “government[s] to ‘banish bureaucracy’ and ‘reinvent’ the public sector.”<sup>16</sup> Today, as governments continue to embrace market-based solutions,<sup>17</sup> the value of state and local government outsourcing is nearly \$12 billion and is expected to grow to \$20 billion by 2011.<sup>18</sup>

This public sector move toward privatization has also given rise to offshoring, a form of outsourcing in which an entity relocates operations to another country.<sup>19</sup> Although offshoring is not a new practice in the United States—private companies have offshored manufacturing jobs for decades<sup>20</sup>—offshoring now affects service-sector jobs and “is creeping from [the] private [sector] into the arena of government.”<sup>21</sup> Technological advancements combined with the availability of large pools of foreign labor have opened the door for government contractors to perform service contracts abroad, particularly in the area of information technology (IT),<sup>22</sup> which is one of the fastest

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<sup>13</sup> See Michael J. Ballard & Mildred E. Warner, *Taking the High Road: Local Government Restructuring and the Quest for Quality 1* (Cornell Univ. Dep’t of City and Regional Planning, Cornell Working Papers in Planning No. 194, 2000), <http://government.cce.cornell.edu/doc/reports/highroad>.

<sup>14</sup> See Peter T. Kilborn, *Reagan Plan to Privatize Government Is Gaining Support from Democrats*, N.Y. TIMES, Feb. 15, 1988, at A10.

<sup>15</sup> Ballard & Warner, *supra* note 13, at 1.

<sup>16</sup> *Id.*; see also NAT’L ASSOC. OF STATE PROCUREMENT OFFICIALS, OFFSHORING AND PROCUREMENT: POSITIONING FOR THE FUTURE 3 (2005), <http://www.naspo.org/whitepapers/OffshoringIssueBrief.pdf>.

<sup>17</sup> See OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, THE PRESIDENT’S MANAGEMENT AGENDA 17 (2002) (“Government should be market-based—we should not be afraid of competition, innovation, and choice. I will open government to the discipline of competition.” (quoting then-Governor George W. Bush)); Mildred Warner & Jennifer Gerbasi, *Rescaling and Reforming the State Under NAFTA: Implications for Subnational Authority*, 28 INT’L J. URB. & REGIONAL RES. 858, 859 (2004) (citation omitted).

<sup>18</sup> See Press Release, INPUT, INPUT Predicts State & Local Government Outsourcing Market to Reach \$20 Billion in 2011 (Jan. 31, 2007), <http://www.input.com/corp/press/detail.cfm?news=1308>.

<sup>19</sup> COUNCIL OF ECON. ADVISERS, ECONOMIC REPORT OF THE PRESIDENT, H. DOC. 108-145, at 229 (2004), available at [http://www.gpoaccess.gov/usbudget/fy05/pdf/2004\\_erp.pdf](http://www.gpoaccess.gov/usbudget/fy05/pdf/2004_erp.pdf). [hereinafter 2004 ECONOMIC REPORT OF THE PRESIDENT]; see also GAO OFFSHORING REPORT, *supra* note 1, at 1. Some refer to the practice as “offshore outsourcing,” for example, 2004 ECONOMIC REPORT OF THE PRESIDENT, *supra*, but this Note simply refers to the concept as “offshoring.”

<sup>20</sup> Blinder, *supra* note 4, at 2.

<sup>21</sup> Bob Fernandez & Jane M. Von Bergen, *State Governments Are Offshoring Jobs*, RUTLAND HERALD (Vt.), Mar. 13, 2004, LexisNexis Academic. Public sector offshoring also occurs in other countries. See Andrew Taylor, *Offshore Jobs Move Revealed in DWP Leak*, FIN. TIMES (London), Jan. 23, 2006, at 3.

<sup>22</sup> See GAO OFFSHORING REPORT, *supra* note 1, at 1.

growing sectors of state spending.<sup>23</sup> One can trace the beginnings of public sector offshoring in part to the Personal Responsibility and Work Opportunity Reconciliation Act of 1996.<sup>24</sup> This federal law requires states to centralize certain child-support-payment functions and establish electronic benefit transfer (EBT) systems for the reimbursement of food stamp and other human services benefits.<sup>25</sup> States have largely managed this federal mandate through private contractors, many of which have in turn performed the contracts outside of the United States.<sup>26</sup>

## B. The Scope of State Government Offshoring

Although one study estimates that state governments spend at least \$2 billion annually on offshore IT contracting,<sup>27</sup> and a U.S. Congresswoman estimates the number could be as high as \$3.8 billion,<sup>28</sup> reliable data on the extent of offshoring in the public sector is sparse.<sup>29</sup> The lack of data is largely due to the failure of most states to track where their contractors perform the work after the state awards the contract.<sup>30</sup> Indeed, state procurement officials are sometimes un-

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<sup>23</sup> See Press Release, INPUT, State & Local IT Outsourcing Spending to Grow by 75 Percent by FY10 (Jan. 23, 2006), available at <http://www.input.com/corp/press/detail.cfm?news=1132>.

<sup>24</sup> See GAO OFFSHORING REPORT, *supra* note 1, at 8; Hopkins, *supra* note 3, at 1A. The text of the act is located at PUB. L. NO. 104-193, 110 STAT. 2105 (codified as amended in scattered sections of 7, 8, 21, 25 & 42 U.S.C.).

<sup>25</sup> See GAO OFFSHORING REPORT, *supra* note 1, at 8–9. EBT systems generally allow beneficiaries to use a plastic card, similar to a debit-card, to redeem their public benefits. See *id.* at 9.

<sup>26</sup> See *id.* at 8–10.

<sup>27</sup> See MATTERA ET AL., *supra* note 3, at 21.

<sup>28</sup> See Press Release, Office of U.S. Rep. John D. Dingell, DeLauro, Dingell Introduce US Worker Protection Act (July 22, 2005), [http://www.house.gov/dingell/documents/press\\_releases/109th\\_Congress/07-22-05.htm](http://www.house.gov/dingell/documents/press_releases/109th_Congress/07-22-05.htm) (quoting U.S. Rep. Rosa DeLauro).

<sup>29</sup> See GAO OFFSHORING REPORT, *supra* note 1, at 1 (“[N]o comprehensive data or studies show the extent of services offshoring by state governments and data for the federal government are limited.”); U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-04-932, INTERNATIONAL TRADE: CURRENT GOVERNMENT DATA PROVIDE LIMITED INSIGHT INTO OFFSHORING OF SERVICES 3 (2004) [hereinafter GAO TRADE REPORT] (“[A]lthough there are anecdotal accounts of state governments using offshore sources, no comprehensive data or studies of the extent to which state governments use these sources are available.”). This lack of reliable data also extends to offshoring in the private sector. See generally Blinder, *supra* note 4, at 6–7 (collecting studies on estimates of job loss); Mankiw & Swagel, *supra* note 6, at 24–27 (discussing various estimates of job loss).

<sup>30</sup> See LEG. RESEARCH COMM’N, STATE OF KENTUCKY, OFFSHORE OUTSOURCING OF KENTUCKY STATE GOVERNMENT SERVICES: DIRECT CONTRACTING IS LIMITED BUT THE AMOUNT OF SUBCONTRACTING IS UNKNOWN, RESEARCH REPORT NO. 325, at v (2005), available at <http://lrc.ky.gov/lrcpubs/RR325.pdf> [hereinafter KENTUCKY REPORT] (“The inability [of Kentucky] to determine whether contracted work is being outsourced overseas is typical of other states also.”); Nancy Hicks, *Bill Would Require Contractors to Reveal Their Overseas Deals*, LINCOLN J. STAR (Neb.), Feb. 14, 2008, at B2, LexisNexis Academic (“[N]o one seems to know how much business, paid for with state tax dollars, is conducted [overseas].”); *How*

aware of the use of offshore labor in state contracts,<sup>31</sup> especially if it results from offshore subcontracting.<sup>32</sup> Notwithstanding the lack of data, it is clear that a majority of states have contracts with vendors that use offshore labor to provide state services,<sup>33</sup> although the extent of such offshoring varies widely by state.<sup>34</sup> The discussion that follows addresses the scope of state offshore contracting through anecdotal press accounts, research studies, and government reports.

One of the most informative reports on state offshore contracting (albeit limited in scope) comes from the Government Accountability Office (GAO).<sup>35</sup> In 2006, the GAO investigated the extent of offshoring in certain state human-services programs, ostensibly because the programs implicated federal dollars.<sup>36</sup> The GAO concluded that a majority of states have offshore contracts related to four programs: Child Support Enforcement, Food Stamp, Temporary Assistance for Needy Families (TANF), and Unemployment Insurance.<sup>37</sup> Offshoring was most pervasive in Food Stamp and TANF programs, in which thirty-one and sixteen states respectively had offshore contracts, while twelve states had offshore Child Support Enforcement contracts, and seven states had offshore Unemployment Insurance contracts.<sup>38</sup>

In total, the GAO found that states annually spent \$335 million—or 18 percent—of annual contract expenditures on offshore contracting related to the four programs,<sup>39</sup> although the data has limitations.<sup>40</sup> In the Food Stamp and TANF programs, states most frequently offshored customer service functions, while in the Unemployment Insurance and Child Support Enforcement programs, states

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*Many Jobs Are Involved?*, PUBLIC CITIZEN, <http://www.citizen.org/trade/offshoring/jobs> (last visited Sept. 20, 2008).

<sup>31</sup> See, e.g., E-mail from Jeff T. Holden, Dir., Office of Procurement Mgmt., S.D., to author (Oct. 9, 2007, 09:01:05 EDT) (on file with author) (“We do not currently have anything in state law or our contracts that requires a contractor to identify where they will perform the work related to a state contract.”).

<sup>32</sup> See, e.g., *infra* note 63 and accompanying text.

<sup>33</sup> See generally GAO OFFSHORING REPORT, *supra* note 1 (finding that a majority of states had offshore contracts in certain human services programs); MATTERA ET AL., *supra* note 3.

<sup>34</sup> Compare E-mail from Carol Wilson, Dir. of Procurement, Dep’t of Admin. Serv., Conn., to author (Oct. 9, 2007, 08:01:13 EDT) (on file with author) (stating that offshoring “affects just about every state contract”), with E-mail from Chris Howe, Dir., Div. of Purchases, Kan., to author (Oct. 8, 2007, 10:20:33 EDT) (on file with author) (stating that offshoring “may appear on fewer than 5 transactions per year”).

<sup>35</sup> GAO OFFSHORING REPORT, *supra* note 1.

<sup>36</sup> See *id.* at 1–2, 6.

<sup>37</sup> See *id.* at 3.

<sup>38</sup> See *id.* at 12–13.

<sup>39</sup> See *id.* at 3.

<sup>40</sup> The total magnitude of state spending on offshore contracts is difficult to quantify because many states classify contracts as offshore even when the contractor will not perform them exclusively offshore. See *id.* at 14. Further complicating this situation is some states’ failure to maintain accurate records; the GAO found offshore state contracting in five states that reported no offshoring. See *id.* at 10–11.

most frequently offshored IT functions.<sup>41</sup> “[S]tate officials rarely contracted directly with foreign companies”; instead, offshoring generally occurred when state contractors either hired foreign subcontractors or used their own offshore operations.<sup>42</sup> India and Mexico were the most common offshore contract locations, but the GAO also documented offshore work in Argentina, Canada, Chile, France, Ireland, Poland, and Spain.<sup>43</sup>

Beyond this GAO report, newspaper articles seem to provide endless anecdotal evidence of state offshore contracting. The *Charlotte Observer*, for instance, reported that U.S. state-run call centers located in foreign nations are a “little-known but widespread government use of a controversial cost-cutting tactic.”<sup>44</sup> A study by that newspaper found that nearly every state is engaged in offshoring, including South Carolina, which awarded a \$2.5 million contract to a firm that planned to use workers in India to build a state unemployment tax system.<sup>45</sup> Similarly, the *Rutland Herald* reported that Pennsylvania contractor Citicorp Electronic Financial Services hired workers in India and Mexico to operate a state welfare call center.<sup>46</sup> In another example, according to the *Lincoln Journal Star*, Nebraska contractor J.P. Morgan employs offshore workers in India and Mexico to handle about 3,500 state food stamp calls per month, as part of a \$600,000 state contract.<sup>47</sup> Nebraska also has contracts with other private IT companies, like Microsoft and IBM, that perform state services in foreign countries including Argentina and Columbia.<sup>48</sup>

In Georgia, according to the *Atlanta Journal-Constitution*, the Governor recently announced that the state would outsource much of its technology infrastructure.<sup>49</sup> The Georgia Technology Authority is tasked with contracting out nearly \$600 million of state spending.<sup>50</sup> The State expects outsourcing to increase efficiency and accordingly plans to layoff 200 workers and transfer hundreds of others to private employers.<sup>51</sup> In the process, the Governor will not limit bidding to

<sup>41</sup> See *id.* at 17–20.

<sup>42</sup> See *id.* at 10.

<sup>43</sup> See *id.* at 21–22.

<sup>44</sup> Hopkins, *supra* note 3, at 1A.

<sup>45</sup> *Id.*

<sup>46</sup> See Fernandez & Von Bergen, *supra* note 21.

<sup>47</sup> Hicks, *supra* note 30. For other anecdotal evidence of state offshore call-centers, see Amy Joi Bryson, *Firm Is Asked to End India Outsourcing*, DESERET MORNING NEWS (Salt Lake City), Mar. 24, 2004, LexisNexis Academic; Karen Imas, *Sending Jobs Overseas: A Growing Policy Debate in the Public Sector*, MONTHLY ISSUE BRIEF (The Council of State Gov'ts/E. Regional Conf., New York, N.Y.), Oct., 2003, at 2–3.

<sup>48</sup> See Hicks, *supra* note 30.

<sup>49</sup> James Salzer, *Offshoring: New Tech Program Will Force Layoffs*, ATLANTA J.-CONST., Dec. 12, 2007, at 1D, LexisNexis Academic.

<sup>50</sup> See *id.*

<sup>51</sup> See *id.*

U.S. businesses; the State will consider vendors who provide the best value, which may include offshore contractors.<sup>52</sup>

One of the most remarkable examples of state government offshoring comes from Indiana. The *Fort Wayne Journal-Gazette* revealed that the Indiana Department of Workforce Development—the state agency responsible for helping unemployed residents find jobs—awarded a \$15.2 million contract to India-based Tata Consultancy Services Ltd. to upgrade the agency’s computers.<sup>53</sup> The agreement called for the contractor to secure temporary work visas for sixty-five Indian contractors to work alongside eighteen Indiana workers.<sup>54</sup> Although Tata’s contract bid was approximately \$8 million less than the next lowest bid, the Governor cancelled the contract after its details became public.<sup>55</sup>

In Massachusetts, according to the *Boston Herald*, the issue of state offshore contracting led to a public fight between the state’s senior U.S. senator, Ted Kennedy, and its then-governor, Mitt Romney.<sup>56</sup> Kennedy, upon learning that Massachusetts’s state contractor J.P. Morgan Chase used workers in India to process state Medicaid data and answer questions about the state’s food stamp program, criticized Romney for “jumping on the offshoring bandwagon.”<sup>57</sup> This was not Massachusetts’s first foray into offshoring: the State Teachers’ Retirement Board previously awarded a \$3 million contract to an information management company that performed work in India for the Board.<sup>58</sup>

Additionally, state-government reports offer some insight into state offshoring practices. The Tennessee Legislature estimates that it spends at least \$45 million annually on offshore contracts.<sup>59</sup> The California State Auditor reports that 185 state contracts totaling \$638.9 million may have been performed offshore. The extent of Califor-

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<sup>52</sup> See *id.*

<sup>53</sup> *Labor Agency Taps India Firm for State Project*, FT. WAYNE J.-GAZETTE, Sept. 30, 2003, at 9, LexisNexis Academic.

<sup>54</sup> *Id.*

<sup>55</sup> The Governor’s cancellation was not welcomed by everyone. Compare THOMAS L. FRIEDMAN, *THE WORLD IS FLAT: A BRIEF HISTORY OF THE TWENTY-FIRST CENTURY* 207 (2005) (“The deal would greatly benefit . . . some Indiana tech workers; and it would save Indiana state residents precious tax dollars that could be deployed to hire more state workers . . .”), with LOU DOBBS, *EXPORTING AMERICA: WHY CORPORATE GREED IS SHIPPING AMERICAN JOBS OVERSEAS* 35 (2004) (“[T]he taxpayers of Indiana . . . would have preferred that their tax dollars be used to help those out-of-work Indiana residents find jobs.”).

<sup>56</sup> See Rothstein, *supra* note 5, at 6.

<sup>57</sup> *Id.* (quoting U.S. Sen. Ted Kennedy).

<sup>58</sup> See MATTERA ET AL., *supra* note 3, at 16.

<sup>59</sup> FISCAL NOTE, H.B. 870 & S.B. 1113, 105th Gen. Sess., 1st. Sess. (Tenn. 2007), available at <http://www.legislature.state.tn.us/bills/currentga/Fiscal/HB0870.pdf> (noting that Tennessee spends 10 percent of \$3 billion service contract expenditures on IT services, 15 percent of which are performed offshore).



nia's offshore contracting, though, remains unclear because state agencies are neither required to track nor report the extent of offshore contracting.<sup>60</sup> The Nebraska Legislature found that the State hired a German company to manage its accounting system and that the Nebraska Employee Retirement System employs an offshore worker to maintain its computer systems.<sup>61</sup> Minnesota estimates that it directly spends 0.42 percent of professional/technical contract funds on offshore contracting.<sup>62</sup> Kentucky reports that it has spent \$5.67 million on offshoring contracting since 1999, but that the actual number is likely higher because the State does not know the extent of its offshore subcontracting.<sup>63</sup>

While states' offshore contracting most often steals the headlines, city governments are not immune from offshoring. In 2002, the *New York Times* reported that workers in Ghana process New York City environmental citations.<sup>64</sup> The City awarded a contract to Delaware-based Data Management Internationale to transcribe handwritten citations into a digital database.<sup>65</sup> The contractor subcontracted the work to Ghana, where its typists typically earn about \$70 per month, about three times the Ghanaian minimum wage.<sup>66</sup> City officials, who claim they didn't know where the contractor would perform the contract and have since moved the work back into the United States, had previously contracted with a Michigan-based firm that transcribed the citations in India and Mexico.<sup>67</sup>

### C. The Outsourcing Controversy of 2004 and The Rise of State Offshore Contracting Restrictions

The debate over offshore contracting took center stage during the 2004 election season.<sup>68</sup> A study notes that interest in outsourcing

<sup>60</sup> CAL. STATE AUDITOR, THE STATE'S OFFSHORE CONTRACTING: UNCERTAINTY EXISTS ABOUT ITS PREVALENCE AND EFFECTS, Report No. 2004-115, in IMPLEMENTATION OF STATE AUDITOR'S RECOMMENDATIONS: AUDITS RELEASED IN JANUARY 2004 THROUGH DECEMBER 2005, Report No. 2006-406R 89, 89-90 (2006) [hereinafter CAL. AUDITOR REPORT].

<sup>61</sup> FISCAL NOTE, L.B. 87, 99th Sess., Reg. Sess. (Neb. 2007), available at <http://uniweb.legislature.ne.gov/FloorDocs/Current/PDF/FN/LB87.pdf>.

<sup>62</sup> Memorandum from Dana B. Badgerow, Comm'r of the Dep't of Admin., Minn. to Tim Pawlenty, Governor, Minn. 1 (Feb. 21, 2007) (on file with author).

<sup>63</sup> KENTUCKY REPORT, *supra* note 30.

<sup>64</sup> Robert F. Worth, *In New York Tickets, Ghana Sees Orderly City*, N.Y. TIMES (late ed.), July 22, 2002, at A1 ("If you are caught playing your radio too loudly in Times Square, selling ice cream while parked in a Harlem crosswalk or dumping your kitchen trash in Prospect Park, your ticket does not just go to City Hall to be processed. It goes to Ghana.")

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> See Mankiw & Swagel, *supra* note 6, at 4-5; Carolyn Said, *Hot-Button Issue Makes for Lively Debate Along the Campaign Trail: Federal, State Lawmakers Seek to Regulate Sending Jobs Overseas*, S. F. CHRON., Mar. 7, 2004, at 15.

“exploded” during the election, with media references to outsourcing in four major newspapers more than tripling during that period.<sup>69</sup> A crucial point in this offshoring debate was the release of the 2004 Economic Report of the President, which reported that it “makes more sense” to import cheaper foreign goods and services rather than produce them domestically.<sup>70</sup> Many took exception to the President’s perceived support of offshoring, and the President’s chief economic adviser ignited further controversy when he characterized offshoring as “just a new way of doing international trade.”<sup>71</sup> U.S. Senator John Kerry seized upon the controversy when he promised to repeal every incentive that “entices any Benedict Arnold company or CEO to take the money and the jobs overseas.”<sup>72</sup>

State lawmakers began to react to the growing public debate over offshoring by taking action to restrict offshore state contracting.<sup>73</sup> These actions have taken many forms, including offshore state contract bans,<sup>74</sup> state contract preferences for in-state vendors,<sup>75</sup> and dis-

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<sup>69</sup> See Mankiw & Swagel, *supra* note 6, at 4–5.

<sup>70</sup> 2004 ECONOMIC REPORT OF THE PRESIDENT, *supra* note 19, at 229.

<sup>71</sup> Jonathan Weisman, *Bush, Adviser Assailed for Stance on ‘Offshoring’ Jobs*, WASH. POST, Feb. 11, 2004, at A6 (quoting N. Gregory Mankiw). For a sampling of controversy that erupted, see, for example, Press Release, U.S. Rep. Marion Berry, Berry Calls for Resignation of Administration Official who Claimed Benefits to Exporting American Jobs (Feb. 13, 2004), available at <http://www.house.gov/berry/pressreleases/archive/021304Mankiw.html> (calling for Mankiw’s resignation); Mike Allen, *Hastert Rebukes Bush Adviser; Speaker Challenges Mankiw’s Statements on U.S. Job Loss*, WASH. POST, Feb. 12, 2004, at A17 (“I understand that Mr. Mankiw is a brilliant economic theorist, but his theory fails a basic test of real economics.” (quoting then-Speaker of the House Dennis Hastert)).

<sup>72</sup> Barry Shlachter, *Kerry’s Offshoring Plan Being Questioned*, FT. WORTH STAR-TELEGRAM, Oct. 21, 2004, at C1.

<sup>73</sup> See *supra* note 7 and accompanying text.

<sup>74</sup> See, e.g., N.J. STAT. ANN. § 52:34-13.2 (West 2005); S.B. 2385, 2008 Leg., Jan. Sess. (R.I. 2008) (“The state or any municipality shall not award a procurement contract for goods and services to be rendered or supplied by a vendor or contractor located outside the United States.”); H.B. 32, 24th Leg., Reg. Sess. (Haw. 2007); L.B. 87, 100th Leg., 1st Sess. (Neb. 2007) (requiring all state service contracts to be awarded to U.S. companies to perform work in the U.S.); S.B. 4077, 213th Leg., Reg. Sess. (N.Y. 2007) (requiring certain state contracts to include clause mandating all services under contract must be performed within U.S.); Keep Jobs in Tennessee Act, H.B. 870, 105th Gen. Assem., 1st Reg. Sess. (Tenn. 2007); Keep Jobs in West Virginia Act, H.B. 2389, 77th Leg., Reg. Sess. (W. Va. 2007); S.B. 1266, 47th Leg., 1st Reg. Sess. (Ariz. 2005). This category also includes legislation that requires a state contractor to employ workers who are authorized to work in the United States. See, e.g., H.B. 692, 94th Gen. Assem., 1st Reg. Sess. (Mo. 2007) (requiring all state service contracts to include a clause that mandates that employees of contractors and subcontractors must be U.S. citizens); S.B. 234, 114th Gen. Assem., 1st Reg. Sess. (Ind. 2005) (requiring state contractors to file an affidavit stating that each individual performing the state contract is authorized to work in the United States); H.B. 2207, 75th Leg., Reg. Sess. (W. Va. 2005).

<sup>75</sup> See, e.g., 30 ILL. COMP. STAT. ANN. 517/10 (West 2005) (requiring state purchasing agencies to give preference to domestic products); L.B. 87, 100th Leg., 1st Sess. (Neb. 2007) (giving preference to Nebraska-based companies as part of a requirement that state contractors perform services in the United States); Ind. Exec. Order No. 05-05 (2005),

qualifying enterprises from certain state benefits because of unrelated offshoring activities.<sup>76</sup> This Note does not specifically address indirect forms of offshoring legislation, but they include restrictions on sending data overseas,<sup>77</sup> directives to study the issue of offshoring,<sup>78</sup> and contractor disclosure requirements.<sup>79</sup> Although many have raised constitutional concerns about state offshore contracting restrictions,<sup>80</sup> a topic this Note addresses,<sup>81</sup> states continue to forge ahead with legislation to restrict offshoring.<sup>82</sup>

In December 2003, offshoring legislation had appeared before only four state legislatures; by early 2004, nearly 100 such bills were pending in state legislatures across the nation.<sup>83</sup> And by the end of 2004, that number grew to more than 200 bills in over forty states.<sup>84</sup> Five of those bills became law, including a Tennessee statute authorizing state officials to implement preferences for service contracts that would be performed within the United States.<sup>85</sup> Then, during

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available at [http://www.in.gov/gov/files/EO\\_05-05\\_Buy\\_Indiana.pdf](http://www.in.gov/gov/files/EO_05-05_Buy_Indiana.pdf) (establishing the preference for in-state goods).

<sup>76</sup> See, e.g., H.B. 568, 95th Gen. Assem., 1st Reg. Sess. (Ill. 2007) (disqualifying an entity from state contract awards if it “has or uses a foreign call service center”); Job Preservation Act of 2007, S.B. 1255, 95th Gen. Assem., 1st Reg. Sess. (Ill. 2007) (disqualifying companies that lose 100 or more employees due to outsourcing from receiving certain state benefits, including procurement contracts); H.B. 129, 2007 Leg., Reg. Sess. (N.H.) (prohibiting companies that have outsourced fifty or more New Hampshire jobs from bidding on state contracts); H.B. 389, 2007 Leg., Reg. Sess. (Pa. 2007) (disqualifying from state contracts those contractors who have offshoring jobs within the past three years from bidding on state contracts).

<sup>77</sup> See, e.g., CAL. ELEC. CODE § 2188.5 (West 2007) (prohibiting voter information from being sent outside the United States); H.B. 2836, 74th Leg., Reg. Sess. (Or. 2007) (mandating, *inter alia*, disclosure of call-center location and prohibiting data transfer to foreign countries).

<sup>78</sup> See, e.g., H.B. 5112, 2008 Gen. Assem., Feb. Sess. (Conn.); H.B. 833, 160th Sess., Reg. Sess. (N.H. 2007).

<sup>79</sup> See, e.g., N.C. GEN. STAT. § 143-59.4 (West 2005); H.B. 4100, 94th Leg., 1st Reg. Sess. (Mich. 2007); S.B. 861, 2007 Sess., Reg. Sess. (Va. 2007).

<sup>80</sup> See, e.g., CAL. AUDITOR REPORT, *supra* note 60, at 92; NFAP REPORT, *supra* note 7, at 3 (noting that California Governor Arnold Schwarzenegger vetoed five state offshoring bills, announcing: “There is a right way and a wrong way to expand economic opportunity in California. The wrong approach is to implement measures that restrict trade, invite retaliation or violate the United States Constitution or our foreign trade agreements.”) (citation omitted); STATE OF WASH., JOINT TASK FORCE ON STATE CONTRACTS 9–10 (2007); SHANNON KLINGER & M. LYNN SYKES, NAT’L FOUND. FOR AM. POLICY, EXPORTING THE LAW: A LEGAL ANALYSIS OF STATE AND FEDERAL OUTSOURCING LEGISLATION 2–3 (2004), [http://www.nfap.net/researchactivities/studies/NFAPStudyExportingLaw\\_0404.pdf](http://www.nfap.net/researchactivities/studies/NFAPStudyExportingLaw_0404.pdf).

<sup>81</sup> See *infra* Part III.

<sup>82</sup> See generally NFAP REPORT, *supra* note 7.

<sup>83</sup> *Id.* at 2.

<sup>84</sup> *Id.*

<sup>85</sup> TENN. CODE ANN § 12-4-109(e) (West 2004). This statute was the first in the nation to give businesses an incentive not to offshore work. See *Tenn. Governor Signs Anti-Outsourcing Bill*, CHI. SUN-TIMES, May 17, 2004, at 40. But, as of mid-2007, Tennessee had not implemented any of the preferences that the statute authorized. See E-mail from Robert Barlow, Office of Contracts Review, Tenn., to author (Oct. 16, 2007, 10:53:06 EDT).

2005–2006, state lawmakers introduced approximately 190 bills on the subject of offshoring,<sup>86</sup> ten of which became law.<sup>87</sup> Several more passed state legislatures but were met with vetoes.<sup>88</sup> Among the new laws were Colorado, Illinois, and North Dakota statutes giving preference to domestic products,<sup>89</sup> a North Carolina contract location disclosure law,<sup>90</sup> and New Jersey's infamous Senate Bill 494, a highly restrictive offshore contract ban.<sup>91</sup> New Jersey State Senator Shirley Turner introduced the bill after learning that the private contractor administering New Jersey's welfare benefits had moved the state customer-service call-center to India.<sup>92</sup>

During 2006–2007, although the number of bills state legislators introduced declined, significant state legislative action aimed at restricting offshoring continued.<sup>93</sup> As of April 2007, more than forty offshoring bills were pending in state legislatures,<sup>94</sup> including a New York bill that would require contractors to perform state service contracts in the United States.<sup>95</sup> Legislative activity has also continued into 2008.<sup>96</sup> In the future, state lawmakers are likely to continue restricting offshore state contracting for political and economic reasons, especially if the economy falters.<sup>97</sup>

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<sup>86</sup> See, e.g., S.B. 13, 126th Gen. Assem., Reg. Sess. (Ohio 2005); S.B. 1150, 58th Leg., 1st Reg. Sess. (Idaho 2005).

<sup>87</sup> See NFAP REPORT, *supra* note 7, at 4 (seven bills restricted offshoring; three established commissions to study offshoring).

<sup>88</sup> See *id.* at 3 (including five California bills).

<sup>89</sup> See COLO. REV. STAT. ANN. § 8-18-103 (West 2005); 30 ILL. COMP. STAT. ANN. 517/10 (West 2005); N.D. CENT. CODE § 44-08-01.1 (2005).

<sup>90</sup> N.C. GEN. STAT. § 143-59.4 (West 2005).

<sup>91</sup> See N.J. STAT. ANN. § 52:34-13.2 (West 2005).

<sup>92</sup> Imas, *supra* note 47, at 2–3.

<sup>93</sup> See NFAP REPORT, *supra* note 7, at 5; Richard Raysman & Peter Brown, *Anti-Outsourcing Legislation: A Brief Summary*, 238 N.Y.L.J. 3, 3 (2007); Bob Sanders, *Lawmakers Face a Slew of Labor-Related Measures*, N.H. BUS. REV., Feb. 2, 2007, at 1.

<sup>94</sup> See NFAP REPORT, *supra* note 7, at 5 (noting that as of April 10, 2007, state legislators had introduced forty-one offshoring bills).

<sup>95</sup> S.B. 4077, 213th Leg., Reg. Sess. (N.Y. 2007).

<sup>96</sup> See, e.g., H.B. 269, 25th Leg., 2d Sess. (Ala. 2008) (“The state shall procure only United States flags or Alaska flags that are manufactured in the United States.”); S.B. 1249, 48th Leg., 2d Reg. Sess. (Ariz. 2008) (“A state governmental unit shall not award a contract or development assistance to a vendor, bidder, contractor or subcontractor or an applicant for development assistance that performs the work at a site outside of the United States.”); H.B. 5112, 2008 Gen. Assem., Feb. Sess. (Conn. 2008) (requiring the state, *inter alia*, to identify offshore contracting and for vendors to disclosure offshore performance); H.B. 1613, 94th Gen. Assem., 2nd Sess. (Mo. 2008) (suggesting that the state should prohibit offshore contracting to mitigate the impact of international trade); L.B. 869, 100th Leg., 2d Sess. (Neb. 2008) (creating a disclosure requirement); S.B. 2385, 2008 Gen. Assem., Jan. Sess., (R.I. 2008); see also Jobs & Trade Act, A.B. 8567, 230th Leg., Reg. Sess. (N.Y. 2007) (suggesting that the state should prohibit offshore contracting to mitigate the impact of international trade).

<sup>97</sup> See Jim Small, *Bill Bans Arizona Contracts to Firms that Outsource to Foreign Companies*, ARIZ. CAPITOL TIMES, Feb. 1, 2008, LexisNexis Academic. In Arizona, for example, State Representative David Schapira is against offshoring because he believes it will eventually

State legislatures are not the only government branches taking issue with offshoring; a handful of governors have issued executive orders limiting public sector offshoring. On August 31, 2007, the Governor of Idaho barred state contractors from offshoring American jobs.<sup>98</sup> Citing the possibility that offshoring may decrease state revenue and create unemployment, the Governor ordered potential state vendors to disclose the location in which the vendor or its subcontractor intends to perform any state service contract.<sup>99</sup> The Governor also prohibited state officials from awarding service contracts to vendors who planned to perform state contracts outside of the United States.<sup>100</sup>

Similarly, in 2004 the Governor of Alaska ordered the State Executive Branch to ensure that service contracts are performed in the United States.<sup>101</sup> Pursuant to that order, the State's Division of General Services now requires state service contracts above \$25,000 to be performed domestically.<sup>102</sup> Other states that have executive orders in force on the subject of offshoring include Indiana,<sup>103</sup> Michigan,<sup>104</sup> Missouri,<sup>105</sup> North Carolina,<sup>106</sup> and Pennsylvania.<sup>107</sup> At least one state, West Virginia, has restricted offshore contracting in the absence of legislative or executive action.<sup>108</sup>

## II

### CONSTITUTIONAL LIMITS ON STATE POWER

#### A. The Foreign Commerce Clause

##### 1. *Overview of Foreign Commerce Power*

Against this backdrop, this Note turns to the Foreign Commerce Clause.<sup>109</sup> Article I, Section 8 of the Constitution grants Congress the affirmative power “[t]o Regulate Commerce with foreign Nations, and

result in lost jobs, stating, “Especially with the economy in the state its in right now, the fear is the next piece may be job loss. I don’t want to see that happen in Arizona.” *Id.*

<sup>98</sup> Idaho Exec. Order No. 2007-09 (2007); Press Release, Office of Governor of Idaho, Governor Protects Idaho Jobs from Outsourcing (Aug. 31, 2007), *available at* [http://gov.idaho.gov/mediacenter/press/pr2007/praug07/pr\\_070.html](http://gov.idaho.gov/mediacenter/press/pr2007/praug07/pr_070.html).

<sup>99</sup> Idaho Exec. Order No. 2007-09 (2007).

<sup>100</sup> *Id.*

<sup>101</sup> Alaska Admin. Order No. 216 (2004), *available at* <http://www.gov.state.ak.us/admin-orders/216.html>.

<sup>102</sup> DIV. OF FIN., ALASKA. DEP’T OF ADMIN., ALASKA ADMIN. MANUAL 81.015 (2007), *available at* [http://fin.admin.state.ak.us/dof/ak\\_admin\\_manual/resource/81.pdf](http://fin.admin.state.ak.us/dof/ak_admin_manual/resource/81.pdf).

<sup>103</sup> Ind. Exec. Order No. 05-05 (2005).

<sup>104</sup> Mich. Exec. Directive No. 2004-3 (2004).

<sup>105</sup> Mo. Exec. Order No. 04-09 (2004).

<sup>106</sup> N.C. Exec. Order No. 60 (2004).

<sup>107</sup> Pa. Exec. Order No. 2006-08 (2006).

<sup>108</sup> See E-mail from David Tincher, Dir., Purchasing Div., W. Va., to author (Oct. 29, 2007, 11:21:53 EDT) (on file with author).

<sup>109</sup> U.S. CONST. art. I, § 8, cl. 3.

among the Several States, and with the Indian Tribes.”<sup>110</sup> These words represent one of the most expansive powers of the federal government.<sup>111</sup> The Commerce Clause subjects virtually all commercial intercourse to national control.<sup>112</sup> This Clause was largely borne out of the drafters’ desire to control the hostile economic relationships that had existed between the States under the Articles of Confederation.<sup>113</sup> The drafters also recognized the need for uniform foreign trade regulations in the aftermath of the Revolutionary War.<sup>114</sup> Although the text of the Commerce Clause might suggest that the scope of the three enumerated commerce powers is coextensive,<sup>115</sup> the Supreme Court in *Japan Line, Ltd. v. County of Los Angeles* announced “there is evidence that the founders intended the scope of the foreign commerce power to be greater.”<sup>116</sup>

The reach of the foreign commerce power is distinctively broad.<sup>117</sup> In its early years, the Supreme Court opined that the Foreign Commerce Clause “comprehend[s] every species of commercial

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<sup>110</sup> *Id.* The Commerce Clause is divided into three parts: the Intrastate Commerce Clause, the Foreign Commerce Clause, and the Indian Commerce Clause. See generally BORIS I. BITTKER, BITTKER ON THE REGULATION OF INTERSTATE AND FOREIGN COMMERCE (1999).

<sup>111</sup> See, e.g., *Gonzales v. Raich*, 545 U.S. 1, 5 (2005) (holding that Congress’s commerce power extends to criminalization of intrastate, noncommercial cultivation of medical marijuana); *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 258 (1964) (upholding the Civil Rights Act of 1964 on Commerce Clause grounds); *Wickard v. Filburn*, 317 U.S. 111, 128–29 (1942) (holding that the commerce power extends to the imposition of wheat quotas on farmers because the cumulative effect of local consumption affects interstate commerce); *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 66–67 (1824) (opining that commerce includes all “commercial intercourse”); *United States v. Clark*, 435 F.3d 1100 (9th Cir. 2006) (holding that the commerce power extends to criminalization of international travel to engage in an unlawful sex act).

<sup>112</sup> See, e.g., cases cited *supra* note 111.

<sup>113</sup> See *Seelig v. Baldwin*, 7 F. Supp. 776, 780 (S.D.N.Y. 1934) (opining that the drafters wanted to end “the mutual jealousies and aggression of the states, taking form in customs barriers and other economic retaliation”); Kenton R. O’Neil, Comment, “Buy American” Statutes: Should the Market Participant Doctrine Shield Pennsylvania’s Steel Products Procurement Act from Commerce Clause Scrutiny?, 96 DICK. L. REV. 519, 524 (1992) (“The drafters of the Clause decided that the source of the problems of the Articles of Confederation stemmed from state governments which had been too responsive to local economic interests in the absence of a central government capable of economically unifying the several states.”) (citation omitted).

<sup>114</sup> See Robert J. Delahunty, *Federalism Beyond the Water’s Edge: State Procurement Sanctions and Foreign Affairs*, 37 STAN. J. INT’L L. 1, 16–26 (2001).

<sup>115</sup> See generally Saikrishna Prakash, *Our Three Commerce Clauses and the Presumption of Intrasentence Uniformity*, 55 ARK. L. REV. 1149 (2003).

<sup>116</sup> 441 U.S. 434, 448 (1979); accord Prakash, *supra* note 115, at 1149 (“[O]ne might say that there is only one power—the power to regulate commerce—that applies [in all] three situations.”).

<sup>117</sup> See *United States v. Clark*, 435 F.3d 1100, 1113 (9th Cir. 2006) (“Born largely from a desire for uniform rules governing commercial relations with foreign countries, the Supreme Court has read the Foreign Commerce Clause as granting Congress sweeping powers.”).

intercourse between the United States and foreign nations.”<sup>118</sup> The Court has never struck down a congressional act as exceeding its foreign commerce power,<sup>119</sup> nor do federalism constraints burden the foreign commerce power.<sup>120</sup> The Foreign Commerce Clause further appears to be immune from two recent Supreme Court cases limiting the scope of Congress’s interstate commerce power<sup>121</sup>—*United States v. Lopez*<sup>122</sup> and *United States v. Morrison*.<sup>123</sup>

Sitting in the shadow of this expansive federal foreign commerce power is the dormant foreign commerce power.<sup>124</sup> The so-called dormant Foreign Commerce Clause, although not found in the actual text of the Constitution,<sup>125</sup> places constitutional limits on states’ ability to regulate foreign commerce.<sup>126</sup> Based on the premise that Congress has the “exclusive” power to regulate foreign commerce,<sup>127</sup> the dormant Foreign Commerce Clause acts “as a self-executing limitation on the power of the States to” substantially burden foreign commerce,<sup>128</sup> even in the absence of explicit Congressional preemption.<sup>129</sup> The dormant nature of the commerce power effectuates the national policy of preventing the “economic balkanization” of the nation “into

<sup>118</sup> *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 193–94 (1824).

<sup>119</sup> *See Clark*, 435 F.3d at 1113.

<sup>120</sup> *See Japan Line*, 441 U.S. at 448 n.13 (noting that “[i]t has never been suggested that Congress’ power to regulate foreign commerce could be . . . limited” by the constraints of federalism); *Bd. of Trs. of Univ. of Ill. v. United States*, 289 U.S. 48, 57 (1933) (“The principle of duality in our system of government does not touch the authority of Congress in the regulation of foreign commerce.”).

<sup>121</sup> *See Clark*, 435 F.3d at 1111; Prakash, *supra* note 115, at 1166–67.

<sup>122</sup> 514 U.S. 549 (1995) (invalidating the Gun Free School Zone Act of 1990 as exceeding Congress’s commerce power because the statute encroached on state police powers).

<sup>123</sup> 529 U.S. 598 (2000) (invalidating the Violence Against Women Act of 1994 as exceeding Congress’s commerce power because it was not directed at instrumentalities, channels, or goods involved in interstate commerce).

<sup>124</sup> *See generally* BITTKER, *supra* note 110, § 6.

<sup>125</sup> *See, e.g., C & A Carbone, Inc., v. Town of Clarkstown*, 511 U.S. 383, 401 (1994) (O’Connor, J., concurring) (“The scope of the dormant Commerce Clause is a judicial creation.”); Prakash, *supra* note 115, at 1169 (highlighting that the Dormant Commerce Clause is a creature of Constitutional interpretation performed by courts and that the resulting jurisprudence is “very complicated and byzantine.”).

<sup>126</sup> *See* U.S. CONST. art. I, § 8, cl. 3; *United Haulers Ass’n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1793 (2007). *But see* *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 610 (1997) (Thomas, J., dissenting) (“The negative Commerce Clause has no basis in the text of the Constitution, makes little sense, and has proved virtually unworkable in application.”).

<sup>127</sup> *See Bd. of Trs. of Univ. of Ill. v. United States*, 289 U.S. 48, 56–57 (1933) (“It is an essential attribute of the [foreign commerce] power that it is exclusive and plenary. As an exclusive power, its exercise may not be limited, qualified or impeded to any extent by state action.”).

<sup>128</sup> *S.-Cent. Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 87 (1984).

<sup>129</sup> *See United Haulers Ass’n*, 127 S. Ct. at 1792; Hon. Sandra L. Lynch, Judge, U.S. Cir. Ct., *The United States, the States, and Foreign Relations*, Address at Suffolk University Law School (Feb. 17, 2000), in 33 SUFFOLK U. L. REV. 217, 225 (2000).

fifty separate and impenetrable markets.”<sup>130</sup> It also relieves the federal government of the burden of policing state regulation and rescuing states from foreign policy problems that might arise because of state regulation of foreign commerce.<sup>131</sup>

## 2. *Standard to Evaluate State Regulation of Foreign Commerce*

### a. *Traditional Commerce Clause Standard*

Lower courts borrow the dormant Interstate Commerce Clause standard to adjudicate challenges to state regulation of foreign commerce because the Supreme Court’s dormant Foreign Commerce Clause jurisprudence is relatively undeveloped.<sup>132</sup> In the interstate context, courts are highly skeptical of state regulation that discriminates against interstate commerce,<sup>133</sup> in which “‘discrimination’ simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.”<sup>134</sup> Accordingly, state measures that facially discriminate against interstate or foreign commerce are subject to strict scrutiny.<sup>135</sup> In *Philadelphia v. New Jersey*, the Court struck down New Jersey’s prohibition on out-of-state trash shipments into the State, holding that a state may not solve a legitimate public policy problem by erecting barriers to trade.<sup>136</sup> Similarly, the Court has invalidated as facially discriminatory Iowa’s less favorable treatment of dividends from a foreign subsidiary of a corporation that has both domestic and foreign operations.<sup>137</sup>

The strict scrutiny applied to facially discriminatory state regulation of interstate or foreign commerce largely depends on the nature of the state action. On the one hand, the Supreme Court has applied

<sup>130</sup> *Trojan Techs., Inc. v. Pennsylvania*, 916 F.2d 903, 909 (3d Cir. 1990).

<sup>131</sup> *See Lynch, supra* note 129, at 225.

<sup>132</sup> *See, e.g., Piazza’s Seafood World, LLC v. Odom*, 448 F.3d 744, 749–50 (5th Cir. 2006) (applying interstate dormant commerce framework to dormant foreign commerce challenge); *Antilles Cement Corp. v. Acevedo Vila*, 408 F.3d 41, 46 (1st Cir. 2005) (“Although the language of dormant Commerce Clause jurisprudence most often concerns interstate commerce, essentially the same doctrine applies to international commerce.”). Most of the Court’s dormant Foreign Commerce Clause jurisprudence concerns taxation. *See, e.g., Barclays Bank PLC v. Franchise Tax Bd.*, 512 U.S. 298 (1994); *Itel Containers Int’l Corp. v. Huddleston*, 507 U.S. 60 (1993); *Wardair Can. Inc. v. Fla. Dep’t of Revenue*, 477 U.S. 1 (1986); *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983); *Japan Line, Ltd. v. County of L.A.*, 441 U.S. 434 (1979).

<sup>133</sup> *See, e.g., United Haulers Ass’n*, 127 S. Ct. at 1793.

<sup>134</sup> *Or. Waste Sys., Inc. v. Dep’t of Envtl. Quality*, 511 U.S. 93, 99 (1994).

<sup>135</sup> *See Kraft Gen. Foods, Inc. v. Iowa Dep’t of Revenue and Fin.*, 505 U.S. 71, 81–82 (1992); *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978); *Nat’l Foreign Trade Council v. Natsios*, 181 F.3d 38, 66–67 (1st Cir. 1999) (“Under standard Commerce Clause analysis, a statute that facially discriminates against interstate or foreign commerce will, in most cases, be found unconstitutional.”), *aff’d in result sub nom. Crosby v. Nat’l Foreign Trade Council*, 530 U.S. 363 (2000).

<sup>136</sup> 437 U.S. 617.

<sup>137</sup> *Kraft Gen. Foods*, 505 U.S. at 92.



a “virtually *per se* rule of invalidity” to state policies that are motivated by “simple economic protectionism,”<sup>138</sup> such as laws that explicitly block the flow of commerce at the states’ borders.<sup>139</sup> This is especially true if states require “business operations to be performed in the home State that could more efficiently be performed elsewhere.”<sup>140</sup> On the other hand, not all facial discrimination is protectionist, and the Court has carved out a narrow exception for facial discrimination that serves “legitimate local purposes that could not adequately be served by available nondiscriminatory alternatives.”<sup>141</sup> In *Maine v. Taylor*, the Court upheld Maine’s facially discriminatory policy of prohibiting the importation of out-of-state baitfish because the fish threatened the state’s local environment.<sup>142</sup> Nonetheless, the Court has narrowly construed this exception, noting that “[s]hielding in-state industries from out-of-state competition is almost never a legitimate local purpose.”<sup>143</sup>

Even if it is not facially discriminatory, a state regulation with the purpose or effect of discriminating against interstate or foreign commerce is met with heightened scrutiny.<sup>144</sup> In these situations, the state bears the burden of justifying its regulation “both in terms of the local benefits . . . and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake.”<sup>145</sup> However, if the state regulates “even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, [the regulation] will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”<sup>146</sup>

<sup>138</sup> *Philadelphia v. New Jersey*, 437 U.S. at 624.

<sup>139</sup> *Id.*

<sup>140</sup> *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145 (1970) (“Even where the state is pursuing a clearly legitimate local interest, this particular burden on commerce has been declared virtually *per se* illegal.”); see also *Philadelphia v. New Jersey*, 437 U.S. at 624; *Piazza’s Seafood World, LLC v. Odom*, 448 F.3d 744, 750 (5th Cir. 2006) (holding that a Louisiana catfish labeling statute that prevented foreign fish from being labeled as “catfish” is *per se* invalid because it facially discriminates against foreign commerce).

<sup>141</sup> *Maine v. Taylor*, 477 U.S. 131, 151 (1986).

<sup>142</sup> *Id.* at 151.

<sup>143</sup> *Id.* at 148.

<sup>144</sup> See *Hunt v. Wash. Apple Adver. Comm’n*, 432 U.S. 333 (1977). *Washington Apple* involved a dormant Commerce Clause challenge to North Carolina’s prohibition on the importation of non-USDA certified apples. *Id.* at 336–42. The Court found that the practical effect of this regulation was to discriminate against Washington apples, which were not USDA-certified but rather certified by Washington under its higher standards. *Id.* at 351–52; see also *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951) (striking down regulations that milk had to be processed near the city of Madison because other less restrictive alternatives exist to protect health and safety).

<sup>145</sup> *Wash. Apple*, 432 U.S. at 353.

<sup>146</sup> *Pike*, 397 U.S. at 142 (invalidating a California regulation requiring farmers to pack cantaloupes locally).

b. "One Voice" Test of Japan Line

State power to regulate foreign commerce is further constrained by the "special need for federal uniformity" and requires a broader constitutional inquiry.<sup>147</sup> In *Japan Line*, the Supreme Court invalidated a California property tax as applied to a foreign corporation under the Foreign Commerce Clause.<sup>148</sup> In doing so, *Japan Line* announced a new standard: state regulation of foreign commerce is unconstitutional if it either results in multiple taxation or frustrates federal uniformity and prevents the nation from "speaking with one voice" in its commercial relations with foreign nations.<sup>149</sup> A state frustrates national uniformity by inviting international disputes or retaliation, the latter being particularly troublesome because the entire nation may suffer as a result of the actions of one state.<sup>150</sup>

Applying this test, the *Japan Line* Court held that the California tax ran counter to national policy, as reflected in the nation's treaty obligations.<sup>151</sup> The Court was concerned about the "acute" risk of foreign retaliation against the United States and the possibility of other states enacting similar taxes, which "would make 'speaking with one voice' impossible."<sup>152</sup> The Court opined that even slight state regulation of foreign commerce assumes significance because it concerns important matters of international relations.<sup>153</sup> Disposing of California's policy arguments, the Court wrote that these are "problems that admit only of a federal remedy."<sup>154</sup>

The Court built upon its *Japan Line* jurisprudence in *Container Corp. of America v. Franchise Tax Board*.<sup>155</sup> There, the Court held that California's unitary business tax based on worldwide business taking place in California did not violate the Foreign Commerce Clause.<sup>156</sup> The Court distinguished state regulations that have mere "foreign resonances" from those that "implicate foreign affairs," opining that the latter violates the Foreign Commerce Clause "if it *either* implicates foreign policy issues which must be left to the Federal Government or

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<sup>147</sup> *Wardair Can., Inc. v. Fla. Dep't of Revenue*, 477 U.S. 1, 8 (1986); *see Japan Line, Ltd. v. County of L.A.*, 441 U.S. 434, 448 (1979) (opining that foreign commerce is a "matter of national concern," and that "with respect to foreign intercourse and trade the people of the United States act through a single government") (citation omitted).

<sup>148</sup> *Japan Line*, 441 U.S. at 434-35; *see infra* Part II.B (discussing foreign affairs preemption).

<sup>149</sup> *Id.* at 451 (citation omitted).

<sup>150</sup> *Id.* at 450.

<sup>151</sup> *Id.* at 452-53.

<sup>152</sup> *Id.* at 453.

<sup>153</sup> *Id.* at 456.

<sup>154</sup> *Id.* at 457.

<sup>155</sup> 463 U.S. 159, 194 (1983).

<sup>156</sup> *Id.* at 197.

violates a clear federal directive.”<sup>157</sup> In upholding the tax, the Court thought the remote likelihood of foreign retaliation and the perceived lack of concern from the Executive Branch about the state tax were particularly important.<sup>158</sup>

Although *Japan Line* and its progeny confronted the issue of taxation, the “one voice” test also applies to state regulation of other areas of foreign commerce.<sup>159</sup> For example, in *South-Central Timber Development, Inc. v. Wunnicke*,<sup>160</sup> the Supreme Court invalidated Alaska’s requirement that purchasers of its state timber process the timber within the state prior to export.<sup>161</sup> Although grounding its ruling in the Interstate Commerce Clause, the Court was buttressed in its conclusion because Alaska’s restriction burdened foreign commerce.<sup>162</sup> After noting that state restrictions burdening foreign commerce are subject to heightened scrutiny, the Court cited *Japan Line* for the proposition that the nation must “speak with one voice” in its foreign commercial relations.<sup>163</sup>

### c. Market Participant Exception

In the interstate commerce context, a state may escape dormant Commerce Clause scrutiny by acting as a so-called “market participant.”<sup>164</sup> In other words, a state may favor its own residents if it does so incident to its role as buyer or seller in the market.<sup>165</sup> In *Reeves, Inc. v. Stake*, for example, the Supreme Court used the market participant exception to sustain a South Dakota policy of selling cement from state plants only to state residents.<sup>166</sup> Once state action crosses the

<sup>157</sup> *Id.* at 194.

<sup>158</sup> *Id.* at 195 (noting that the Executive Branch did not file an *amicus* brief).

<sup>159</sup> See, e.g., *Piazza’s Seafood World, LLC v. Odom*, 448 F.3d 744, 749 (5th Cir. 2006) (Louisiana catfish labeling statute); *Antilles Cement Corp. v. Acevedo Vilá*, 408 F.3d 41 (1st Cir. 2005) (Puerto Rico Buy American Act); *Nat’l Foreign Trade Council v. Natsios*, 181 F.3d 38, 68–70 (1st Cir. 1999), *aff’d in result sub nom.* *Crosby v. Nat’l Foreign Trade Council*, 530 U.S. 363 (2000) (Massachusetts Burma Law); *Trojan Techs., Inc. v. Pennsylvania*, 916 F.2d 903, 912 (3d Cir. 1990) (Pennsylvania Steel Products Procurement Act); *Bd. of Trs. of the Employee’s Ret. Sys. of Balt. v. Mayor & City Council of Balt.*, 562 A.2d 720 (Md. 1989) (South Africa divestment ordinance).

<sup>160</sup> 467 U.S. 82 (1984).

<sup>161</sup> See *id.* at 101.

<sup>162</sup> See *id.* at 100.

<sup>163</sup> *Id.*

<sup>164</sup> See *Reeves, Inc. v. Stake*, 447 U.S. 429, 437 (1980) (“There is no indication of a constitutional plan to limit the ability of the States themselves to operate freely in the free market.”).

<sup>165</sup> See *Wunnicke*, 467 U.S. at 93 (“Our cases make clear that if a State is acting as a market participant, rather than as a market regulator, the dormant Commerce Clause places no limitation on its activities.”); *White v. Mass. Council of Constr. Employers, Inc.*, 460 U.S. 204, 206 (1983) (holding that Boston was acting as a market participant when it required its contractors to employ city residents on projects that the city paid for with public funds).

<sup>166</sup> *Reeves*, 447 U.S. at 446–47.

line from participation to regulation, however, the state becomes a “market regulator” and the exception no longer applies.<sup>167</sup> A state acts as a “market regulator” if its actions have a substantial regulatory effect outside of the market in which the state is participating.<sup>168</sup> In *Wunnicke*, for instance, the Court held that Alaska was acting as a “market regulator” when it required purchasers of state timber to process the timber in Alaska prior to export.<sup>169</sup> Alaska was participating in the timber market, yet regulating in the processing market, and its requirement had a substantial downstream regulatory effect on foreign commerce with Japan.<sup>170</sup>

But the market participant exception may not apply to the Foreign Commerce Clause. The Supreme Court has not decided the issue, leaving commentators and lower courts divided.<sup>171</sup> The Third Circuit, in *Trojan Technologies, Inc. v. Pennsylvania*,<sup>172</sup> used the market participant exception to uphold, against a Foreign Commerce Clause attack, a Pennsylvania law that required state contractors to use American-made steel on public projects.<sup>173</sup> In contrast, the First Circuit, in *National Foreign Trade Council v. Natsios*,<sup>174</sup> argued that the market participant exception likely does not apply because of the sensitive foreign affairs considerations that arise in the foreign commerce context.<sup>175</sup> While the Supreme Court has not ruled on the matter, the Court suggested in *Reeves* that it would either not apply the exception or would construe it very narrowly.<sup>176</sup> There, while re-affirming the distinction between “market participation” and “market regulation,” the Court included a footnote about state regulation of foreign commerce.<sup>177</sup> In this footnote, although the Court had “no occasion to

<sup>167</sup> See *Wunnicke*, 467 U.S. at 93.

<sup>168</sup> See *Wis. Dep’t of Indus., Labor & Human Relations v. Gould Inc.*, 475 U.S. 282, 289 (1986) (holding that Wisconsin acted as a market regulator by prohibiting state purchases from violators of federal labor law); *Wunnicke*, 467 U.S. at 97–98.

<sup>169</sup> 467 U.S. at 82.

<sup>170</sup> *Id.* at 85 n.4, 100–01.

<sup>171</sup> See, e.g., *Antilles Cement Corp. v. Acevedo Vila*, 408 F.3d 41, 47 (1st Cir. 2005) (opining that case law on the matter “appears to be in some disarray”); *Nat’l Foreign Trade Council, Inc. v. Giannoulis*, 523 F. Supp. 2d 731, 748 (N.D. Ill 2007) (“It is not a foregone conclusion . . . that the market participant exception applies to the Foreign Commerce Clause. Courts have split on the issue.”) (citations omitted); J.T. Hutchens, Note, *The Market-Participant Exception and the Dormant Foreign Commerce Clause*, 5 CARDOZO PUB. L. POL’Y & ETHICS J. 445, 446 (2007). Compare *Trojan Techs., Inc. v. Pennsylvania*, 916 F.2d 903, 910 (3rd Cir. 1990) (exception applies), and *K.S.B. Technical Sales Corp. v. N.J. Dist. Water Supply Comm’n*, 75 N.J. 272, 296 (1977) (same), with *Nat’l Foreign Trade Council v. Natsios*, 181 F.3d 38, 52 (1st Cir. 1999) (exception likely does not apply), *aff’d in result sub nom. Crosby v. Nat’l Foreign Trade Council*, 530 U.S. 363 (2000).

<sup>172</sup> 916 F.2d at 903.

<sup>173</sup> *Id.* at 904–05.

<sup>174</sup> 181 F.3d at 38.

<sup>175</sup> *Id.* at 60.

<sup>176</sup> *Reeves, Inc. v. Stake*, 447 U.S. 429, 437–38 n. 9 (1980).

<sup>177</sup> *Id.*

explore the limits imposed on state proprietary actions by the ‘foreign commerce’ Clause” because the case dealt with interstate commerce, the Court opined that “Commerce Clause scrutiny may well be more rigorous when a restraint on foreign commerce is alleged.”<sup>178</sup>

3. *Application of Foreign Commerce Clause to State Offshore Contracting Restrictions*
  - a. *Regulation of and Discrimination Against Foreign Commerce Under Traditional Commerce Clause Standard*

State offshore contract restrictions regulate foreign commerce—a broad category that includes international trade in services.<sup>179</sup> By impeding or blocking the flow of contract funds between state governments and worksites located in foreign nations, a state undeniably regulates international trade. Just as the Supreme Court has held that the flow of value between a U.S. corporation and its foreign subsidiaries constitutes foreign commerce, the flow of value between states and state contractors or subcontractors engaged in offshore operations constitutes foreign commerce.<sup>180</sup> And state offshoring measures substantially affect such commerce.<sup>181</sup>

Not only do state offshore contract restrictions regulate foreign commerce, they also facially discriminate against such commerce by treating differently domestic and foreign economic interests.<sup>182</sup> The text of state offshore contracting bans explicitly prevents state contract funds from entering the stream of foreign commerce.<sup>183</sup> New

<sup>178</sup> *Id.* For further treatment of the market participant exception, see *infra* Part II.A.3.c.

<sup>179</sup> See *Kraft Gen. Foods, Inc. v. Iowa Dep’t of Revenue & Fin.*, 505 U.S. 71, 76 (1992); *United States v. Clark*, 435 F.3d 1100, 1115 n.18 (9th Cir. 2006) (“It is now universally acknowledged that foreign trade or commerce includes both goods and services.”) (citations omitted).

<sup>180</sup> See *id.*

<sup>181</sup> Even if a state with minimal offshore contracts restricts offshore contracting, the restriction would amount to more than an incidental burden on foreign commerce. See *Japan Line, Ltd. v. County of L.A.*, 441 U.S. 434, 455–56 (1979) (opining that even *de minimis* inference in the domestic commerce context assumes significance in the foreign commerce context); *Wickard v. Filburn*, 317 U.S. 111, 128–29 (1942) (considering the cumulative affect of commercial activity); *Nat’l Foreign Trade Council v. Natsios*, 181 F.3d 38, 53 (1st Cir. 1999), *aff’d in result sub nom. Crosby v. Nat’l Foreign Trade Council*, 530 U.S. 363 (2000). Cf. *Bob-Lo Excursion Co. v. Michigan*, 333 U.S. 28 (1948) (holding that a state civil rights statute did not affect foreign commerce because the effect was so minimal as applied to a Michigan ferry operator that traveled between Detroit and a small Canadian island).

<sup>182</sup> Cf. *Or. Waste Sys., Inc. v. Dep’t of Envtl. Quality*, 511 U.S. 93, 99 (1994). Offshore contract restrictions need not discriminate against foreign corporations to discriminate against foreign commerce. See *Natsios*, 181 F.3d at 53.

<sup>183</sup> See, e.g., *Keep Jobs in Tennessee Act*, H.B. 870, 105th Gen. Assem., 1st Reg. Sess. (Tenn. 2007) (“Each vendor submitting a bid or contract to provide services and all development assistance applicants shall certify that the services covered by the bid, contract or development assistance will be performed in the United States.”); S.B. 4077, 213th Leg.,

Jersey's contract statute, for instance, mandates that every state service contract "shall be performed within the United States."<sup>184</sup> Additionally, state preferences for domestic vendors and disqualification of potential contractors for unrelated offshoring activities facially discriminate against foreign commerce because they treat vendors engaged in foreign commerce less favorably.<sup>185</sup> The legislative intent of offshore contract restrictions is irrelevant because the measures are otherwise facially discriminatory: states can always argue that they intended to benefit one party, not burden another.<sup>186</sup>

To the extent that certain offshore contracting restrictions do not facially discriminate against foreign commerce, the regulations are nonetheless motivated by a protectionist purpose. Statements by lawmakers who support the restrictions show that a major goal of the measures is to affect contractors' business decisions by not permitting them to perform state contracts in, or subcontract them to, foreign work sites.<sup>187</sup> As then-Acting Governor Richard Codey of New Jersey explained, "[W]e are sending a clear message that if a company wants to take jobs from our hard working families and send them overseas, then it will not do business with the state."<sup>188</sup> Lawmakers similarly use offshore contracting restrictions to secure domestic or local benefits.<sup>189</sup>

Because state offshore contracting restrictions facially discriminate against foreign commerce or are motivated by a protectionist purpose, they are subject to heightened scrutiny under the dormant

Reg. Sess. (N.Y. 2007) ("State contracts shall be required to include a provision stating all services performed under such contract or any subcontract awarded under such contract shall be performed within the United States."); S.B. 1266, 47th Leg., 1st Reg. Sess. (Ariz. 2005) ("A State agency . . . shall not enter into any agreement . . . that results in a state service position being directly or indirectly established or transferred outside of the United States.").

<sup>184</sup> N.J. STAT. ANN. § 52:34-13.2 (West 2005).

<sup>185</sup> See *Kraft Gen. Foods*, 505 U.S. at 81.

<sup>186</sup> See *Bacchus Imps., Ltd. v. Dias*, 468 U.S. 263, 273 (1984) ("A discrimination claim . . . requires a comparison of the two classifications . . . It could always be said that there was no intent to impose a burden on one party, but rather the intent was to confer a benefit on the other.").

<sup>187</sup> See, e.g., Press Release, Office of Governor of N.J., Codey Signs Bill to Protect New Jersey Jobs from Offshore Outsourcing (May 5, 2005); Press Release, Office of Governor of Mich., Market Denial, Not Market Access, Governor Granholm Joins Rep. Steve Beida to Keep State Contracting Jobs in Michigan, U.S. (Mar. 22, 2004) ("Today, I have signed two executive directives that will ensure that Michigan taxpayers are not subsidizing the export of jobs." (quoting Mich. Governor Jennifer M. Granholm)).

<sup>188</sup> Press Release, Office of Governor of N.J., *supra* note 187.

<sup>189</sup> See, e.g., William Welsh, *Offshore Storm: States Get Tangled in Contractor's Outsourcing Moves*, WASH. TECH, Apr. 19, 2004, available at [http://www.washingtontechnology.com/print/19\\_2/23301-1.html](http://www.washingtontechnology.com/print/19_2/23301-1.html) (quoting a policy associate at the National Conference of State Legislators who suggests that states employ offshore contracting restrictions to combat growing local economic problems).

Foreign Commerce Clause.<sup>190</sup> Applying heightened scrutiny, a court is likely to find that the restrictions amount to “simple economic protectionism” and thus are per se invalid.<sup>191</sup> Individual states are attempting to block the flow of international commerce at the nation’s borders and limit foreign access to state markets by requiring “business operations to be performed in the home State that could more efficiently be performed elsewhere.”<sup>192</sup> This is plainly impermissible because states may not discriminate against foreign commerce based on the location of the business operations if the discrimination is unrelated to differences in the business operations.<sup>193</sup> Furthermore, state offshore contracting restrictions do not fit into the *Maine v. Taylor* exception because shielding in-state industries from out-of-state competition is not a legitimate local purpose, especially because less discriminatory means exist to stimulate the local economy.<sup>194</sup>

Even if state offshore contracting restrictions are not facially discriminatory or they otherwise escape the per se rule of invalidity, they fail because the states could employ less burdensome alternatives to further their interest in local economic growth and employment. States could use taxes, subsidies, and social services as tools to attract investment and promote employment.<sup>195</sup> Additionally, states could increase spending in non-offshorable areas of procurement—like public works projects—to drive the economy.<sup>196</sup> Another option would be for states to invest in human capital through education and training to ensure a capable, attractive local workforce.<sup>197</sup> Indeed, the U.S. Department of Commerce notes that one of the best remedies for offshore job loss is economic growth to create new jobs.<sup>198</sup> Moreover, the Constitution does not force states to privatize;<sup>199</sup> states could simply avoid offshore contracting by performing services in-house, a strategy used by the State of Michigan.<sup>200</sup> In fact, many governments have recently reclaimed public functions from private contractors

<sup>190</sup> See *Kraft Gen. Foods*, 505 U.S. at 81.

<sup>191</sup> See *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978).

<sup>192</sup> *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145 (1970).

<sup>193</sup> *Amerada Hess Corp. v. N.J. Taxation Div.*, 490 U.S. 66, 78 (1989).

<sup>194</sup> See *infra* notes 195–02 and accompanying text.

<sup>195</sup> See Andy Opsahl, *The Line Government Won't Cross*, GOV'T TECH, Oct. 2, 2006, <http://www.govtech.com/gt/101350>.

<sup>196</sup> See FRIEDMAN, *supra* note 55, at 207 (arguing that the offshoring deal “would save Indiana state residents precious tax dollars that could be deployed to hire more state workers somewhere else, or build new schools that would permanently shrink its roles of unemployed”).

<sup>197</sup> See SUSAN B. HANSEN, *GLOBALIZATION AND THE POLITICS OF PAY: POLICY CHOICES IN THE AMERICAN STATES* 137–43 (2006).

<sup>198</sup> GAO TRADE REPORT, *supra* note 29, at 71.

<sup>199</sup> See Hutchens, *supra* note 171, at 463 (“The states certainly have the option of *not* spending the money . . .”).

<sup>200</sup> See Opsahl, *supra* note 195.

through “reverse privatization.”<sup>201</sup> If a state elects to use the open market, however, it may not employ discriminatory means to give contractors engaged in domestic commerce an advantage over those engaged in foreign commerce.<sup>202</sup>

b. *Prevents Nation from Speaking with “One Voice” in International Trade*

Assuming that state offshoring restrictions pass muster under the traditional Commerce Clause scrutiny, the measures nonetheless fail because they prevent the nation from speaking with “one voice” in international trade relations.<sup>203</sup> In effect, the regulations are attempts by states to mold national trade policy to fit the states’ local policy objections.<sup>204</sup> Because regulation of international trade implicates sensitive matters of foreign affairs, independent state regulation can only impede and complicate foreign relations.<sup>205</sup> Indeed, one of the bases of this nation’s foreign relations is international trade. The United States is a party to scores of international trade treaties,<sup>206</sup> and it would be “utterly inconsistent” if states could frustrate the spirit of those agreements with conflicting sub-national policies.<sup>207</sup>

i. *Undermines National Trade Policy*

State offshore contracting restrictions undermine national trade policy, which aggressively supports open-market and free-trade principles.<sup>208</sup> By championing free trade, the United States seeks to “remov[e] perceived barriers to the flow of money, services, and goods.”<sup>209</sup> As the President’s 2007 Trade Policy Agenda reports:

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<sup>201</sup> See Amir Hefetz & Mildred Warner, *Beyond the Market Versus Planning Dichotomy: Understanding Privatisation and its Reverse in U.S. Cities*, 33 LOCAL GOV’T STUD. 555, 556 (2007).

<sup>202</sup> Cf. *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 394 (1994) (“[H]aving elected to use the open market to earn revenues . . . , the town may not employ discriminatory regulation to give that project an advantage over rival businesses from out of State.”).

<sup>203</sup> See *Japan Line, Ltd. v. County of L.A.*, 441 U.S. 434, 450 (1979).

<sup>204</sup> Cf. *Bethlehem Steel Corp. v. Bd. of Comm’rs of the Dep’t of Water & Power*, 80 Cal. Rptr. 800, 805–06 (1969) (holding that the California Buy American Act undermines the federal government’s power to conduct foreign relations).

<sup>205</sup> See *id.* at 803.

<sup>206</sup> See generally Trade Compliance Center: Making America’s Trade Agreements Work for You!, [http://tcc.export.gov/Trade\\_Agreements](http://tcc.export.gov/Trade_Agreements) (last visited Oct. 2, 2008).

<sup>207</sup> Cf. *Bethlehem Steel Corp.*, 80 Cal. Rptr. at 803 n.6 (citation omitted).

<sup>208</sup> See OFFICE OF THE U.S. TRADE REP., EXECUTIVE OFFICE OF THE PRESIDENT, THE PRESIDENT’S TRADE POLICY AGENDA 14 (2007) [hereinafter PRESIDENT’S TRADE POLICY AGENDA]; Jean Heilman Grier, *Recent Developments in International Trade Agreements Covering Government Procurement*, 35 PUB. CONT. L.J. 385, 386 (2006).

<sup>209</sup> Mildred Warner & Jennifer Gerbasi, *Is There a Democratic Deficit in the Free Trade Agreements? What Local Governments Should Know*, PUB. MGMT., Mar. 2004, at 16, 17.



The necessity of opening the world to free and fair trade is imperative . . . . For generations, America has opened its markets and increased its exports of goods and services to the world. America's embrace of competition, the rule of law, and innovation have spurred its tremendous economic growth and prosperity. In the face of growing competition and increased globalization, the United States must embrace and advance the free and fair trade princip[le]s that have led to so much economic success. This remains a guiding imperative in U.S. trade policy as we pursue an exciting agenda for 2007 and beyond.<sup>210</sup>

Within this free-trade framework, national trade policy strongly advocates liberalized government procurement.<sup>211</sup> The United States has, through its international agreements, successfully pried open foreign-government markets to U.S. suppliers and opened domestic-government markets to foreign bidding.<sup>212</sup> And the federal government has encouraged the states to do the same.<sup>213</sup> Although Congress took limited action to restrict offshore performance of federal contracts in 2004,<sup>214</sup> this is best viewed as an aberration to the otherwise strong and consistent national free-trade agenda. Even a recent bipartisan trade agreement does not permit states to restrict offshore performance of contracts.<sup>215</sup>

Today, the United States uses two primary vehicles to pursue liberalization of government procurement markets: the Agreement on Government Procurement (GPA) and the so-called Free Trade Agreements (FTAs). The GPA—dubbed the “first major breakthrough” in liberalized government procurement<sup>216</sup>—is a multilateral treaty that binds only those nations that have specifically signed on to it.<sup>217</sup>

<sup>210</sup> PRESIDENT'S TRADE POLICY AGENDA, *supra* note 208, at 14.

<sup>211</sup> See generally Grier, *supra* note 208; Office of the U.S. Trade Rep., USTR Focus on Government Procurement, [http://www.ustr.gov/Trade\\_Sectors/Government\\_Procurement/Section\\_Index.html](http://www.ustr.gov/Trade_Sectors/Government_Procurement/Section_Index.html) (last visited Oct. 2, 2008) (“A longstanding objective of U.S. trade policy has been to open opportunities for U.S. suppliers to compete on a level playing field for foreign government contracts.”).

<sup>212</sup> See OFFICE OF THE U.S. TRADE REP., EXECUTIVE OFFICE OF THE PRESIDENT, TRADE FACTS: STATE GOVERNMENT PROCUREMENT AND TRADE AGREEMENTS: SENDING A POSITIVE SIGNAL ABOUT WELCOMING INTERNATIONAL BUSINESS AND INVESTMENT (2006), [http://www.ustr.gov/assets/Document\\_Library/Fact\\_Sheets/2006/asset\\_upload\\_file344\\_9260.pdf](http://www.ustr.gov/assets/Document_Library/Fact_Sheets/2006/asset_upload_file344_9260.pdf) [hereinafter USTR, SENDING POSITIVE SIGNAL].

<sup>213</sup> See *id.*

<sup>214</sup> See, e.g., Consolidated Appropriations Act, 2004, Pub. L. No. 108-199, § 647, 118 Stat. 3, 361–62 (2004) (requiring a one-year, limited ban on offshoring certain federal agency contacts in 2004).

<sup>215</sup> See OFFICE OF THE U.S. TRADE REP., EXECUTIVE OFFICE OF THE PRESIDENT, TRADE FACTS: BIPARTISAN TRADE DEAL (2007), [http://www.ustr.gov/assets/Document\\_Library/Fact\\_Sheets/2007/asset\\_upload\\_file127\\_11319.pdf](http://www.ustr.gov/assets/Document_Library/Fact_Sheets/2007/asset_upload_file127_11319.pdf) [hereinafter USTR, BIPARTISAN TRADE DEAL].

<sup>216</sup> OFFICE OF THE U.S. TRADE REP., EXECUTIVE OFFICE OF THE PRESIDENT, ANNUAL REPORT ON DISCRIMINATION IN FOREIGN GOVERNMENT PROCUREMENT I (2001).

<sup>217</sup> See Grier, *supra* note 208, at 387.

Under its terms, parties are generally required to accord “no less favourable” treatment to products, services, and suppliers of any other party to the Agreement than they give to their own domestic products, services, and suppliers.<sup>218</sup> In the United States, the GPA only binds federal entities, but the federal government has persuaded many states to join voluntarily.<sup>219</sup> In recent years, the United States has used the GPA as a model for procurement provisions in FTAs, which are regional or bilateral free-trade agreements.<sup>220</sup> Because “[m]ost of the Parties to FTAs are not Parties to the GPA,”<sup>221</sup> the FTAs are an important means for the United States to gain access to new government-purchasing markets.

Against this strong national policy of free trade and liberalized government procurement, one can observe that state offshore contracting restrictions run contrary to national trade policy.<sup>222</sup> States are subverting the nation’s liberal procurement agenda by advancing protectionist offshore contracting policies that attempt to regulate conduct beyond the nation’s borders. The nation cannot speak with “one voice” in its trade relations if the nation has fifty-one State Departments, some of which promote or implement protectionist policies.<sup>223</sup> Although a lack of data makes the effect of these restrictions on the nation’s “one voice” less than transparent, these restrictions clearly burden a significant amount of international trade in services,<sup>224</sup> one of the fastest growing areas of trade.<sup>225</sup> The threat to national uniformity is magnified if these individual state restrictions are viewed in the aggregate.<sup>226</sup>

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<sup>218</sup> Agreement on Government Procurement art. III, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 4B, 1915 U.N.T.S. 103; *cf.* General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1915 U.N.T.S. 103 (dealing with the private sector).

<sup>219</sup> See Grier, *supra* note 208, at 390 (noting that the United States applies a \$526,000 threshold for member states to be subject to GPA provisions); James E. Meadows, *Dealing with the Offshore Outsourcing Controversy*, 807 PLI/PAT 413, 434–35 (2004).

<sup>220</sup> See Grier, *supra* note 208, at 388.

<sup>221</sup> See *id.* at 395.

<sup>222</sup> See Warner & Gerbasi, *supra* note 209, at 17 (“Clearly, protectionist legislation would be contrary to the spirit of the trade agreements . . .”).

<sup>223</sup> See Brannon P. Denning & Jack H. McCall, Jr., *The Constitutionality of State and Local “Sanctions” Against Foreign Countries: Affairs of State, States’ Affairs, or a Sorry State of Affairs?*, 26 HASTINGS CONST. L.Q. 307, 331–34 (1999).

<sup>224</sup> See *supra* Part I.B.

<sup>225</sup> See Aaditya Mattoo & Sacha Wunsch-Vincent, *Pre-empting Protectionism in Services: The GATS and Outsourcing*, 7 J. INT’L ECON. L. 765, 765 (2004).

<sup>226</sup> See Nat’l Foreign Trade Council v. Natsios, 181 F.3d 38, 53 (1st Cir. 1999), *aff’d in result sub nom.* Crosby v. Nat’l Foreign Trade Council, 530 U.S. 363 (2000); *cf.* Japan Line, Ltd. v. County of L.A., 441 U.S. 434, 453 (1979).

ii. *Frustrates International Trade Relations*

States' attempts to restrict offshore contracting frustrate international trade relations and have caused a rift between the United States and India. On March 4, 2004, the Indian mission to Geneva, Switzerland organized a meeting to discuss the rise of state offshoring legislation.<sup>227</sup> Then, on March 9, 2004, India voiced its concerns to the World Trade Organization (WTO) about state-government anti-offshoring measures.<sup>228</sup> India's Ambassador to the WTO K.M. Chandrasekhar, referring to a state offshoring bill, stated that "[c]learly we are concerned about what is happening in the United States."<sup>229</sup>

Situations like this may also impair future trade negotiations between the United States and India. Indeed, state offshore contracting restrictions risk undermining the spirit of future U.S.-India trade relations by discouraging the free flow of U.S. state contract funds into India.<sup>230</sup>

Accordingly, Ambassador Chandrasekhar hinted that U.S. offshoring restrictions might have "negative consequences" for the Doha Round of trade negotiations.<sup>231</sup> The Indian Department of Commerce similarly announced that anti-offshoring measures send the wrong signal in the context of trade negotiations, which are aimed at improving market access.<sup>232</sup> India's Commerce Minister also told U.S. officials that offshoring restrictions are "unacceptable for India."<sup>233</sup> The situation is reminiscent of the 1960s, when the Kennedy administration feared that it could not secure tariff concessions from foreign nations in the face of state Buy American laws.<sup>234</sup> Likewise today, given the rapid growth of U.S.-India bilateral trade and India's possible accession to the GPA, one must view sub-national interference with U.S.-Indian trade relations with increased skepticism because of the sensitive and ongoing nature of the negotiations.<sup>235</sup>

<sup>227</sup> Daniel Pruzin, *Outsourcing: At WTO Meeting, India Signals Concern About U.S. Moves to Counter Outsourcing*, WTO Rep. (BNA) ISSN 1529-4153 (Mar. 9, 2004).

<sup>228</sup> *Id.*

<sup>229</sup> *Id.*

<sup>230</sup> *Id.*

<sup>231</sup> *Id.*

<sup>232</sup> See Press Release, Dep't of Commerce of India, Market Denial, Not Market Access, Says Jaitley Reacting to Reported US Move to Ban Outsourcing (May 26, 2003), available at [http://commerce.nic.in/PressRelease/pressrelease\\_detail.asp?id=363](http://commerce.nic.in/PressRelease/pressrelease_detail.asp?id=363) (last visited Oct. 2, 2008).

<sup>233</sup> Pruzin, *supra* note 227.

<sup>234</sup> See *Bethlehem Steel Corp. v. Bd. of Comm'rs of the Dep't of Water & Power*, 80 Cal. Rptr. 800, 805 n.11 (1969).

<sup>235</sup> See Press Release, U.S. Mission to the United Nations in Geneva, Trade Policy Review of India: Statement by Ambassador Peter F. Allgeier, U.S. Permanent Representative to the WTO (May 24, 2007), available at <http://geneva.usmission.gov/Press2007/0524TPRIndia.html> ("We understand that India is considering the possibility of joining the WTO Agreement on Government Procurement (GPA), and we strongly encourage its ac-

State offshore contracting restrictions may also frustrate bilateral trade relations between the United States and Canada.<sup>236</sup> Given the large value of cross-border trade between the two nations—an estimated \$580 billion in 2005—state regulations that burden this trade are of particular concern to the Canadian government.<sup>237</sup> In 2004, Canadian provinces were worried that proposed state anti-offshoring legislation would result in loss of call-center jobs in Canada,<sup>238</sup> potentially placing 200,000 Canadian jobs at risk.<sup>239</sup> In an effort to mitigate the potential damage to its economy from the measures, the Canadian government went on the offensive in 2004 and lobbied U.S. federal officials, businesses, and the public.<sup>240</sup> To that end, Canada has sent letters to officials in Washington outlining the negative economic consequences of U.S. state anti-offshoring policies and suggesting that the policies might violate U.S. treaty obligations.<sup>241</sup> Overall, Canada has put its faith in the U.S. federal government to “step in to prevent [the proposed bills] from affecting Canada’s economy.”<sup>242</sup>

### iii. *Invites Retaliation*

State offshoring restrictions also invite foreign retaliation that individual states are ill-equipped to handle. As the U.S. Trade Representative warns, a state’s non-commitment to “transparent and competitive purchasing” may cause foreign nations to discriminate against goods and services from that state,<sup>243</sup> and foreign companies might hesitate to conduct business with private firms in that state.<sup>244</sup> Some retaliation might even be automatic.<sup>245</sup> Not only are individual

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cession to the agreement.”); OFFICE OF THE U.S. TRADE REP., EXECUTIVE OFFICE OF THE PRESIDENT, TRADE FACTS: U.S.-INDIA TRADE POLICY FORUM (2006), [http://www.ustr.gov/assets/Document\\_Library/Fact\\_Sheets/2006/asset\\_upload\\_file321\\_9583.pdf](http://www.ustr.gov/assets/Document_Library/Fact_Sheets/2006/asset_upload_file321_9583.pdf) (describing the ongoing nature of U.S.-India bilateral negotiations).

<sup>236</sup> See Steven Chase, *U.S. Bills Threaten Canada’s Call Centres: American Contracts Could Be Affected*, THE GLOBE & MAIL (Canada), Feb. 19, 2004, at B1, LexisNexis Academic (quoting a letter from the Canadian Ambassador to United States sent to U.S. Trade Representative: “New Jersey’s proposed [offshoring] legislation would unduly and unjustifiably affect cross-border trade in a number of key service sectors including business services, distribution services, financial services and tourism and travel-related services.”).

<sup>237</sup> See E-mail from Matthew Shannon, Foreign Affairs Canada and Int’l Trade, Gov’t of Can., to author (Oct. 17, 2007, 12:02:00 EDT) (on file with author); Chase, *supra* note 236.

<sup>238</sup> See Chase, *supra* note 236.

<sup>239</sup> Stephen Handelman, *Getting Hung Up on Call Centers: Why an Anti-Outsourcing Bill in New Jersey Could Wreak Havoc in Canada*, TIME INT’L, Apr. 18, 2004, at 30, LexisNexis Academic.

<sup>240</sup> See E-mail from Matthew Shannon, *supra* note 237; Letter from Robert Zoellick, U.S. Trade Rep., to Michael Kergin, Ambassador of Can. to the U.S. (Aug. 11, 2003) (on file with author).

<sup>241</sup> See Letter from Robert B. Zoellick, *supra* note 240.

<sup>242</sup> See Chase, *supra* note 236.

<sup>243</sup> USTR, SENDING POSITIVE SIGNAL, *supra* note 212.

<sup>244</sup> *Id.*

<sup>245</sup> See *Japan Line, Ltd. v. County of L.A.*, 441 U.S. 434, 453 n.18 (1979).

states not competent to deal with foreign retaliation,<sup>246</sup> but also the actions of one state can trigger retaliation against the entire nation.<sup>247</sup> The citizens of one state should not have to rely on the legislature of another state to minimize foreign retaliation against the entire nation and not jeopardize national trade policy.<sup>248</sup> Additionally, foreign retaliation could undermine the local economic policies that the states are seeking to effectuate through offshore contracting restrictions.<sup>249</sup> In the end, only the federal government can minimize the risk of retaliation by ensuring that all appropriate foreign interests are represented in policy decisions that affect foreign commerce.<sup>250</sup>

iv. *Embarrasses the Nation*

Finally, state offshore contracting restrictions embarrass the nation in the international arena by undermining the appearance of national unity. The world could view the federal government as unable to control its sub-national units if states choose the protectionist road while the national government continues down the road of trade liberalization.<sup>251</sup> This lack of perceived unity might impair the federal government's ability to negotiate favorable trade agreements.<sup>252</sup> A lack of unity might also deter private foreign investment into the country because of conflicting and uncertain foreign commercial regulatory schemes in the states.<sup>253</sup>

c. *Market Participant Exception Does Not (or Should Not) Apply*

State offshore contracting restrictions cannot escape scrutiny under the market participant exception to the Interstate Commerce Clause because that exception does not (or should not) apply to the

<sup>246</sup> See Denning & McCall, *supra* note 223, at 350.

<sup>247</sup> See *Japan Line*, 441 U.S. at 450.

<sup>248</sup> See Alisa B. Klein & Mark B. Stern, *Back to First Principles: The Constitutional Rationale for Invalidating Local Sanctions Against Foreign Trade*, 33 LAW & POL'Y INT'L BUS. 77, 93 (2001).

<sup>249</sup> See Adam Mordecai, Note, *Anti-Offshoring Legislation: The New Wave of Protectionism*, 5 RICH. J. GLOBAL L. & BUS. 85, 102 (2005) ("Any successful protectionist measures will do little to create jobs and will only serve to encourage foreign retaliation, thus resulting in more jobs lost than saved."); O'Neil, *supra* note 113, at 542 ("Retaliation causes increased trade barriers, which in turn result in the loss of gains from trade and deterioration in the economic welfare of the nation.") (citation omitted).

<sup>250</sup> See *S.-Cent. Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 92 (1984); Klein & Stern, *supra* note 248, at 91 ("And it is axiomatic that when the interests of all of the nation's citizens are concerned, the power to act lies exclusively with the federal government.")

<sup>251</sup> See *Nat'l Foreign Trade Council v. Natsios*, 181 F.3d 38, 53 (1st Cir. 1999) ("Massachusetts has chosen a course divergent . . . from the federal law, thus raising the prospect of embarrassment for the country."), *aff'd in result sub nom. Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363 (2000).

<sup>252</sup> See Anderson L. Cao, Comment, *Limiting States' Roles in Foreign Commerce: Teaching Old-World Dogs New-World Tricks*, 23 HOUS. J. INT'L L. 349, 373-74 (2001).

<sup>253</sup> See *id.* at 374.

Foreign Commerce Clause.<sup>254</sup> Although the exception may allow states to get past traditional Commerce Clause scrutiny,<sup>255</sup> it cannot shelter state activity under *Japan Line's* heightened scrutiny of state regulation of foreign commerce.<sup>256</sup> The Supreme Court has implied as much.<sup>257</sup> Superimposing the exception onto the "one voice" test of *Japan Line* would ignore the sensitive foreign affairs concerns that arise in the foreign commerce context.<sup>258</sup> It would also condone state entry into the forbidden field of foreign relations that the Constitution reserves *exclusively* to the federal government.<sup>259</sup> Allowing state regulation of offshore contracting would create "a dangerous precedent" for state involvement in foreign affairs.<sup>260</sup>

Although state spending is a traditional area of state competence,<sup>261</sup> the state spending power is not without its limits,<sup>262</sup> and a state may not use its spending power to obstruct national foreign trade policy.<sup>263</sup> The Constitution cannot allow a state to affect international trade relations by banning offshore contracting merely because it is acting as a purchaser of goods or services in the market. It is unreasonable to assume that a foreign government could understand the constitutional distinction between a "market participant" and a "market regulator."<sup>264</sup> Thus, even one state's discrimination against foreign commerce incident to its role as a participant in the market risks retaliation against the entire nation.<sup>265</sup>

Even if the market participant exception did apply to the Foreign Commerce Clause, certain forms of offshore state contracting restrictions would not be covered by the exception because they cross the line from market participation to market regulation. Some states, for

<sup>254</sup> See, e.g., *Natsios*, 181 F.3d at 65–66.

<sup>255</sup> But this too is questionable. See *infra* notes 266–71 and accompanying text.

<sup>256</sup> See *Wardair Can., Inc. v. Fla. Dep't of Revenue*, 477 U.S. 1, 8 (1986); *S.-Cent. Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 100 (1984); *Japan Line, Ltd. v. County of L.A.*, 441 U.S. 434, 446 (1979).

<sup>257</sup> See *Reeves v. Stake*, 447 U.S. 429, 437–38 n. 9 (1980); *supra* Part II.A.2.c.

<sup>258</sup> See *supra* Part II.A.3.

<sup>259</sup> See *United States v. Pink*, 315 U.S. 203, 233 (1942) ("Power over external affairs is not shared by the States; it is vested in the national government exclusively."); *Hutchens*, *supra* note 171, at 476 (arguing that applying the market-participant exception to dormant Foreign Commerce Clause "would do violence to the foreign affairs powers that the Constitution vests solely in the federal government").

<sup>260</sup> See *Mattoo & Wunsch-Vincent*, *supra* note 225, at 773.

<sup>261</sup> See *Reeves*, 447 U.S. at 436–41.

<sup>262</sup> See, e.g., *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528 (1985) (holding that state and local governments must pay the federal minimum wage).

<sup>263</sup> See, e.g., *U.S. Term Limits, Inc. v. Thornton*, 514 U.S. 779, 841 (1995) (Kennedy, J., concurring) ("The States have no power, reserved or otherwise, over the exercise of federal authority within its proper sphere.") (citation omitted).

<sup>264</sup> See Kevin P. Lewis, *Dealing with South Africa: The Constitutionality of State and Local Divestment Legislation*, 61 *TUL. L. REV.* 469, 484–85 (1987).

<sup>265</sup> *Hutchens*, *supra* note 171, at 462; *Lewis*, *supra* note 264, at 485.

instance, seek to disqualify companies that have offshored American jobs from receiving state procurement contracts, even if the offshoring is unrelated to the state contract.<sup>266</sup> These attempts amount to market regulation because the states are participating in the public procurement market yet regulating the unrelated private operations of its vendors.<sup>267</sup> Additionally, state offshore contract bans like New Jersey's<sup>268</sup> may amount to market regulation because they burden not only the initial contractor, but also downstream subcontractors and suppliers.<sup>269</sup> Furthermore, state offshore contracting restrictions have substantial regulatory effect outside of the procurement market because they burden foreign commerce and interfere with national trade policy and international trade relations.<sup>270</sup> Nonetheless, even if the market participant exception did apply, and the state was acting as a market participant, the restrictions fail because they unduly interfere with the federal government's ability to conduct foreign affairs.<sup>271</sup>

## B. Foreign Affairs Power

### 1. Overview of Foreign Affairs Power

Many provisions of the Constitution taken together stand for the principle that the federal government has the exclusive power to conduct foreign affairs.<sup>272</sup> The Supreme Court has long held that federal power over foreign affairs is "not shared by the States."<sup>273</sup> Similar to the dormant foreign commerce power, the dormant foreign affairs power can preempt state law in the absence of any federal action to the contrary.<sup>274</sup> The leading case in this area is *Zschernig v. Miller*, in which the Court invalidated an Oregon statute that effectively prevented inheritance by citizens of communist nations.<sup>275</sup> The Court held that the dormant foreign affairs power preempted the Oregon statute because it interfered with the federal government's ability to conduct international relations by casting judgment on foreign na-

<sup>266</sup> See, e.g., S.B. 1249, 48th Leg., 2d Reg. Sess. (Ariz. 2008); Job Preservation Act of 2007, S.B. 1255, 95th Gen. Assem., 1st Reg. Sess. (Ill. 2007); *supra* note 76.

<sup>267</sup> See, e.g., H.B. 389, 2007 Leg., Reg. Sess. (Pa.) (disqualifying those contractors who have offshored jobs within the past three years from bidding on state contracts); H.B. 568, 95th Gen. Assem., 1st Reg. Sess. (Ill. 2007) (disqualifying an entity from state contract awards if it "has or uses a foreign call service center").

<sup>268</sup> See N.J. STAT. ANN. § 52:34-13.2 (West 2005).

<sup>269</sup> See O'Neil, *supra* note 113, at 538-39.

<sup>270</sup> See *S.-Cent. Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 100 (1984); *supra* Part II.A.3.

<sup>271</sup> See *infra* Part II.B.

<sup>272</sup> See *Nat'l Foreign Trade Council v. Natsios*, 181 F.3d 38 (1st Cir. 1999), *aff'd in result sub nom. Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363 (2000).

<sup>273</sup> See *United States v. Pink*, 315 U.S. 203, 233 (1942).

<sup>274</sup> See *Zschernig v. Miller*, 389 U.S. 429, 441 (1968) (Stewart, J., concurring) ("[E]ven in absence of a treaty, a State's policy may disturb foreign relations.").

<sup>275</sup> *Id.* at 429.

tions.<sup>276</sup> Although the “precise boundaries” of *Zschernig* are unclear,<sup>277</sup> notwithstanding state interests,<sup>278</sup> states may not exceed a threshold level of involvement in foreign affairs.<sup>279</sup> In one case, a California court invalidated California’s Buy American Act because it amounted to a “usurpation” by California of the federal power to conduct international trade policy by placing a de-facto embargo on foreign products.<sup>280</sup> In another case, the Third Circuit rejected a dormant foreign affairs challenge to Pennsylvania’s Buy American Act because the Act did not involve scrutiny of foreign governments, any interference with national trade policy was speculative, and Congress had not taken any action to preempt the Act.<sup>281</sup>

## 2. *Application of Foreign Affairs Power to State Offshore Contracting Restrictions*

The same analysis that would render state offshoring restrictions unconstitutional under *Japan Line* would do the same under the doctrine of dormant foreign affairs preemption. The “‘one-voice’ test [of *Japan Line*] is functionally similar to dormant foreign affairs preemption” because it focuses primarily on the risk of a state action offending foreign nations and provoking retaliation.<sup>282</sup> Except, here, no market-participant exception exists<sup>283</sup> and state interests are irrelevant.<sup>284</sup> Although some argue that the Supreme Court prefers dormant foreign affairs preemption to dormant foreign commerce preemption, the better view is to treat both doctrines as distinct and equally valid in the absence of explicit Supreme Court guidance to the contrary.<sup>285</sup>

<sup>276</sup> *Id.* at 440–42.

<sup>277</sup> *Natsios*, 181 F.3d at 51–52.

<sup>278</sup> *Id.* at 52 (“We do not read *Zschernig* as instructing courts to balance the nation’s interests in a unified foreign policy against the particular interests of an individual state.”).

<sup>279</sup> Compare *Trojan Techs., Inc. v. Pennsylvania*, 916 F.2d 903, 909 (3d Cir. 1990), with *Bethlehem Steel Corp. v. Bd. of Comm’rs of the Dep’t of Water & Power*, 80 Cal. Rptr. 800 (1969).

<sup>280</sup> See *Bethlehem Steel*, 80 Cal. Rptr. at 803.

<sup>281</sup> See *Trojan Techs.*, 916 F.2d at 909.

<sup>282</sup> Jack Goldsmith, *Statutory Foreign Affairs Preemption* 22 (John M. Olin Law & Econ. Working Paper No. 116, 2007).

<sup>283</sup> See *Natsios*, 181 F.3d at 59 (rejecting, as novel and unsupported, the argument that the market participant exception exists as to the foreign affairs power).

<sup>284</sup> See *id.* at 52.

<sup>285</sup> Those who argue that recent Supreme Court decisions evince the Court’s preference to decide cases on preemption grounds instead of dormant commerce grounds contend that the Court should avoid needless constitutional confrontation. See, e.g., Leanne M. Wilson, Note, *The Fate of the Dormant Foreign Commerce Clause After Garamendi and Crosby*, 107 COLUM. L. REV. 746, 784–85 (2007) (suggesting the elimination of dormant foreign commerce in favor of foreign affairs preemption). But the Court has never indicated that dormant foreign commerce challenges are disfavored, and dormant foreign af-



State offshore contracting restrictions amount to an embargo on foreign service providers and unduly interfere with the federal government's ability to conduct international relations.<sup>286</sup> As discussed earlier, the restrictions frustrate national uniformity because they undermine the spirit of the nation's liberalized trade agenda, which is a major tenant of the nation's foreign policy.<sup>287</sup> The restrictions also risk offending foreign nations and have in fact provoked strong rebukes from India and Canada.<sup>288</sup> These sub-national restrictions entail a serious risk of retaliation, especially because foreign nations may view them as "selfish provincialism" instead of an expression of important local policy.<sup>289</sup> Even though state offshore contracting restrictions do not target a particular nation,<sup>290</sup> they nonetheless undermine and frustrate the nation's foreign policy agenda and embarrass the nation in its international dealings.

### III

#### GOVERNMENT BY THE PEOPLE? POLICY CHOICES FOR THE NATION

Application of these constitutional principles to state offshore contracting restrictions leads to a curious outcome. If a state places a contract into the stream of commerce, the Constitution renders the state virtually powerless to prevent its contractors from using offshore labor. But this legal conclusion begs the question: does this result make for good public policy?

Proponents of offshore contracting argue that offshoring is too advantageous for state governments to pass up because it has the potential to save them a significant amount of money.<sup>291</sup> South Carolina, for instance, realized savings of nearly \$10 million in 2004 by hiring an IT contractor that used offshore labor.<sup>292</sup> Indiana similarly would have saved almost \$8 million by using Indian workers to build a state computer had the Governor not canceled the contract once its

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fairs preemption does in fact implicate the Constitution vis-à-vis the Supremacy Clause. See BITTKER, *supra* note 110, § 5.06[F].

<sup>286</sup> See *Bethlehem Steel Corp.*, 80 Cal. Rptr. at 803 ("Only the federal government can fix the rules of fair competition when such competition is on an international basis . . . . State regulation can only impede, not foster, national trade policies.").

<sup>287</sup> See *supra* Part II.A.3.

<sup>288</sup> See *supra* Part II.A.3.b.2. Cf. *Trojan Techs., Inc. v. Pennsylvania*, 916 F.2d 903, 909 (3d Cir. 1990) (opining that any interference with foreign relations is merely speculative).

<sup>289</sup> Cf. *Bethlehem Steel Corp.*, 80 Cal. Rptr. at 805.

<sup>290</sup> Cf. *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363 (2000) (invalidating Massachusetts Burma law on statutory preemption grounds).

<sup>291</sup> See Opsahl, *supra* note 195; Salzer, *supra* note 49; Alison Lake, *Why Not Mumbai?*, GovTECH, Dec. 19, 2006, <http://www.govtech.com/pcio/102966> ("The public sector's skepticism, even hostility, toward offshore outsourcing seems off-base, given its apparent success in the private sector.").

<sup>292</sup> See Hopkins, *supra* note 3, at 1A.

details became public.<sup>293</sup> Indeed, the costs of requiring domestic performance, instead of offshore performance, can be staggering: New Jersey spends an additional 37 cents per call—or \$73,800 per month—to maintain a call center in the United States rather than in India.<sup>294</sup> Using the savings that they might realize through offshore contracting, states can lower taxes or redeploy the savings to hire American workers in other areas, like public works.<sup>295</sup> Additionally, offshoring may afford state personnel managers greater flexibility by increasing opportunities to employ part-time and overnight workers.<sup>296</sup>

Opponents of offshore state contracting argue that it threatens the very nature of state government. At a time when states are seeking to stimulate the local economy, many believe that performing state services abroad exacerbates unemployment by depriving Americans of government jobs.<sup>297</sup> As New Jersey lawmaker Shirley Turner remarked, “It is poor public policy to use taxpayer money to create jobs outside of the country when we have people here who are unemployed.”<sup>298</sup> Turner believes that sending state jobs overseas when state residents are unemployed is akin to “‘shooting yourself in the foot.’”<sup>299</sup> Moreover, offshoring may erode the state tax base, as offshore workers do not pay state taxes.<sup>300</sup> It may also deprive states of the economic benefits that the jobs bring.<sup>301</sup> Consistent with these concerns, states like New Jersey have cast aside strict adherence to the free-market principles advocated on the national level and have adopted more pragmatic approaches to procurement by restricting

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<sup>293</sup> See *Labor Agency Taps India Firm for State Project*, *supra* note 53, at 9.

<sup>294</sup> Fernandez & Von Bergen, *supra* note 21.

<sup>295</sup> See FRIEDMAN, *supra* note 55, at 207.

<sup>296</sup> Mark B. Baker, “*The Technology Dog Ate My Job*”: *The Dog-Eat-Dog World of Offshore Labor Outsourcing*, 16 FLA. J. INT’L L. 807, 814 (2004).

<sup>297</sup> See Small, *supra* note 97.

<sup>298</sup> Fernandez & Von Bergen, *supra* note 21; see also Press Release, Office of Governor of N.J., *supra* note 187 (“It is foolish for the state to send taxpayer dollars abroad to hire workers in India, China or Indonesia when these same jobs can be performed by the unemployed here in the United States.” (quoting N.J. State Senator Shirley K. Turner)).

<sup>299</sup> Ed Parry, “*Not in My Backyard*”—*State Lawmakers Fight Offshoring*, SEARCHCIO.COM, Mar. 15, 2004 (quoting N.J. State Senator Shirley K. Turner) (on file with the author).

<sup>300</sup> See Karen MacPherson, *States Sending Jobs Overseas: Legislatures Consider Ban on “Outsourcing” Government Business*, PITTSBURGH POST-GAZETTE, Apr. 4, 2004, at A8, LexisNexis Academic (“By hiring Americans, you create taxpayers. You pump money into your local economy.”) (quoting Ohio State Rep. Marcy Kaptur). Similarly, as one public-employee union official declared, “It’s outrageous to use taxpayer dollars to erode your tax base.” Hopkins, *supra* note 3, at 1A.

<sup>301</sup> See Press Release, Office of Governor of N.J., *supra* note 187 (“Not only are we losing the benefits those jobs bring to the individual, but we also lose the tax and economic growth benefits those jobs bring to the state.” (quoting N.J. State Senator Shirley K. Turner)).

contractors from performing contracts overseas.<sup>302</sup> These approaches consider the special duty of the state to promote democracy and to ensure the general welfare of its residents,<sup>303</sup> in addition to the potential for offshore contracting to increase costs to the state.<sup>304</sup>

Two solutions exist for the state seeking to curtail the offshore performance of state service contracts within the bounds of the Constitution. First, the state can withdraw offshoreable state service contracts from the stream of commerce and handle such services in-house.<sup>305</sup> Second, Congress can sanction state regulation of offshore state contracting.<sup>306</sup> So, if a state seeks to take advantage of privatization, while keeping jobs in the United States, the question comes down to whether Congress should, as a policy matter, permit states to do so.<sup>307</sup>

Given the challenges that offshore state contracting may pose for state governments, the nation should engage in a serious debate about whether Congress should permit states to restrict offshore contracting. Until now, this debate has been lacking. Many previous federal requests for state input into national trade policy have been “one-sided” and directed at the executive rather than the legislature.<sup>308</sup> Although the federal government has recently shown some willingness to recognize local policies in international trade agreements, such as minimum wage and environmental policies, these discussions have not considered offshore state contracting.<sup>309</sup>

The federal government must recognize the states’ traditional role as guardian of their citizens and promoter of their general welfare, while balancing the national interest in uniform trade regulation

<sup>302</sup> See Opsahl, *supra* note 195. Interestingly, Texas has engaged in “bestshoring,” which requires the work to be performed in, of course, Texas. *Id.*

<sup>303</sup> See generally Jennifer Gerbasi & Mildred E. Warner, *Privatization, Public Goods and the Ironic Challenge of Free Trade Agreements*, 39 ADMIN. & SOC. 127 (2007) (arguing that sub-national governments are fundamentally concerned with democracy, voice, and choice); Warner & Gerbasi, *supra* note 209, at 18 (remarking that the primary role of state government is to guard and serve residents). As one lawmaker says, state government “should not be in the business of putting our own citizens out of work.” Press Release, Office of Governor of N.J., *supra* note 187.

<sup>304</sup> See Lindquist, *supra* note 1, at A1 (noting that the cost to run a Florida state call-center increased after the state contractor moved offshore). See generally DELOITTE CONSULTING, *CALLING A CHANGE IN THE OUTSOURCING MARKET: THE REALITIES FOR THE WORLD’S LARGEST ORGANIZATIONS 2–3* (2005) (discussing the hidden costs of offshoring).

<sup>305</sup> See *supra* notes 199–200 and accompanying text.

<sup>306</sup> It is a well-established principle that, “whether a case is decided on preemption or dormant Commerce Clause grounds, the judicial verdict can be reversed by Congress.” BITTKER, *supra* note 110, § 5.06[F].

<sup>307</sup> Cf. *Japan Line, Ltd. v. County of L.A.*, 441 U.S. 434, 457 (1979) (“The problems to which appellees refer are problems that admit only of a federal remedy. They do not admit of a unilateral solution by a State.”).

<sup>308</sup> See Gerbasi & Warner *supra* note 303, at 143.

<sup>309</sup> See USTR, *BIPARTISAN TRADE DEAL*, *supra* note 215.

and liberalized procurement. Notwithstanding the benefits of free trade, the current national trade agenda undercuts the authority of states to regulate contractors that are active within their borders.<sup>310</sup> By interpreting offshore contracting restrictions as barriers to trade,<sup>311</sup> national trade policy substitutes international trade norms for the sound judgment of state lawmakers attempting to protect the public welfare.<sup>312</sup> This “singular focus on reducing trade barriers” might frustrate the states’ ability to act as the invisible hand in their own markets such that they may achieve optimal social welfare.<sup>313</sup> In the end, states are concerned about more than efficiency; states must also consider public accountability, democratic choice, and quality of life.<sup>314</sup> States’ lack of constitutional power to manage offshore contracting may hinder their ability to act as guardian of the general welfare.

Before this debate can occur, however, federal and state governments must commit to comprehensively study the issue of offshore contracting because solutions, if any, depend on the availability of data.<sup>315</sup> At present the nation knows too little about the consequences of offshoring.<sup>316</sup> Most states do not track the location of contract performance and state proposals to restrict offshore contracting are often accompanied by more political rhetoric than economic analysis.<sup>317</sup> As one article warns, “[b]ecause no clear consensus or study citing the actual impact [of offshoring] on U.S. domestic labor currently exists, new offshore outsourcing regulation faces the risk of being based on false data.”<sup>318</sup> Accordingly, Congress should require states proposing offshore contracting restrictions to study its inci-

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<sup>310</sup> See Gerbasi & Warner, *supra* note 303, at 142 (“New agreements target government regulation of areas traditionally reserved to states including the protection of health, morals, and economic development within state borders. Lack of involvement of states in the negotiation of these rules can undermine their traditional areas of authority.”).

<sup>311</sup> See *id.*

<sup>312</sup> Warner & Gerbasi, *supra* note 209, at 18.

<sup>313</sup> Gerbasi & Warner, *supra* note 303, at 144; see also Hefetz & Warner, *supra* note 201, at 558.

<sup>314</sup> See Mildred E. Warner & Amir Hafetz, *Managing Markets for Public Service: The Role of Mixed Public–Private Delivery of City Services*, 68 PUB. ADMIN. REV. 155, 163 (2008).

<sup>315</sup> See GAO TRADE REPORT, *supra* note 29, at 4; Justin Kent Holcombe, *Solutions for Regulating Offshore Outsourcing in the Service Sector: Using the Law, Market, International Mechanisms, and Collective Organization as Building Blocks*, 7 U. PA. J. LAB. & EMP. L. 539, 549 (2005).

<sup>316</sup> See *supra* Part I.B.

<sup>317</sup> See, e.g., MacPherson, *supra* note 300 (“No one has yet done a comparison of the costs to the state vs. the costs of sending the jobs overseas.”) (citation omitted).

<sup>318</sup> Holcombe, *supra* note 315, at 549. Similarly, a union official recently testified, “The outsourcing debate is hampered by the lack of objective data to reinforce policy recommendations to either allow the continued unrestricted use of outsourcing or to restrict outsourcing to protect American jobs.” *Public Hearing Before Assembly Outsourcing and Off-Shoring Commission*, 212th N.J. Leg. 39 (Sept. 14, 2007) (statement of Eric Richard, Legislative Affairs Coordinator, N.J. State AFL-CIO).

dence and consequences as a prerequisite to federal approval. Armed with these studies, Congress can narrowly tailor any authorization to minimize states' intrusion into foreign affairs while specifically addressing problems that the states identify. By working together, federal and state officials can apply a global perspective to the challenges of offshoring, rather than leaving offshore contracting policy in the hands of state lawmakers with local concerns.<sup>319</sup> In the end, the states might just provide the nation with an "ideal laboratory" to test the future course of national trade policy.<sup>320</sup>

#### CONCLUSION

In a 2006 *Foreign Affairs* article, Princeton economist Alan Blinder wrote that almost none of the 22 million government jobs in the United States "are candidates for offshoring—for obvious political reasons."<sup>321</sup> Although political considerations generally prevent states from directly offshoring jobs,<sup>322</sup> a perfect storm of privatization and globalization has allowed state contractors to do indirectly what politics prevent the states from doing directly. Thus, although states do not generally hire foreign workers directly, many state contractors are performing state service contracts offshore. Yet politics caught up with the states as the media began to report on this phenomenon during the 2004 election, and a political backlash ensued. Lawmakers in virtually every state have introduced legislation to restrict offshore state contracting.

But the Constitution deprives states of the power to restrict offshore contracting. The restrictions violate the Foreign Commerce Clause of the Constitution because they discriminate against foreign commerce and prevent the federal government from speaking with "one voice" in foreign affairs. By regulating the international commercial activities of their contractors, states undermine national trade policy, frustrate international trade relations, invite retaliation, and embarrass the nation in its foreign dealings. Furthermore, state offshore contracting restrictions are not permissible under the "market participant" exception to the Interstate Commerce Clause because that exception does not (or should not) apply to the Foreign Commerce Clause. Even if it did, state offshore contracting restrictions are invalid under the doctrine of foreign affairs preemption.

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<sup>319</sup> See O'Neil, *supra* note 113, at 544.

<sup>320</sup> HANSEN, *supra* note 197, at 7.

<sup>321</sup> Alan Blinder, *Offshoring: The Next Industrial Revolution?*, 85 FOREIGN AFF. 113, 121 (2006).

<sup>322</sup> See, e.g., *Labor Agency Taps India Firm for State Project*, *supra* note 53, at 9 (reporting that Indiana's Governor canceled an offshore contract after public backlash).

Two solutions exist for states to prevent offshoring of their state contracts without violating the Constitution. Either the state withdraws certain contracts from the stream of commerce, or Congress sanctions state offshore contracting restrictions. Accordingly, a state that seeks to privatize and ensure that the jobs stay in the United States must seek authorization from Congress. In this regard, the nation should engage in a serious debate about whether to permit states to enact these restrictions, given the challenges that offshoring might pose for state governments. Congress must recognize the states' traditional role as guardian of their citizens and balance this against the benefits of uniform trade regulation and liberalized procurement. Federal and state governments must also make a serious commitment to study offshore contracting because policy solutions, if any, depend on the availability of data.