Local Liability in International Economic Law

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On February 4, 2016, the United States and eleven other countries signed the Trans-Pacific Partnership ("TPP")—the most far-reaching free trade agreement since the World Trade Organization's founding in 1995. Unlike most prior trade agreements, the TPP's purported benefits do not come primarily from reductions in tariffs paid on goods at the border. Instead, they flow from assumptions that so-called non-tariff barriers—such as discrimination against foreign investors or service providers—will fall significantly under the TPP.

Yet to date, unnoticed among the TPP's thirty chapters, schedules, and annexes, are provisions that exempt state, provincial, and local measures from compliance with many of the agreement's nondiscrimination rules. Under the TPP, subnational governments such as California or Ontario—governments with substantial regulatory authority over regional economies much larger than many national economies—may continue to discriminate against foreign investors or foreign service providers indefinitely. These exemptions represent the multilateralization of a trend underway for a number of years in U.S. treaty practice: efforts to reduce the federal government's liability for subnational action that the federal government often cannot control and of which it is frequently unaware. Indeed, forty-one percent of the claims brought under the investor-state dispute settlement ("ISDS") provisions of the 1994 North American Free Trade Agreement ("NAFTA") have challenged subnational government action. These exemptions also reflect a growing pushback against ISDS in countries such as Australia, France, Germany, and the United States.

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Contrary to U.S. treaty practice and ISDS's critics, this Article argues that foreign investors or aggrieved trading partners should be able to make their claims directly against subnational governments, such as California, rather than only against national governments, like the United States. The case is made by presenting and analyzing international liability rules for local action. Governments use three kinds of local liability rules: (1) immunity, under which neither the subnational nor national governments are answerable under international law for the actions of a subnational government; (2) vicarious liability, under which nations are liable for the actions of their subnational units even if they do not control them as a matter of domestic law; and (3) direct liability, under which a claimant's case is brought directly against the offending subnational government. Vicarious liability is the default rule under the international law of state responsibility. However, immunity—the rule under an increasing number of economic treaties, including the TPP's investment and services chapters—is on the rise. Direct liability is rare, but exists in certain investment agreements and applies to the European Union.

The choice among these liability rules is the most important front in efforts to reconcile a robust federalism with the increasing importance of local governments to international affairs—an ongoing battle in the United States, the European Union, and other federal nations. Direct liability best achieves the twin goals of fostering local governance and international cooperation for three reasons. First, direct liability would force subnational governments to internalize the costs of their actions, thereby deterring violations. Under vicarious liability, the costs of violations are borne by the national government, and under immunity, they are borne by the claimant who is left with no recourse. Second, a move to direct liability would have beneficial distributional consequences, ensuring that powerful federal nations do not force liberalization in developing countries while protecting discriminatory practices within their own countries. Third, a move to direct liability would recognize the considerably more important role subnational governments play in international affairs today. From climate change and renewable energy to international trade, subnational governments are incredibly active in tackling matters of international concern. They should also bear responsibility for their actions.

INTRODUCTION

On February 4, 2016, the United States and eleven other countries signed the Trans-Pacific Partnership ("TPP").[1] Touted by

1. *Trans Pacific Partnership Trade Deal Signed in Auckland*, BBC NEWS (Feb. 4, 2016), http://www.bbc.com/news/business-35480600 [http://perma.cc/FL22-B3XW]. As this Article goes to press, the TPP's future has become uncertain in light of U.S. President-elect Donald Trump's pledge not to go forward with the agreement. Nicky Woolf, Justin McCurry & Benjamin Haas, *Trump to Withdraw from Trans-Pacific Partnership on First Day in Office*, GUARDIAN (Nov. 22, 2016, 5:01 AM), https://www.theguardian.com/us-news/2016/nov/21/donald-trump-100-days-plans-video-trans-pacific-partnership-withdraw [https://perma.cc/8CDD-ZPU8]. The analysis in this Article of liability rules for subnational governments does not depend, however, on whether the United States

President Obama as "writ[ing] the rules of global trade for the 21st century[,]" the twelve TPP signatories account for forty percent of global GDP and one-third of global trade.[2] These figures stand to grow, both as the size of Asian economies increase and as potential new members, such as South Korea[3] and China,[4] join the agreement. In short, its proponents view the TPP as the "state of the art for international trade agreements," creating a powerful precedent for future economic integration.[5] Economists disagree about the TPP's effects. While some argue that the TPP will lead to higher unemployment and inequality,[6] most agree that the agreement will lead to significant income growth across member states.[7] Unlike most prior trade agreements,[8] however, the TPP's purported benefits do not come primarily from reductions in tariffs paid on goods at the border; instead, they flow from assumptions that so-called non-tariff barriers—such as discrimination against foreign investors or service providers—will fall significantly under the TPP.[9]

ultimately joins the TPP. As discussed *infra*, the TPP's local liability rules are similar to those found in many other international economic law agreements.

2. President Barack Obama, Remarks by President Obama in Meeting on the Trans-Pacific Partnership (Nov. 18, 2015), https://www.whitehouse.gov/the-press-office/2015/11/18/remarks-president-obama-meeting-trans-pacific-partnership [http://perma.cc/2H74-HNTJ].

3. Kwanwoo Jun, *South Korea Reiterates Interest in Trans-Pacific Partnership*, WALL ST. J. (Oct. 5, 2015, 10:59 AM), http://www.wsj.com/articles/south-korea-reiterates-interest-in-trans-pacific-partnership-1444057143.

4. Sarah Hsu, *China and the Trans-Pacific Partnership*, DIPLOMAT (Oct. 14, 2015), http://thediplomat.com/2015/10/china-and-the-trans-pacific-partnership/ [http://perma.cc/6M6G-2KCE] ("China has long stated that it is willing to consider joining the Trans-Pacific Partnership . . . .").

5. ADVISORY COMM. FOR TRADE POLICY & NEGOTIATIONS, REPORT TO THE PRESIDENT, THE CONGRESS, AND THE UNITED STATES TRADE REPRESENTATIVE ON THE TRANS-PACIFIC PARTNERSHIP (TPP) 5 (2015), https://ustr.gov/sites/default/files/Advisory-Committee-on-Trade-Policy-and-Negotiations.pdf [http://perma.cc/9UE8-BF9W].

6. *See* Jeronim Capaldo & Alex Izurieta, *Trading Down: Unemployment, Inequality and Other Risks of the Trans-Pacific Partnership Agreement* 1 (Glob. Dev. & Env't Inst., Working Paper No. 16-01, 2016), http://www.ase.tufts.edu/gdae/Pubs/wp/16-01CapaldoIzurietaTPP.pdf [http://perma.cc/44DN-MZES].

7. *See, e.g.*, Peter A. Petri & Michael G. Plummer, *The Economic Effects of the Trans-Pacific Partnership: New Estimates* 1–3 (Peterson Inst. for Int'l Econ., Working Paper No. 16-2, 2016), http://www.iie.com/publications/wp/wp16-2.pdf [https://perma.cc/DFT6-WWZP].

8. *See, e.g.*, *Summary of the U.S.-Australia Free Trade Agreement*, OFF. U.S. TRADE REPRESENTATIVE (Feb. 2004), https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/archives/2004/february/summary-us-australia-free-trade-agreement [https://perma.cc/2FJK-ZWFE] (noting that the Australia-U.S. FTA provided "immediate benefits for America's manufacturing workers" pursuant to significant tariff reductions).

9. Dani Rodrik, *The Trade Numbers Game*, PROJECT SYNDICATE (Feb. 10, 2016), https://www.project-syndicate.org/commentary/tpp-debate-economic-benefits-by-dani-rodrik-2016-02 [http://perma.cc/ACG7-NNRB].

This Article argues that the TPP is unlikely to reduce discrimination significantly in many major TPP signatory nations. Unnoticed among the thirty chapters, schedules, and annexes are provisions that exempt existing state, provincial, and local measures from the nondiscrimination rules contained in the investment and services chapters.[10] Local, state, and provincial governments can therefore continue to discriminate against foreign investors and service providers indefinitely. To give but one example, international tribunals have held that state and local laws that permit services such as gambling and betting to be provided in person but not online discriminate unlawfully against foreign service providers.[11] Under the TPP, these laws would be immune from challenge.[12]

These exemptions represent the multilateralization of a trend underway for a number of years in U.S. treaty practice: efforts to immunize the federal government against liability for subnational government action that it often cannot control and of which it is frequently unaware. Indeed, forty-one percent of the claims brought under the investor-state dispute settlement ("ISDS") provisions of the 1994 North American Free Trade Agreement ("NAFTA") have challenged subnational government action.[13] These exemptions also reflect a growing pushback against ISDS, a push led by Senator Elizabeth Warren[14] in the United States and supported by nations

10. Trans-Pacific Partnership arts. 9.12, 10.7, *opened for signature* Feb. 4, 2016 [hereinafter TPP] (providing that the nondiscrimination rules contained in chapter 9 on investment and chapter 10 on trade in services "shall not apply to: any existing non-conforming measure . . . [at] a regional level of government, as set out by that Party in its Schedule to Annex I, or a local level of government[,]" as well as the continuation, renewal, or amendment of such measures). The four federal TPP signatories—Australia, Canada, Mexico, and the United States—included reservations in their schedules that exempted all non-conforming measures at the state or provincial levels of government. *See id.* Annexes I & II. For the full text of the Trans-Pacific Partnership, see *TPP Full Text*, OFF. U.S. TRADE REPRESENTATIVE, https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text [https://perma.cc/723C-AZ6E].

11. *See* Appellate Body Report, *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, ¶ 5, WTO Doc. WT/DS285/AB/R (adopted Apr. 7, 2005) (finding that U.S. and local laws prohibiting internet gambling while permitting in-person gambling violate the General Agreement on Trade in Services).

12. *See infra* Section I.B.

13. *See infra* notes 71–73 and accompanying text.

14. Elizabeth Warren, Opinion, *The Trans-Pacific Partnership Clause Everyone Should Oppose*, WASH. POST (Feb. 25, 2015), https://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html [http://perma.cc/4BSD-36JR].

such as Australia,[15] France, and Germany.[16] These critics call for an end to the system that allows private citizens to sue governments for violations of rights conferred by economic treaties.[17] While these exemptions do not end ISDS, they are part of an increasingly large hole in the scope of governmental action subject to review by tribunals.[18] Along with sector-specific carve-outs for politically noxious industries such as tobacco,[19] exemptions for subnational discrimination could presage ISDS's death by a thousand cuts.

Contrary to U.S. treaty practice, this Article argues that foreign investors or aggrieved trading partners should be able to bring claims directly against subnational governments such as California, rather than only against national governments like the United States. The choice among liability rules for subnational action is the most important front in efforts to reconcile a robust federalism with the increasing importance of subnational governments to international affairs—an ongoing battle in the United States, the European Union ("EU"), and other federal nations. The trend towards immunity means that increasingly large swaths of regulatory activity remain outside international economic law's disciplines. Insulating subnational measures from international review may also encourage nations with malleable federal structures—where regulatory authority can be reallocated from the center to local governments and vice versa—to push discriminatory activity down to the local level. (This Article shall use the terms "subnational" and "local"

15. *See* Tom Iggulden, *Trans-Pacific Partnership Opposition Blamed on Dispute Clauses*, ABC NEWS (Apr. 1, 2015), http://www.abc.net.au/news/2015-04-01/transpacific-partnership-why-so-much-opposition/6363326 [https://perma.cc/TP6A-FV85].

16. Cecile Barbiere, *France and Germany to Form United Front Against ISDS*, EURACTIV (Jan. 15, 2015), http://www.euractiv.com/sections/trade-society/france-and-germany-form-united-front-against-isds-311267 [http://perma.cc/V4TZ-UNFS].

17. *See, e.g.*, Warren, *supra* note 14 (arguing that ISDS may make sense "in an arbitration between two corporations, but not in cases between corporations and governments").

18. These exemptions originated in bilateral investment agreements, largely in response to the different incentives created by investor-state dispute settlement. *See infra* Section III.B. Today, though, these exemptions appear both in the investment and trade services chapters of agreements such as the TPP. *See* TPP, *supra* note 10, art. 11.10. I therefore discuss both trade and investment throughout the Article, although I do differentiate between the two. Investment disputes are between private parties and states and lead to monetary awards, while trade disputes are between states only and lead to the reciprocal withdrawal of concessions. *See infra* notes 187–90 and accompanying text. These differences in dispute resolution have important implications for states' willingness to use immunity. *See infra* Part III.

19. TPP, *supra* note 10, art. 29.5 ("A Party may elect to deny the benefits of Section B of Chapter 9 (Investment) with respect to claims challenging a tobacco control measure.").

interchangeably.[20]) It also has distributional implications, as federal nations are more likely to get away with significant discrimination than are unitary states. California's economy, to take the most significant example, would be the sixth largest national economy in the world.[21] Under the TPP, California is free to continue its existing discriminatory practices while smaller economies such as Vietnam or New Zealand must cease. Direct liability, on the other hand, better achieves the twin goals of fostering local governance and international cooperation.

To make the case, I present the first study of international liability rules for local action. I find that countries use three different local liability rules: strict vicarious liability, immunity, and direct liability. Strict vicarious liability is the default rule that applies under international law.[22] A national government is liable for the actions of its subnational units, even when it does not control those actions. Thus, for example, when the province of Ontario provides discriminatory renewable energy subsidies, Canada, and not Ontario, is the party held accountable before the World Trade Organization ("WTO") and a NAFTA investment tribunal.[23] Similarly, when the State of Washington provides subsidies to Boeing that violate the WTO's rules, the United States—not Washington—is held responsible through the WTO dispute settlement system.[24]

20. One can think of four levels of governmental action: international, national, regional (i.e., state or provincial), and local (e.g., city, county, town). These terms quickly become confusing. For example, in international law, nations are referred to as "states," while federal countries such the United States, Mexico, and Australia refer to their regional governments as "states." Three levels of governance—international, national, and subnational—are, for the most part, sufficient for my purposes. I shall therefore use both the terms "subnational" and "local" to refer collectively to regional and local governments. I shall use the term "state" to refer to nations except where the context makes clear that I am referring to, e.g., U.S. states. Where I refer to them specifically, I shall call city, county, and town governments "truly local."

21. Robin Respant, *California Passes France as World's 6th-Largest Economy*, REUTERS, (June 17, 2016, 9:17 PM), http://www.reuters.com/article/us-california-economy-idUSKCN0Z32K2 [https://perma.cc/4YBF-MVJD].

22. *See infra* Part I.

23. Appellate Body Reports, *Canada—Certain Measures Affecting the Renewable Energy Generation Sector, Canada—Measures Relating to the Feed-in Tariff Program*, ¶ 5.85, WTO Doc. WT/DS412/AB/R, WT/DS426/AB/R (adopted May 24, 2013) [hereinafter *Canada—Renewable Energy*] (finding that Canada's local content requirement ("LCR") programs—"Minimum Required Domestic Content Levels"—violate article III, section 4 of the General Agreement on Tariffs and Trade 1994 standards).

24. Appellate Body Report, *United States—Measures Affecting Trade in Large Civil Aircraft—(Second Complaint)*, ¶ 1350, WTO Doc. WT/DS353/AB/R (adopted Mar. 23, 2012) [hereinafter *U.S.—Aircraft*] (holding that subsidies granted to Boeing by the State of

Immunity, under which neither the national nor local government can be held responsible for otherwise unlawful discriminatory acts, has appeared with increasing frequency in economic treaties in the last fifteen years.[25] In U.S. treaty practice, crafting exemptions for U.S. states, either through substantive law or through reservations, has a long and sometimes contentious history.[26] Immunity is a recent innovation in economic agreements, however. As late as 1994, when nations negotiated the WTO agreements, they expressed particular concern about the ability of local governments to stymy efforts to liberalize international trade. The WTO's Technical Barriers to Trade Agreement ("TBT Agreement"), for example, confirms not only that members are responsible for the actions of their local governments;[27] it also provides that "[m]embers shall formulate and implement positive measures and mechanisms in support of the observance of the provisions of Article 2 by other than central government bodies."[28] The TBT Agreement thus provides an independent duty to supervise local governments that goes beyond mere responsibility for their actions. Today, however, a blanket exemption for existing non-conforming local measures is standard in

Washington and the City of Wichita, Kansas, violated the WTO's Agreement on Subsidies and Countervailing Measures).

25. Immunity is the rule that applies as a matter of domestic law in the United States between the federal and state governments. A plaintiff may not sue the federal government for actions of state governments, nor, as a result of Eleventh Amendment sovereign immunity, may a plaintiff sue the state (i.e., regional) government directly in federal court unless the state has consented. U.S. CONST. amend XI; *see also, e.g.*, Blatchford v. Village of Noatak, 501 U.S. 775, 779 (1991) ("[W]e have understood the Eleventh Amendment to stand . . . for the presupposition of our constitutional structure which it confirms: that the States entered the federal system with their sovereignty intact; that the judicial authority in Article III is limited by this sovereignty; and that a State will therefore not be subject to suit in federal court unless it has consented to suit, either expressly or in the 'plan of the convention.' ").

26. *See* Curtis A. Bradley & Jack L. Goldsmith, *Treaties, Human Rights, and Conditional Consent*, 149 U. PA. L. REV. 399, 409 (2000) (discussing how, historically, the United States has limited the application of international agreements to the states). A recent example comes from the United States' reservation to the United Nations Convention Against Corruption, where "[t]he United States of America reserve[d] the right to assume obligations under the Convention in a manner consistent with its fundamental principles of federalism." S. REP. NO. 109-4, § 2(1), at 6–7 (2005).

27. Agreement on Technical Barriers to Trade art. 3.5, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1868 U.N.T.S. 120 [hereinafter TBT Agreement] (providing with respect to local governments that "[m]embers are fully responsible under this Agreement for the observance of all provisions of Article 2[,]" which provides the main substantive rules of the TBT Agreement).

28. *Id.*

multilateral trade and investment agreements, such as the TPP, as well as federal nations' bilateral investment treaties ("BIT").[29]

Direct liability, under which claimants can bring claims directly against an offending local government, is the least common of the three rules. The International Convention on the Settlement of Investment Disputes ("ICSID Convention") provides a mechanism through which nations can render their local governments liable to direct suit, but few nations avail themselves of this opportunity.[30] The EU and its member states also practice a form of direct liability in their economic agreements.[31] The rule exists domestically as well. The United States Supreme Court held in *Monell v. Dep't. Social Services*[32] that local governments can be sued even where U.S. state governments—of which local governments are part—are immune under the Eleventh Amendment.[33]

This Article argues that direct liability for subnational governments should replace strict vicarious liability and immunity in international economic law. This proposal has two components. First, under the international law of state responsibility, local governments should be directly responsible for their breaches of international economic obligations. Second, grants of jurisdiction to international tribunals to resolve trade and investment disputes should be understood to include jurisdiction over claims against subnational governments unless otherwise specified.[34]

This rule would have a number of beneficial consequences. First, local governments presently externalize all international liability for their actions. When a U.S. state or Canadian province violates an

29. *See infra* Section II.B.

30. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, art. 25(1), 25(3), *opened for signature* Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 [hereinafter ICSID Convention].

31. *See infra* Section I.C.

32. 436 U.S. 658 (1978).

33. *Id.* at 690.

34. International law distinguishes between the law of state responsibility and jurisdiction. The law of state responsibility describes when a state is responsible for a breach of international law and the consequences thereof. *See generally* Int'l Law Comm'n, Draft Articles on Responsibility of States for Internationally Wrongful Acts, at 31, U.N. Doc. A/56/10 (2001) [hereinafter Draft Articles on State Responsibility], http://www.un.org/documents/ga/docs/56/a5610.pdf [https://perma.cc/4XPT-F95X] ("These articles seek to formulate . . . the basic rules of international law concerning the responsibility of States for their internationally wrongful acts."). A state may have responsibility even if no tribunal has jurisdiction. The concept of direct liability argued for here encompasses both the notion of state responsibility and jurisdiction. Essentially, local governments would be amenable to jurisdiction and responsible under international law to the same extent as their parent states.

international legal obligation, the federal government has no mechanism to recoup from the local government the costs of either defending the suit or any resulting liability.[35] Thus, monetary awards against the United States or Canada under an investment agreement for violations by a subnational government are paid by the national government, not by the responsible local government.[36] Neither can the federal government easily control the actions of local governments. Resource constraints prevent federal governments in large nations from monitoring all local government action. Moreover, political and legal constraints make preempting local acts difficult at best. For example, the United States federal government has the power to seek a declaratory judgment that a state or local law is preempted because it conflicts with U.S. obligations under the WTO founding agreements.[37] As far as I am aware, the federal government has never exercised this authority.

Second, a move to direct liability would have beneficial distributional and welfare consequences. Strict vicarious liability is only a default rule. The countries that most frequently push to change the default rule are large federal states such as the United States, Canada, Mexico, and Australia.[38] These powerful and wealthy countries obtain immunity for their state and provincial governments, which often have expansive regulatory powers.[39] Meanwhile, many weaker developing nations are centralized and thus do not benefit from immunity for discriminatory regional acts. The result is that federal countries may be permitted to discriminate at a higher rate than unitary countries. In general, permitting discrimination to continue is bad both for the unitary countries discriminated against, as well as the consumers in the discriminating federal countries who pay higher prices for goods, services, and capital as a result of their own government's discrimination.[40]

35. *See infra* Section II.A.1.

36. *See infra* notes 74–82 and accompanying text.

37. *See, e.g.*, Uruguay Round Agreements Act, 19 U.S.C. § 3512(c)(2) (2012) ("It is the intention of Congress . . . to occupy the field with respect to any cause of action or defense under or in connection with any of the Uruguay Round Agreements, including by precluding any person other than the United States from bringing any action against any State or political subdivision thereof or raising any defense to the application of State law . . . .").

38. *See infra* Section I.B.

39. *See infra* Section I.B.

40. *See* Timothy Meyer, *How Local Discrimination Can Promote Global Public Goods*, 95 B.U. L. REV. 1937, 1942 (2015) (noting that "[f]oreign businesses and disfavored domestic consumers absorb the economic costs [of discrimination]"). Discrimination does create benefits for protected domestic producers and the politicians

Third and finally, direct liability recognizes the considerably more important role subnational governments play in international affairs today. Strict vicarious liability pretends that the world is a place in which actions with global consequences originate primarily in national capitals. Yet the nation-state's role has receded in favor of both supranational and subnational action. Indeed, national governments frequently contemplate a role for local governments in fulfilling international objectives. To give but one example, on September 15, 2015, the top climate change negotiators from the United States and China met in Los Angeles.[41] They did not meet to discuss national efforts to mitigate climate change; instead, they convened with the leaders of about a dozen American and Chinese cities, states, and provinces to discuss local measures that "are intended to support the achievement and implementation of each country's respective post-2020 national climate targets."[42] Direct accountability is necessary to ensure that local governments can play their important role in international affairs responsibly and constructively.

This Article proceeds in five parts. Part I presents a novel survey of the three local liability rules used in international law. This survey demonstrates that immunity is on the rise. Part II analyzes these three rules in light of the regulatory and compensatory functions of liability; while strict vicarious liability and direct liability each have benefits, immunity is the least efficient rule. This framework presents a puzzle: if immunity is such an inefficient rule, why are nations increasingly using it? Part III provides the answer to this question, showing that large federal nations are willing to use their leverage in trade negotiations to reduce local liability that they cannot easily avoid as a matter of domestic law. Part IV considers the implications of the trend towards immunity for international economic law. Part V makes the case for direct liability as the default local liability rule.

they support, although in general, these benefits are outweighed by the costs to foreign businesses and domestic consumers. *Id.* The exception to this rule is when discrimination promotes some non-economic objective, such as environmental protection or health and safety. *See id.* (arguing that discriminatory measures can facilitate the passage at the local level of global public goods measures such as renewable energy subsidies).

41. U.S.-CHINA CLIMATE LEADERS' DECLARATION: ON THE OCCASION OF THE FIRST SESSION OF THE U.S.-CHINA CLIMATE-SMART/LOW-CARBON CITIES SUMMIT, LOS ANGELES, CA, SEPTEMBER 15–16, 2015, at 1 (2015), https://www.whitehouse.gov/sites/default/files/us_china_climate_leaders_declaration_9_14_15_730pm_final.pdf [http://perma.cc/2WUP-6TU5].

42. *Id.*

I. THREE LIABILITY RULES

This Part presents the first comprehensive review of international liability rules for local action. The default rule under international law is that a national government is vicariously liable for the actions of its subnational governments. Two alternative liability schemes exist, however: immunity and direct liability. Under immunity, a complainant does not have a claim against either the subnational government or the national government. Under direct liability, a complainant may make a claim directly against the subnational government. As documented below, immunity for local action is on the rise, but direct liability offers a promising alternative.

A. Strict Vicarious Liability

Strict vicarious liability (or "vicarious liability") for national governments is the default rule under international law. The International Law Commission's (ILC) Draft Articles on State Responsibility, which to a large extent reflect customary international law,[43] provide that the "conduct of any State organ shall be considered an act of that State under international law . . . whatever its character as an organ of the central Government or of a territorial unit of the State."[44] Moreover, the draft articles provide that whether a state has committed an internationally wrongful act "is not affected by the characterization of the same act as lawful by internal law."[45] Indeed, these provisions are bedrock principles of international law, confirmed by dozens of cases.[46]

As a result, states bear legal responsibility under international law for the actions of their local governments, even if the local government's actions are made pursuant to an express allocation of authority between the national and local governments. The Consular Cases provide a perfect illustration. The United States lost a series of disputes before the International Court of Justice ("ICJ"),[47] culminating in the *Avena*[48] judgment, which held that the United

43. *See* Draft Articles on State Responsibility, *supra* note 34, at 84.

44. *Id*. ("[Article 4.1] includes an organ of any territorial governmental entity within the State on the same basis as the central governmental organs of that State . . . .").

45. *Id.* at 36.

46. *Id*. at 75–90 & nn.78–125 (citing cases upholding these two principles).

47. *See* LaGrand (Ger. v. U.S.), Judgment, 2001 I.C.J. Rep. 466, ¶ 128 (June 27); Vienna Convention on Consular Relations (Para. v. U.S.), Judgment, 1998 I.C.J. Rep. 248, ¶ 41 (Apr. 9).

48. Avena and Other Mexican Nationals (Mex. v. U.S.), Judgment, 2004 I.C.J. Rep. 12 (Mar. 31).

States had violated the consular rights of Mexican nationals on death row in Texas.[49] In fact, Texas (and other U.S. states) had violated the foreign nationals' rights during the course of administering state criminal law, and the remedy prescribed by the ICJ would have required state court review of the foreign nationals' convictions.[50] In *Medellin v. Texas*,[51] the Supreme Court held that the President lacked the ability to compel Texas to comply with the ICJ's judgment.[52] This lack of presidential authority domestically, however, had no impact on the United States' international responsibility for the violations.[53]

The traditional justification for vicarious liability is that "federal States vary widely in their structure and distribution of powers, and . . . in most cases the constituent units have no separate international legal personality of their own."[54] Because local governments generally lack legal personality under international law and therefore cannot bear legal responsibility, vicarious liability ensures that all domestic exercises of governmental authority can be reached by international law. In this sense, the rule holding a state accountable for the actions of its constituent parts has similar rationales to vicarious liability in tort law.[55]

In principle, vicarious liability need not be strict. Just as domestic law sometimes only holds superiors responsible if they behave negligently in supervising their subordinates,[56] so too one can imagine holding a state responsible only if it has failed to adequately exercise its oversight authority over local governments.[57] Instead, international

49. *See Avena*, 2004 I.C.J. ¶ 153.

50. *Id.* at 64–67.

51. 552 U.S. 491 (2008).

52. *Id.* at 523–32.

53. *Id.* at 504 ("No one disputes that the *Avena* decision—a decision that flows from the treaties through which the United States submitted to ICJ jurisdiction with respect to Vienna Convention disputes—constitutes an *international* law obligation on the part of the United States. But not all international law obligations automatically constitute binding federal law enforceable in United States courts.").

54. Draft Articles on State Responsibility, *supra* note 34, at 42.

55. *See* ERIC A. POSNER & ALAN O. SYKES, ECONOMIC FOUNDATIONS OF INTERNATIONAL LAW 113 (2013); *see also* Attila Atanar, *How Strict Is Vicarious Liability? Reassessing the Enterprise Risk Theory*, 64 U. TORONTO FAC. L. REV. 63, 78–80 (2006) (describing various rationales for vicarious liability, including the composite theory, under which an employee and an employer should be treated as a "single, unitary entity").

56. Atanar, *supra* note 55, at 69 (discussing vicarious liability regimes in which the employer's conduct must itself be wrongful or negligent before vicarious liability arises).

57. Inevitably, however, such an inquiry would raise messy questions about a state's ability to oversee local government action. Who would determine whether the national government had legal authority to correct a violation by a local government: national courts or international tribunals? Even if a national government had the appropriate authority, would it be entitled to a defense based on capabilities? Would developing

law's strict approach to vicarious liability follows what might be termed a lowest-cost avoider approach. National governments are better positioned than foreign governments to monitor and promote local government compliance with international law. This justification does not require that national governments have significant monitoring and supervisory capacity as an absolute matter. It turns only on relative capacity. This lowest-cost avoider rationale likely made sense in the nineteenth and early twentieth centuries, when detailed information about foreign legal systems might not have been readily available overseas. Today, however, technology has greatly reduced the cost of researching foreign legal systems. National governments may therefore no longer have a comparative advantage in monitoring local action.[58]

Until recently, nations were so enamored of vicarious liability that they actually sought to expand nations' responsibility for local governments by imposing an affirmative duty on nations to supervise local government compliance with international economic treaties. This duty was independent of and additional to liability for breaches by local governments. Article 105 of NAFTA, for instance, provides that "[t]he Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments."[59] Likewise, the WTO's TBT Agreement contains an article on local governments. That article confirms that "[m]embers are fully responsible under this Agreement for the observance of all provisions of Article 2[,]" which provides the main substantive rules of the TBT Agreement.[60] Going beyond confirming the default rule that states are responsible for local action, however, the TBT Agreement provides that "[m]embers shall formulate and implement positive measures and mechanisms in support of the observance of the provisions of Article 2 by other than central government bodies."[61]

As a result of vicarious liability, nations are regularly called upon to answer for the offenses of their local governments. To take but one example, the peace treaty between the Allies and Italy at the end of

countries, for example, be less responsible for the actions of their local governments owing to their relative resource constraints?

58. *See infra* Section II.A.

59. North American Free Trade Agreement, Can.-Mex.-U.S., art. 105, Dec. 17, 1992, 32 I.L.M. 296 [hereinafter NAFTA].

60. TBT Agreement, *supra* note 27, art. 3.5.

61. *Id.*

World War II established an obligation on Italy to return property wrongfully taken from foreign nationals,[62] as well as bilateral conciliation commissions to arbitrate disputes between such nationals and Italy.[63] In *Heirs of the Duc de Guise*,[64] a case involving an expropriation effected by the Sicilian government, the Franco-Italian Conciliation Commission made clear that "the Italian State is responsible for implementing the Peace Treaty, even for Sicily, notwithstanding the autonomy granted to Sicily in internal relations under the public law of the Italian Republic."[65] The Franco-Mexican Claims Commission reached a similar conclusion in a case involving the taking of assets of a French citizen by the Mexican State of Sonora.[66] The commission noted that Mexico was responsible for the conduct of its subunits "even in cases where the federal constitution denies the central Government the right of control over the separate States or the right to require them to comply, in their conduct, with the rules of international law."[67]

Although an old rule, the significance of vicarious liability has dramatically increased with the creation of compulsory dispute resolution mechanisms in investment and trade agreements. Prior to the 1980s, state responsibility for local action existed in theory but could only be tested before a tribunal if the parties happened to agree to the jurisdiction of an international tribunal. Since then, however, economic relations between states have been heavily judicialized. Today over 2,500 BITs, preferential trade agreements such as NAFTA and the TPP, and the WTO itself give international tribunals compulsory jurisdiction over claims arising under those treaties.[68]

62. Treaty of Peace with Italy art. 75, ¶ 1, Feb. 10, 1947, 49 U.N.T.S. 747 ("Italy . . . shall return, in the shortest time possible, property removed from the territory of any of the United Nations.").

63. *Id.* art. 83.

64. 13 R.I.A.A. 150 (Franco-Italian Conciliation Comm'n 1951), *translated in* Draft Articles on State Responsibility, *supra* note 34, at 88.

65. *Id.* at 161.

66. Estate of Hyacinthe Pellat v. United Mexican States (Fr. v. Mex.), 5 R.I.A.A. 534 (1929), *translated in* Draft Articles on State Responsibility, *supra* note 34, at 89.

67. *Id.* at 89. Interestingly, in its commentaries, the International Law Commission notes that strict vicarious liability was not consistently followed until the late nineteenth century, although it has consistently been followed since then. *See id.* at 88.

68. *See* STEPHAN W. SCHILL, THE MULTILATERALIZATION OF INTERNATIONAL INVESTMENT LAW 40–41 (2009) (chronicling the rise of, and subsequent changes to, bilateral and regional investment agreements); Andreas F. Lowenfeld, *Investment Agreements and International Law*, 42 COLUM. J. TRANSNAT'L L. 123, 125–28 (2003) (discussing developing countries' increased use of BITs in recent years to attract capital from multinational companies).

State responsibility for local action is thus engaged with considerably greater frequency today than ever before.

NAFTA investor-state disputes clarify this trend. Investors have filed seventy-eight claims total against the three NAFTA parties—thirty-eight claims against Canada,[69] twenty claims against Mexico,[70] and twenty claims against the United States.[71] Of these, thirty-three challenge local action.[72] Put differently, an astonishingly high 41% of the investment claims brought under NAFTA—the largest preferential trade agreement between federal countries currently in force—seek to hold federal governments responsible for local action.[73]

Canada, the most frequent respondent under NAFTA chapter 11, also has the highest percentage of claims involving local action. Twenty-two of its thirty-eight claims involve local action, a remarkable 58% of claims.[74] These claims have created substantial liability for Canada. For example, Canada settled the *AbitibiBowater*[75] dispute, in which Newfoundland and Labrador expropriated the assets of a U.S. timber company, for $130 million dollars.[76] Moreover, Canada, like most federal countries, had no domestic mechanism to impose this loss on the provincial government.[77] Following the settlement, Canadian Prime Minister

69. *See Cases Filed Against the Government of Canada*, GLOBAL AFF. CAN., http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gov.aspx?lang=eng [http://perma.cc/LLS4-7N6M] (last modified Apr. 7, 2016). International investment disputes are not reported with the same transparency as federal cases. While the Canadian government maintains a transparent and up-to-date website of its claims, identifying claims against the United States and Mexico involve searching out more comprehensive lists of disputes than those maintained by the respective governments.

70. *See* Todd Weiler, *Disputes with Mexico*, NAFTACLAIMS.COM, http://www.naftaclaims.com/disputes-with-mexico.html [https://perma.cc/Q5SC-8H57] [hereinafter *Disputes with Mexico*].

71. *See* Todd Weiler, *Disputes with USA*, NAFTACLAIMS.COM, http://www.naftaclaims.com/disputes-with-usa.html [https://perma.cc/62CE-3SL5] [hereinafter *Disputes with USA*].

72. *See Disputes with Mexico*, *supra* note 70; *Disputes with USA*, *supra* note 71.

73. *See Disputes with Mexico*, *supra* note 70; *Disputes with USA*, *supra* note 71.

74. Twenty-one cases against Canada either were completed or are ongoing, while sixteen were withdrawn or are inactive. *Cases Filed Against the Government of Canada*, *supra* note 69. Of the former category, fourteen involved local action, while eight of the latter category involved local action. *Id.*

75. *See Cases Filed Against the Government of Canada: AbitibiBowater Inc. v. Government of Canada*, GLOBAL AFF. CAN., http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/AbitibiBowater.aspx?lang=eng [http://perma.cc/SD87-D548].

76. *Id.*

77. Bertrand Marotte & John Ibbitson, *Provinces on Hook for Future Trade Disputes: Harper*, GLOBE & MAIL (Aug. 26, 2010, 3:49 PM), http://www.theglobeandmail.com

Stephen Harper said he would consider legislation to create such a mechanism if provincial governments continued to act irresponsibly.[78]

Only five out of the twenty cases—25%—against the United States involve local action.[79] These claims, however, challenge a number of different U.S. states and a wide range of regulatory activity. Several of them challenged environmental regulations in California,[80] while one challenged Mississippi state court rulings concerning funeral parlors.[81] Another challenged a Massachusetts Supreme Judicial Court decision holding that the claimant could not recover for intentional torts committed by authorities in Boston.[82] Yet another case sought between $310 and $664 million on the grounds that the master settlement agreement U.S. state attorneys general entered into with the tobacco industry in the late 1990s—which provided the most comprehensive regulation of the tobacco industry at that time—discriminated against Canadian cigarette producers.[83] For Mexico, six of its twenty claims involve local action, many challenging zoning and environmental decisions.[84]

The WTO has also seen its share of claims challenging local action. Out of 502 cases filed to date, at least forty-one have challenged subnational action (including, as explained below, claims against EU member states)—a bit more than eight percent of cases.[85]

/report-on-business/provinces-on-hook-in-future-trade-disputes-harper/article1378647/ [http://perma.cc/5N97-GQSR] (noting Canada's lack of such a mechanism and the potential need to create one in the future).

78. *Id.*

79. *See Disputes with USA*, *supra* note 71.

80. *See* Glamis Gold, Ltd. v. United States, Award, at 26–32 (NAFTA Ch. 11 Arb. Tri. June 8, 2009), http://www.italaw.com/sites/default/files/case-documents/ita0378.pdf [https://perma.cc/4TZQ-V65Z]; Methanex Corp. v. United States, Award, ¶¶ 3–8 (NAFTA Ch. 11 Arb. Trib. Aug. 3, 2005), http://www.italaw.com/sites/default/files/case-documents/ita0529.pdf [http://perma.cc/WB3G-HTAL].

81. *See* Loewen Grp., Inc. v. United States, ICSID Case No. ARB(AF)/98/3, Award, ¶ 3 (June 26, 2003), 7 ICSID Rep. 442 (2005).

82. *See* Mondev Int'l Ltd. v. United States, ICSID Case No. ARB(AF)/99/2, Award, ¶¶ 1, 139–40 (Oct. 11, 2002), 6 ICSID Rep. 182 (2004).

83. *See* Grand River Enter. Six Nations, Ltd. v. United States, Award, ¶ 1 (NAFTA Ch. 11 Arb. Trib. 2011), http://www.italaw.com/sites/default/files/case-documents/ita0384.pdf [https://perma.cc/ZWZ7-LNEK].

84. *See Disputes with Mexico*, *supra* note 70.

85. To access the underlying data for this analysis, see *Chronological List of Dispute Cases*, WORLD TRADE ORG., https://www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm [https://perma.cc/GM3L-DXF3]. I arrived at this number by examining the requests for consultations in WTO disputes, current as of January 2016. This number may underestimate the number of disputes involving local measures if a party did not name a local measure in its request for consultations. I also followed the WTO's system of numbering disputes, counting each dispute to which the WTO gave an individual number as an individual dispute, even if two disputes were linked. Thus, for example, I counted the

Fourteen of those cases challenged action taken by provinces or states within federal countries. Moreover, thirteen of these cases were brought against the United States or Canada (the last targeted provincial measures in Belgium).[86] The EU and Japan, for example, challenged a Massachusetts law that prohibited the state from procuring goods or services from anyone doing business with, or in, Myanmar.[87] In the famous *Gambling*[88] case, Antigua and Barbuda successfully challenged allegedly discriminatory limitations on the provision of online gambling services from outside the United States (given that gambling is legal within the United States). Antigua and Barbuda named laws in each of the fifty states, as well as Guam, Puerto Rico, and the U.S. Virgin Islands.[89] Finally, a number of disputes challenged state and provincial subsidies for industries such as aircrafts and renewable energy.[90]

Outside of North America, twenty-eight cases challenged actions by EU member states.[91] EU member states function in trade and investment matters more as subnational units of a federal state than as independent nations. Article 207 of the Treaty on the Functioning of the EU, which came into effect in 2009, provides that trade in goods, trade in services, the commercial aspects of intellectual property, and foreign direct investment are all part of the EU's common commercial policy.[92] The common commercial policy, in

EU's and Japan's challenges to Ontario's Feed-in Tariff Program as two disputes because the WTO gave the disputes two numbers (DS412 and DS426).

86. *See* Request for Consultations by the Russian Federation, *European Union and Its Member States—Certain Measures Relating to the Energy Sector*, ¶¶ 2–5, WTO Doc. WT/DS476/1 (Apr. 30, 2015) [hereinafter *EU—Energy*].

87. *See* Request for Consultations by Japan, *United States—Measure Affecting Government Procurement*, at 1, WTO Doc. GPA/D3/1 WT/DS95/1 (July 18, 1997). This issue was resolved on supremacy clause grounds in litigation in the United States. *See* Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 366 (2000).

88. Request for Consultations by Antigua and Barbuda, *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WTO Doc. WT/DS285/1 (Apr. 1, 2003).

89. *Id.* Annex I & II.

90. *See Canada—Renewable Energy*, *supra* note 23, ¶ 5.85; *U.S.—Aircraft*, *supra* note 24, at 567; Request for Consultations by the United States, *European Communities and Certain Member States—Measures Affecting Trade in Large Civil Aircraft*, ¶¶ 1–6, WTO Doc. WT/DS347/1 (Jan. 31, 2006) [hereinafter *EC—Aircraft*].

91. One case, *Request for Consultations by the Russian Federation, European Union and its Member States*, at 1–3, WTO Doc. WT/DS476/1 (May 8, 2014), challenged both EU member states' actions, as well as actions within an EU member state, Belgium. As a consequence, this case counts as both a challenge to a provincial measure and an EU member state. This explains why there are forty-one local WTO cases, but twenty-eight such cases against EU member states and fourteen against regional actors.

92. Consolidated Version of the Treaty on the Functioning of the European Union art. 207, May 9, 2008, 2008 O.J. (C 115) 47, 140.

turn, is a matter of EU exclusive competence, meaning that the EU has jurisdiction and its member states do not.[93] Nevertheless, just as U.S. states and Canadian provinces can trigger claims against their national governments, so too can EU member states trigger claims against the EU.[94] Not surprisingly, these claims look very similar to those claims against North American state and provincial governments. They involve, for example, subsidies for aircraft manufacturers;[95] energy regulation, including cases regarding renewable energy markets;[96] a handful of product regulations, such as limitations on asbestos or the products made from seal skins;[97] and challenges to tax measures.[98]

93. Allan Rosas, *EU External Relations: Exclusive Competence Revisited*, 38 FORDHAM INT'L L.J. 1073, 1081 (2015) ("It thus became clear that these areas are included in the concept of common commercial policy and thus are covered by TFEU Article 3(1)(e), providing for an exclusive competence in the area of 'common commercial policy.").

94. Whether a claim is or was brought against the EU or a member state directly depends on the allocation of authority between the EU and its member states at the time the challenge is brought. This allocation of authority, regarding both international economic policy and defending international claims, has shifted over time. *See* Frank Hoffmeister, *Litigating Against the European Union and Its Member States—Who Responds Under the ILC's Draft Articles on International Responsibility of International Organizations?*, 21 EUR. J. INT'L L. 723, 724 (2010) (describing the international law rules for responsibility of claims between the European Union and its member states).

95. *EC—Aircraft*, *supra* note 90, ¶¶ 2–6; *U.S.—Aircraft*, *supra* note 24, ¶ 1348; Request for Consultations by the European Union, *United States—Conditional Tax Incentives for Large Civil Aircraft*, ¶ II, WTO Doc. WT/DS487/1 (Dec. 19, 2014).

96. *See EU—Energy*, *supra* note 86, at 2–5; Request for Consultations by Argentina, *European Union and Certain Member States—Certain Measures on the Importation and Marketing of Biodiesel and Measures Supporting the Biodiesel Industry*, ¶¶ 1–11, WTO Doc. WT/DS459/1 (Dec. 19, 2014).

97. Appellate Body Report, *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, ¶ 58, WTO Doc. WT/DS135/1 (adopted Mar. 12, 2001); Panel Reports, *European Communities—Measures Prohibiting the Importation and Marketing of Seal Products*, ¶ 7.7, WTO Doc. WT/DS400/1 (adopted Nov. 25, 2013); Request for Consultations by Norway, *European Communities—Measures Prohibiting the Importation and Marketing of Seal Products*, ¶¶ 1–2, WTO Doc. WT/DS401/1 (Oct. 21, 2010).

98. *See*, *e.g.*, Request for Consultations by the United States, *France—Certain Income Tax Measures Constituting Subsidies*, ¶ 1, WTO Doc. WT/DS131/1 (May 11, 1998); Request for Consultations by the United States, *Ireland—Certain Income Tax Measures Constituting Subsidies*, ¶ 1, WTO Doc. WT/DS130/1 (May 11, 1998); Request for Consultations by the United States, *Greece—Certain Income Tax Measures Constituting Subsidies*, ¶ 1, WTO Doc. WT/DS129/1 (May 11, 1998). These cases proceed against the individual member states because tax policy is within the competence of individual EU members.

As this case law makes clear, strict vicarious liability is a rule with teeth.[99] Nations and private investors frequently challenge the legality of the actions of local governments in other jurisdictions. Frequently, they win. The national government is left holding the bag, either paying compensation to investors or grappling with a settlement or the possibility of countermeasures within the WTO. Ironically, this very success in terms of creating means to adjudicate international economic law disputes has put pressure on the system. Vicarious liability has become much costlier for states now that they can and are regularly called before tribunals to defend actions that they themselves have not taken.[100] Vicarious liability makes federal nations, in particular, defense counsel for their local governments—a position in which they may not wish to be.

B. Immunity

In response to the surge in challenges to local action, national governments in the twenty-first century have increasingly changed their treaty practices to limit international responsibility for local action. The overwhelming trend is to replace vicarious liability with immunity for existing discriminatory measures.[101] As used here, immunity refers to a rule that exempts a state from liability it would otherwise face. In this sense, immunity is broader than simply a jurisdictional immunity from suit. It includes limitations on the substantive application of international legal rules to local conduct.[102]

99. *See* Gerard Conway, *Breaches of EC Law and the International Responsibility of Member States*, 13 EUR. J. INT'L L. 679, 684–85 (2002) (describing vicarious liability for member states arising from the actions of organizations belonging to the member state).

100. *See* Alan O. Sykes & Eric Posner, *An Economic Analysis of State and Individual Responsibility Under International Law* 16–19 (John M. Olin Program in Law & Econ., Working Paper No. 279, 2006), http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1042&context=law_and_economics [https://perma.cc/V2QK-B2JH] (extrapolating the adverse economic effects on member states of vicarious liability).

101. *See infra* notes 131–37 and accompanying text.

102. The use of immunity in this broad sense, rather than merely jurisdictional immunity, is significant because under international law, the notion of responsibility or liability is completely divorced from the existence of a tribunal's jurisdiction over a dispute. Many, if not most, international agreements prohibit an international tribunal from exercising jurisdiction over disputes. Jurisdiction exists only when states expressly consent to it, which they usually do not. States remain responsible to each other, however, for violations of international law. For example, the United States withdrew from the Optional Protocol to the Vienna Convention on Consular Relations (VCCR) that granted the ICJ jurisdiction over disputes. While this action removed the basis for jurisdiction, the United States remains responsible under international law for violations of the VCCR. *See* John Quigley, *The United States' Withdrawal from International Court of Justice Jurisdiction in Consular Cases: Reasons and Consequences*, 19 DUKE J. COMP. & INT'L L.

The 2004 U.S. Model BIT offers an illustrative example of a treaty provision that creates immunity for local action. Article 14, entitled "Non-Conforming Measures," provides that the treaty's rules forbidding discrimination against foreign investors and investments (nondiscrimination rules) do not apply to existing non-conforming measures, or any amendment or renewal thereto, at the local level of government or at the regional level of government if a party so declares.[103] In its BITs concluded since 2004, the United States has declared that the treaties' nondiscrimination rules do not apply to "[a]ll existing non-conforming measures of all states of the United States, the District of Columbia, and Puerto Rico."[104] Identical provisions can be found in both the investment and services chapters of recent multilateral trade agreements, such as the Central America-Dominican Republic Free Trade Agreement ("CAFTA-DR"),[105] as well as bilateral trade agreements, such as the Korea-U.S. Free Trade Agreement ("KORUS"),[106] U.S.-Australia Free Trade Agreement ("U.S.-Australia FTA"),[107] the U.S.-Colombia FTA,[108] and the U.S.-

263, 263–64 (2009) (explaining the jurisdictional implications of United States' withdrawal from the VCCR).

103. *See* 2004 U.S. Model Bilateral Investment Treaty art. 14, http://www.state.gov/documents/organization/117601.pdf [https://perma.cc/D8U5-AFGC]. Specifically, the exemption applies to the national treatment obligation, the most-favored nation obligation, the ban on performance requirements, and nondiscrimination rules with respect to senior management and boards of directors. *Id.*arts. 3–4, 8–9. This language was carried forward to the 2012 U.S. Model Bilateral Investment Treaty. *See* 2012 U.S. Model Bilateral Investment Treaty art. 14, http://www.state.gov/documents/organization/188371.pdf [https://perma.cc/RS93-B68N].

104. *See, e.g.*, Treaty Concerning the Encouragement and Reciprocal Protection of Investment, Rwanda-U.S., Annex I, art. 14, Feb. 19, 2008, T.I.A.S. No. 12-101; Treaty Concerning the Encouragement and Reciprocal Protection of Investment, Uru.-U.S., Annex I, Nov. 4, 2004, T.I.A.S. No. 06-1101 [hereinafter Uruguay-U.S. BIT]. The United States has also attempted to contract out of international responsibility for state actions in non-economic areas through so-called "federalism reservations." These reservations purport to exclude from the United States' obligations any actions for which the U.S. Constitution allocates authority to the states. *See* U.S. Ratification of United Nations Convention Against Transnational Organized Crime ¶ 1, *ratified* Nov. 3, 2005, 2346 U.N.T.S. 440 ("The United States of America reserves the right to assume obligations under the Convention in a manner consistent with its fundamental principles of federalism . . . .").

105. Free Trade Agreement, Cent. Am.-Dom. Rep.-U.S., arts. 10.13, 11.6, 12.9, Jan. 28, 2004, 43 I.L.M. 514 (2004).

106. Free Trade Agreement, S. Kor.-U.S., arts. 11.12, 12.6, 13.9, Annex I, June 30, 2007 [hereinafter KORUS FTA], http://www.wipo.int/edocs/trtdocs/en/kr-us/trt_kr_us.pdf [https://perma.cc/ZB5V-3SQK].

107. Free Trade Agreement, Austl.-U.S., arts. 10.6, 11.13, 13.8, Annex I-Australia-2, Annex I-United States-12, May 18, 2004, 43 I.L.M. 1248 (2004) [hereinafter Austl.-U.S. FTA].

Chile FTA,[109] among others. The culmination of this trend in U.S. practice is the inclusion of identical provisions in the investment and services chapters of the TPP.[110]

Significantly, in most of these agreements the United States is the only party to make a declaration with respect to regional levels of government. The exceptions are the U.S.-Australia FTA, where both parties exempted all regional measures,[111] and the TPP, where Australia, Canada, Mexico, and the United States all adopted this approach.[112] As a result, all parties to these agreements receive immunity for the acts of truly local governments. However, the United States (along with the other federal nations in the TPP) receives an additional exemption for state and provincial governments.[113]

The significance of this distinction in a federal country cannot be overstated. The scope of regulatory activity at the U.S. state level is massive. For example, professional licensing is done almost entirely at the state level in the United States.[114] Licensing schemes restrict who can provide certain services,[115] and therefore have significant implications for efforts to liberalize trade in services. The immunity provisions that are now standard in economic treaties insulate discriminatory aspects of licensing schemes from challenge in perpetuity, so long as they are not allowed to lapse. The same can be said of zoning and land-use ordinances, which are local laws. These provisions have been the source of a number of investment disputes, especially against Mexico.[116] Once again, so long as they remain in

108. Trade Promotion Agreement, Colom.-U.S., arts. 10.13, 11.6, 12.9, Annex I-US-13, Nov. 22, 2006, https://ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text [https://perma.cc/6E3D-K4MF].

109. Free Trade Agreement, Chile-U.S., arts. 10.7, 11.6, 12.9 & Annex I-US-14, June 6, 2003, 42 I.L.M. 1026 (2003).

110. *See* TPP, *supra* note 10, arts. 9.12 & 10.7.

111. Austl.-U.S. FTA, *supra* note 107, arts. 10.6, 11.13, Annex I-Australia-2, Annex I-United States 12.

112. *See* TPP, *supra* note 10, arts. 9.12, 10.7 & Annex I.

113. *See id.*

114. Aaron Edlin & Rebecca Haw, *Cartels by Another Name: Should Licensed Occupations Face Antitrust Scrutiny?*, 162 U. PA. L. REV. 1093, 1096 (2014) ("[N]early a third of American workers need a state license to perform their job legally, and this trend toward licensing is continuing. The service sector—the most likely to be covered by licensing—has grown enormously, with its share of nonfarm employment growing from roughly 40% in 1950 to over 60% in 2007.").

115. *Id.*

116. *See, e.g.*, Metalclad Corp. v. United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, ¶¶ 74–112 (Aug. 30, 2000), 5 ICSID Rep. 209 (2002) (holding that Mexico violated NAFTA chapter 11's fair and equitable treatment and expropriation

effect, discriminatory aspects of those schemes are immune to challenge under the TPP or its ilk. Indeed, in the United States the states are thought to have plenary police powers, while the federal government is one of enumerated powers. Although the reality is somewhat different—the modern federal government has successfully regulated nearly everything it has tried to regulate—the fact remains that the daily operations of businesses and lives of ordinary people remain more closely tied to state and local laws. Exempting those laws from challenge thus creates a major hole in the nondiscrimination provisions of economic treaties.

The relative size of the exempted economies provides another clue as to the scope of the exemptions immunity creates. A comparison of nominal GDP data indicates that California alone has the sixth largest economy in the world, exceeding the economies of Brazil, India, Russia, and France.[117] Indeed, California's GDP exceeds all other TPP signatories' except for Japan.[118] Texas and New York equal or exceed the GDPs of all TPP signatories except Japan, Canada, and Australia.[119] Excluding Japan and the four federal TPP nations, nineteen U.S. states have annual nominal GDPs that exceed the next largest TPP economy, Singapore.[120] The top three Canadian provinces—Ontario, Quebec, and Alberta—all have higher GDPs than half of the TPP's signatories.[121]

As a result, immunity creates asymmetric pressure on nations to liberalize their economies. Immunity exempts an enormous swath of local laws in federal countries from nondiscrimination rules. The exempted laws cover state and provincial economies that in many cases dwarf the economies of small, less developed, centralized

provisions through the actions of its subnational governments in denying permits for a landfill).

117. *Compare Gross Domestic Product (GDP) by State (Millions of Current Dollars)*, U.S. BUREAU ECON. ANALYSIS, http://www.bea.gov/iTable/drilldown.cfm?reqid=70&stepnum=11&AreaTypeKeyGdp=5&GeoFipsGdp=XX&ClassKeyGdp=NAICS&ComponentKey=200&IndustryKey=1&YearGdp=2015Q2&YearGdpBegin=-1&YearGdpEnd=-1&UnitOfMeasureKeyGdp=Levels&RankKeyGdp=1&Drill=1&nRange=5 [https://perma.cc/MYT4-GBQD] [hereinafter 2015 State GDP] (listing U.S. state GDPs for 2015), *with Gross Domestic Product 2014*, WORLD BANK [hereinafter 2014 World GDP], https://web.archive.org/web/20160624102936/http://databank.worldbank.org/data/download/GDP.pdf [https://perma.cc/SQ4F-BRWX] (listing national GDPs for 2014).

118. *Compare* 2015 State GDP, *supra* note 117, *with* 2014 World GDP, *supra* note 117.

119. *Compare* 2015 State GDP, *supra* note 117, *with* 2014 World GDP, *supra* note 117.

120. *Compare* 2015 State GDP, *supra* note 117, *with* 2014 World GDP, *supra* note 117.

121. *Compare* 2014 World GDP, *supra* note 117, *with Gross Domestic Product, Expenditure-Based, by Province and Territory*, STAT. CAN., http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/econ15-eng.htm [https://perma.cc/8DL5-UGQA] (last modified Nov. 10, 2015).

nations. Yet these same centralized countries have no similar comprehensive exemption for discriminatory regulations—such as professional licensing regimes—that they promulgate at the central level of government.[122] Indeed, the sweeping nature of the U.S. declaration of exemption for its states caused South Korea to demand the inclusion of an illustrative list of exempted state-level measures in the KORUS Agreement.[123]

To be sure, these provisions do not create all-encompassing immunity. First, the immunity applies only to the treaty's nondiscrimination rules.[124] Rules on expropriation and a minimum standard of treatment are fully applicable, for example.[125] This limitation is important, but discrimination claims are often easier for a challenger to win. Tribunals may be more comfortable finding that a government acted unlawfully when the government itself establishes the applicable standard of conduct through its behavior towards similarly situated parties. For example, in *Feldman v. Mexico*,[126] an American company challenged Mexico's inconsistent application of tax rebates for the export of gray market cigarettes.[127] The tribunal rejected Feldman's expropriation claim, while nevertheless acknowledging that Feldman had been treated "in a less than reasonable manner."[128] Yet on the same facts the tribunal ruled in favor of Feldman on his discrimination claim, since a similarly situated Mexican company received more favorable treatment than Feldman.[129]

Second, these exemptions on their face apply only to non-conforming measures in existence at the time the treaty comes into force. All new local action is fully subject to the treaty's rules. While a significant limitation on the scope of immunity, amendments or reenactments of existing measures are also immunized from

122. To be sure, each country does have an opportunity to enter its own list of exemptions. Countries often, for example, tailor their commitments in the financial services sector. They do not, however, take the across-the-board geographic approach to exemptions taken by federal countries.

123. KORUS FTA, *supra* note 106, art. 11.12 ¶¶ 1–5.

124. *See* TPP, *supra* note 10, arts. 9.12, 10.7.

125. *See, e.g.*, TPP, *supra* note 10, art. 9.12 (stating that the non-conforming provisions apply only to the National Treatment, Most-Favoured-Nation Treatment, Performance Requirements, and Senior Management and Boards of Directors provisions).

126. Feldman Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1, ¶ 1 (Dec. 16, 2002), 7 ICSID Rep. 341 (2005).

127. *Id.*

128. *Id.* ¶ 113.

129. *Id.* ¶ 188.

challenge.[130] In practice, then, savvy local governments (or national governments defending suits) can relate their new discriminatory acts to non-conforming acts existing at the treaty's entry into force. This introduces another asymmetry. Sophisticated governments can design their discriminatory actions to take advantage of the exception for renewals, amendments, and modifications. Unsophisticated governments, even in federal states, are unlikely to follow suit. Practically speaking, the result will be that large, wealthy regional governments, such as California and Ontario, are likely to benefit more from immunity than are small, poor regional governments.

Critically, immunity for local action is not limited to U.S. treaty practice. Other federal nations regularly include similar provisions in their economic treaties. Canada's 2004 Model BIT contains a provision substantially similar to article 14 of the U.S. Model BIT.[131] Similarly, India added a new exemption for truly local government action in its 2015 Model BIT.[132] The Canada-EU Comprehensive Economic and Trade Agreement ("CETA") includes a similar provision exempting all truly local measures and listed measures at the provincial and EU member state level, although neither Canada nor the EU entered blanket exemptions for the latter.[133] The 2015 Australia-China FTA exempts existing local and listed regional measures for services.[134] For investment, however, the agreement exempts all local and regional measures for Australia, and *all* existing non-conforming measures in all of China, including central government measures.[135] The Canada-China FTA contains a similar provision, although the exemption for existing non-conforming

130. 2004 U.S. Model Bilateral Investment Treaty, *supra* note 103, art. 14(b)–(c).

131. 2004 Model Canadian Bilateral Investment Treaty art. 9, http://www.italaw.com/documents/Canadian2004-FIPA-model-en.pdf [https://perma.cc/59V7-B26L] (providing that the treaty's nondiscrimination rules shall not apply to measures adopted by sub-national governments, where sub-national governments are defined to include both local and regional governments).

132. *Compare* 2015 Model Text for the Indian Bilateral Investment Treaty art. 2.4(i), http://finmin.nic.in/the_ministry/dept_eco_affairs/investment_diviion/ModelBIT_Annex.pdf [https://perma.cc/4XM6-BCUP] (providing that the "Treaty shall not apply to any measure by a local government"), *with* 2003 Indian Model Text of BIPA, http://www.italaw.com/sites/default/files/archive/ita1026.pdf [https://perma.cc/E5Q3-W8PY] (containing no such language).

133. Comprehensive Economic and Trade Agreement, Can.-EU, arts. 8.15(1)(a), 9.7(1)(a), 13.10(1)(a), 13.10(2)(a), 14.4(1)(a), Oct. 30, 2016 [hereinafter Canada-EU Trade Agreement], http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf [https://perma.cc/U39M-5KFJ].

134. Free Trade Agreement, Austl.-China, art. 8.9, Nov. 17, 2014, http://investmentpolicyhub.unctad.org/Download/TreatyFile/3454 [https://perma.cc/NJC3-K7UA].

135. *Id.* art. 9.5.

measures applies to all such measures in both countries.[136] China, in other words, demands complete exemption for all its existing non-conforming measures as the price for agreeing to federal states' immunity for sub-national actions. As one of the world's largest markets, China is in a position to extract concessions from other countries in a way that countries with smaller markets—such as Central and South American states—are not.[137]

Finally, some states follow a "positive list" approach in trade negotiations. Under the positive list approach, the default rule is that economic activity is not covered by liberalization commitments unless a state specifically opts into it.[138] In effect, a positive list approach makes immunity the default rule and state responsibility the exception. The positive list approach is often associated with the General Agreement on Trade in Services ("GATS").[139] The GATS divides obligations into "General Obligations and Disciplines" and "Specific Commitments."[140] The General Obligations and Disciplines—which include the most favored nation obligation—create state responsibility across the board.[141]

The Specific Commitments—which include the national treatment obligation not to discriminate in favor of one's own nationals—applies only to sectors into which states opt.[142] By opting in, federal states can limit their commitments in regard to local governments. For example, many of the United States' commitments

136. Agreement between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of Investments, Can.-China, art. 8.2, Sept. 9, 2014, http://investmentpolicyhub.unctad.org/Download/TreatyFile/3476 [https://perma.cc/24U4-MKYN]. Articles 5–7 do not apply to any existing non-conforming measures maintained within the territory of a contracting party. *See id.* arts. 5–7.

137. China's exemption for all existing non-conforming measures seems to be a standard provision in its trade agreements. The exemption appears in agreements, such as the China-South Korea FTA, that do not involve federal countries. *See, e.g.*, Free Trade Agreement, China-S. Kor., art. 12.3, Jun. 1, 2005, http://investmentpolicyhub.unctad.org/Download/TreatyFile/3461 [https://perma.cc/KGJ9-HY9H] ("Paragraph 1 [National Treatment] shall not apply to non-conforming measures, if any, existing at the date of entry into force of this Chapter . . . .").

138. *See, e.g.*, Kevin C. Kennedy, *A WTO Agreement on Investment: A Solution in Search of a Problem?*, 24 U. PA. J. INT'L ECON. L. 77, 111 (2003) (describing the positive list approach).

139. General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183 [hereinafter GATS].

140. *Id.* Annex 1B.

141. *Id.*

142. *Id.* art. XX, ¶ 1 ("Each Member shall set out in a schedule the specific commitments *it undertakes* . . . ." (emphasis added)).

in its GATS schedule include limitations based on state law.[143] Other agreements, such as the WTO's Agreement on Government Procurement, follow a similar approach.[144] The positive list approach does not target local action specifically. However, by limiting those local measures listed or carving out local measures from more general commitments, as is done in the United States' GATS schedule, countries can use the positive list approach to achieve the same effect as under immunity.

Taken together, these provisions suggest that large federal nations now routinely exempt their local governments from the nondiscrimination rules in investment and trade in services agreements. These provisions, however, have significant asymmetric components. For federal states, they exempt significant amounts of regulation applying to large regional economies. Moreover, powerful, relatively centralized countries like China have met this demand with even broader exceptions to its liberalization commitments. Smaller centralized states, however, receive no similar exemption. Immunity thus risks reinforcing the view that international economic law perpetuates or even exacerbates existing inequalities.

C. Direct Liability

Direct liability against local governments—in which a claimant can challenge the local government itself—is international law's third, and rarest, liability rule.[145] As practiced, direct liability has two components: (1) the local government is itself responsible for the breach of international obligations and (2) jurisdiction exists over the local government at least to the extent it exists over the national government.

Direct liability in international law generally takes the form of joint and several liability, meaning that the national government retains responsibility for the local government to the extent the former does not resolve any liability arising from its violations. Joint and several liability can work in at least two ways. In some cases, such as local responsibility under the ICSID Convention, a claim can proceed directly against a local government.[146] In these cases, the

143. *See, e.g.*, *id.* Annex on Financial Services ¶ 2 (listing state law limitations on market access and national treatment commitments in the financial services sector).

144. Agreement on Government Procurement, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 4(b), 1867 U.N.T.S. 154 [hereinafter GPA].

145. *See infra* notes 147–50 and accompanying text.

146. ICSID Convention, *supra* note 30, art. 25(1).

national government's international responsibility still exists, but it is satisfied by a judgment against the local government.[147] Moreover, jurisdiction may not exist over the national government. The local government may have consented to arbitrate an investment dispute with an investor, while the national government may not have. In other cases, such as the EU and its member states' liability under the WTO Agreements, jurisdiction exists over both the superior and subordinate governments and, in theory, both can be held responsible.[148] The key idea, however, is that under direct liability, the local government itself is subject to claims, even if the national government may evade a tribunal's jurisdiction.

Like immunity, creating direct liability requires a treaty provision. Article 25 of the ICSID Convention is perhaps the most important such provision in a multilateral agreement. The ICSID Convention established the International Centre for the Settlement of Investment Disputes ("ICSID") as an institution affiliated with the World Bank and charged ICSID with resolving investment disputes between states and foreign investors.[149] Article 25 states,

> The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (*or any constituent subdivision or agency of a Contracting State designated to the Centre by that State*) and the national of another Contracting State . . . .[150]

Thus, member states can permit their local governments (or other units) to act as respondents for cases involving their own actions.[151]

147. *Id.* art. 53(1) ("The award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in this Convention.").

148. *See* GPA, *supra* note 144, arts. XI, XIV (describing how European member states and the European communities (now the EU) can both become WTO members).

149. *See* ICSID Convention, *supra* note 30, art. 1 ("There is hereby established the International Centre for Settlement of Investment Disputes . . . .").

150. *Id.* (emphasis added).

151. The local government itself must still consent to the claim, just as the national government would have to. *Id.* art. 25(3) ("Consent by a constituent subdivision or agency of a Contracting State shall require the approval of that State unless that State notifies the Centre that no such approval is required."). In *Cable Television of Nevis Ltd. v. Federation of St. Kitts and Nevis*, ICSID Case No. ARB/95/2, Award (Jan. 13, 1997), 5 ICSID Rep. 106 (2002), an ICSID tribunal declined to find jurisdiction in a suit against the Nevis Island Administration (NIA), a subdivision of St. Kitts and Nevis. *Id.* ¶ 2.33. Although the NIA had included an ICSID arbitration clause in its agreement with the complainant, St. Kitts and Nevis had neither designated the NIA as capable of participating directly nor consented to its participation. *Id.*; *see also* LUCY REED, JAN PAULSSON & NIGEL BLACKABY, GUIDE TO ICSID ARBITRATION 33 (2d ed. 2011).

States avail themselves of this opportunity infrequently, however.[152] Only twelve states have notified ICSID that subunits may participate directly in claims.[153] Of these, eight states' notifications deal only with commercial agencies (primarily state-owned oil companies).[154]

The four states that have consented to claims directly against their subunits are Australia, Canada, Indonesia, and the United Kingdom.[155] Of these four, Australia and Canada are the most interesting.[156] Australia, a federal nation consisting of six states and two territories, consented in 1991 to direct suits against both of its territories and five out of its six states.[157] Canada, long a notable holdout from the ICSID Convention, consented to suits against three of its provinces (Alberta, British Columbia, and Ontario) shortly after it finally ratified the ICSID Convention in 2014.[158] As discussed above, suits directly against Canadian provinces became an especially important issue after the *AbitibiBowater* settlement, with the Canadian federal government stating that it may pursue a mechanism

152. Even when states create direct liability, they remain internationally responsible for their local governments' actions barring a treaty provision to the contrary. A designation under article 25 of the ICSID Convention is about jurisdiction, although the enforcement provisions of the ICSID Convention mean that the local government has substantive liability as well. *See* ICSID Convention, *supra* note 30, art. 25.

153. International Centre for Settlement of Investment Disputes, *Contracting States and Measures Taken by Them for the Purpose of the Convention*, ICSID/8-C, at 2–3 (May 2016) [hereinafter ICSID/8-C], https://icsid.worldbank.org/apps/ICSIDWEB/icsiddocs/Documents/ICSID%208-Contracting%20States%20and%20Measures%20Taken%20by%20Them%20for%20the%20Purpose%20of%20the%20Convention.pdf [https://perma.cc/2NME-27A3].

154. *Id.* Ecuador had also given consent to suit against several state-owned enterprises. Ecuador withdrew from the ICSID Convention in 2010, however. *See* Fernando Cabrera Diaz, *Ecuador Prepares for Life After ICSID, While Debate Continues over Effect of Its Exit from the Centre*, INV. TREATY NEWS (Sept. 2, 2009), https://www.iisd.org/itn/2009/08/28/ecuador-prepares-for-life-after-icsid-while-debate-continues-over-effect-of-its-exit-from-the-centre/ [https://perma.cc/G6N7-2ZNM].

155. ICSID/8-C, *supra* note 153, at 1–3.

156. Indonesia's consent relates only to a single local government, while the United Kingdom's relates to a number of its former colonies for which it continues to have international responsibility, such as Bermuda and the Cayman Islands. *See id.* at 2–3.

157. International Centre for Settlement of Investment Disputes, *Contracting States and Measures Taken by Them for the Purpose of the Convention*, ICSID/8-A, at 1 (May 2016), https://icsid.worldbank.org/apps/ICSIDWEB/icsiddocs/Documents/ICSID%208-Contracting%20States%20and%20Measures%20Taken%20by%20Them%20for%20the%20Purpose%20of%20the%20Convention.pdf [https://perma.cc/2NME-27A3]. The lone exception is the sparsely populated province of Western Australia. *See* ICSID/8-C, *supra* note 153, at 1. Interestingly, Western Australia's economy is based heavily on the extractive sector, from which many investment claims arise. *See* RESOURCE CURSE OR CURE? ON THE SUSTAINABILITY OF DEVELOPMENT IN WESTERN AUSTRALIA 1 (Martin Bruekner et al. eds., 2014).

158. ICSID/8-C, *supra* note 153, at 2.

to allow it to recoup the costs of successful claims against it based on provincial action.[159] Direct liability under the ICSID Convention provides such a mechanism, one that does not require domestic legislation.

The EU and its member states provide a more complicated example of direct liability. Of course, EU member states such as France and Germany are sovereign nations each with international legal personality in their own right.[160] Historically, the EU and its member states are often both party to international economic agreements such as the WTO Agreements.[161] When both the EU and its member states are party to an economic agreement, both can be internationally responsible for a breach of the agreement.[162] Both are usually subject to jurisdiction under an economic agreement's dispute resolution provisions as well.[163] Under the WTO's dispute settlement system, for example, complainants often name both the EU and the relevant member states in cases involving actions by the member states.[164]

More recent free trade agreements give the EU the opportunity to tell a complainant which level of government will serve as respondent.[165] CETA, the Canada-EU free trade agreement, provides that prior to initiating an investor-state arbitration, a claimant must "deliver to the European Union a notice requesting a determination of the respondent."[166] In the event that the EU does not make a determination within fifty days, the EU is the default respondent unless all of the challenged measures originate in a member state.[167]

This approach retains a greater role for the member states than the EU itself initially (and perhaps ultimately) envisioned. In 2010, the European Commission (the EU's executive body) published its views on a future common investment law policy.[168] The commission

159. Marotte & Ibbitson, *supra* note 77; *see also supra* Section I.A.

160. Jeremy Rabkin, *Is EU Policy Eroding the Sovereignty of Non-Member States?*, 1 CHI. J. INT'L L. 273, 274 (2000).

161. *Id.* at 275.

162. *See* Eva Steinberger, *The WTO Treaty as a Mixed Agreement: Problems with the EC's and the EC Member States' Membership of the WTO*, 17 EUR. J. INT'L L. 837, 838 (2006).

163. *See id.*

164. *See, e.g.*, *EC—Aircraft*, *supra* note 90, ¶¶ 1–6.

165. Canada-EU Trade Agreement, *supra* note 133, art. 8.21.

166. *Id.*

167. *Id.*

168. *Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions—*

indicated that it believed itself to have exclusive competence for foreign direct investment under the Treaty on the Functioning of the European Union.[169] The commission took "the view that the European Union will also be the sole defendant regarding any measure taken by a Member State which affects investments by third country nationals or companies falling within the scope of the agreement concerned."[170] Despite its desire to be the sole defendant, however, the Commission was less enthusiastic about the financial responsibility that usually accompanies that role, indicating that it would pursue new legislation to allocate fiscal responsibility.[171] Recognizing that EU member states also have hundreds of BITs in force that make no mention of the EU, the Commission put forward legislation to govern the relationship between the EU and member states regarding BITs.[172] In particular, even though member states remain primarily responsible, the regulation requires member states to consult with the EU in the event they are named a respondent, permit the EU's participation as necessary, and initiate proceedings at the EU's request.[173]

Other federal systems offer additional examples of the direct role subnational governments can play in international legal affairs. A number of constitutions of federal nations—including Germany,[174] Switzerland,[175] and Belgium[176]—grant subnational governments the right to enter into treaties on matters within the scope of their authority. While violations of such treaties might still give rise to

Towards a Comprehensive European International Investment Policy, at 2, COM (2010) 343 final (July 7, 2010) [hereinafter *Comprehensive European Investment Policy*].

169. *Id.* at 2.

170. *Id.* at 10.

171. *See id.*

172. *See* Commission Regulation 1219/2012, 2012 O.J. (L 351) 40.

173. *Id*. at 44.

174. GRUNDGESETZ [GG] [BASIC LAW], art. 32(3) (Ger.), *translation at* http://www.gesetze-im-internet.de/englisch_gg/index.html [https://perma.cc/TL2T-9QYK] ("Insofar as the *La¨nder* have power to legislate, they may conclude treaties with foreign states with the consent of the Federal Government.").

175. BUNDESVERFASSUNG [BV] [CONSTITUTION] Apr. 18, 1999, SR 101, art. 56, para. 1 (Switz.), *translated in* FED. COUNCIL, FEDERAL CONSTITUTION OF THE SWISS CONFEDERATION 14 (June 14, 2015), https://www.admin.ch/opc/en/classified-compilation/19995395/201506140000/101.pdf [https://perma.cc/X89V-CGQC] ("A Canton may conclude treaties with foreign states on matters that lie within the scope of its powers.").

176. 1994 CONST. art. 127 (Belg.), *translated in* BELG. HOUSE OF REPRESENTATIVES, THE BELGIAN CONSTITUTION 37 (2009), https://www.unodc.org/tldb/pdf/Belgium_const_1994.pdf [https://perma.cc/FA73-CK9U] ("The Parliaments of the Flemish and French communities . . . regulate by federate law . . . cooperation between the Communities, as well as international cooperation, including the concluding of treaties . . . .").

international responsibility for the parent-state, they also create responsibility for the subnational government concluding the treaty.[177]

Other countries, such as the United States, expressly forbid treaties between subnational governments and foreign countries.[178] As Duncan Hollis has demonstrated, however, U.S. states regularly enter into compacts with foreign nations on a wide range of issues without congressional consent or even reporting the compacts to the federal government.[179] Likewise, in Canada the federal executive branch has sole responsibility for negotiating and concluding treaties.[180] Nevertheless, Canadian provinces such as Quebec maintain their own set of "government offices" in a range of cities around the world, and Canadian provinces participated directly in the trade negotiations with the EU that led to CETA.[181]

While these practices of U.S. states and Canadian provinces do not lead to international responsibility for those entities, they do indicate a robust level of participation in international relations. Moreover, they indicate a sophisticated capacity to engage in legalized international relationships. Coupled with the increasingly federalized nature of the EU, these examples demonstrate that legal personality and legal responsibility can and do filter down to multiple layers of government in the modern world. Direct liability is the logical extension of these trends. While uncommon to date, it appears both in coalescing federal systems like the EU, as well as established ones like Canada. In both cases, direct liability is a testament to the tension between local government's freedom of action in federal systems and the international obligations that those local governments bear.

* * *

177. By signing the treaty, other states recognize that the subnational government has legal personality for purposes of the treaty, thereby giving rise to responsibility. *See* Allan Rosas, *The Status in EU Law of International Agreements Concluded by EU Member States*, 34 FORDHAM INT'L L.J. 1304, 1343–35 (2011).

178. U.S. CONST. art. I, § 10 ("No State shall enter into any Treaty, Alliance, or Confederation . . . .").

179. *See* Duncan B. Hollis, *Unpacking the Compact Clause*, 88 TEX. L. REV. 741, 749–55, 759 (2010). The U.S. Constitution permits states to enter into "compact[s,]" but not treaties, so long as Congress provides its consent. U.S. CONST. art. I, § 10.

180. Gerald P. Heckman, *International Human Rights Law Norms and Discretionary Powers: Recent Developments*, 16 CANADIAN J. ADMIN. L. & PRAC. 31, 33 n.5 (2002) ("The federal executive may exercise its prerogative powers to enter into international treaties that bind Canada on the international plane . . . .").

181. *See* Pierre Marc Johnson, Patrick Muzzi & Veronique Bastien, *The Voice of Quebec in the CETA Negotiations*, 68 INT'L J. 560, 561 (2013) (discussing Quebec's participation in the international trade negotiations that led to CETA).

The conventional wisdom that nation-states do or should answer for the actions of their local governments is under stress. The rise of robust dispute resolution and compulsory jurisdiction in international economic law has brought a wave of claims against national governments based on local action. Nations have responded by creating exemptions for local action—exemptions that frequently benefit federal states more than non-federal states. The trend in international law has thus been away from the strict vicarious liability of national governments and towards immunity from claims based on local action. At the same time, however, a nascent system of direct liability has emerged as a possible rival to immunity. Below, each of these liability rules is evaluated, both from the standpoint of states as well as from the standpoint of general welfare.

II. EVALUATING LOCAL LIABILITY RULES

In order to make sense of the trend towards immunity for local action, we first must have an idea of how well liability rules perform their underlying function. This Part evaluates three liability rules in light of the two key purposes of liability: (1) providing incentives for governments to comply with the law (litigation's regulatory function) and (2) ensuring the availability of relief to a successful claimant (litigation's compensatory function). Direct liability provides better incentives for compliance than vicarious liability, although vicarious liability may provide greater relief for claimants. However, in a vacuum, direct liability is superior to vicarious liability because better regulation of conduct will reduce the need for compensation. Immunity performs the worst of these three rules under both criteria. This result creates a puzzle: why are governments moving from a relatively effective liability rule to one that fails to achieve liability's aim? Part III turns to that question.

A. Incentivizing Compliance

From an economic point of view, efficient liability rules impose the total costs (and benefits) of an action on the actor, whether or not the actor feels the effect directly.[182] An actor that internalizes the costs and benefits of its actions in this way will act in a way that

182. *See* Allan M. Feldman & John M. Frost, *A Simple Model of Efficient Tort Liability Rules*, 18 INT'L REV. L. & ECON. 201, 212 (1998) (noting that standard efficient tort liability rules can be applied to situations with multiple defendants).

maximizes global welfare.[183] In this way, liability serves a regulatory function: it creates prospective incentives for actors to behave in the interest of the general welfare. In domestic law, this internalization principle is familiar. Its logic is clearest when examining the theory of efficient breach of contract. There, the imposition of expectation damages ensures that the plaintiff is made whole for the harm she suffers as a result of the defendant's conduct.[184] Expectation damages should therefore cause a defendant to internalize the costs of its breach of contract. Knowing that it faces efficient expectation damages, the defendant will only breach the contract if the gains it privately captures exceed the costs its actions create for potential plaintiffs.[185]

Two variables affect a liability rule's ability to incentivize government compliance: (1) whether the liability rule leads to the actual violating party paying the costs of its action and (2) the likelihood that a claimant will bring a challenge. As explained below, direct liability forces the acting government to internalize the costs of its actions. On the other hand, vicarious liability and immunity both allow the acting government to externalize its costs. Moreover, direct liability is unlikely to reduce the likelihood of investment claims, although it would marginally reduce the probability of claims challenging local action in trade law.

183. In the liability context, actors are typically expected to internalize the costs of their actions to avoid an oversupply of costly conduct. Legal rules should also, however, reward actors for benefits they create that they do not directly capture. Otherwise, actors undersupply the beneficial conduct. *See* Meyer, *supra* note 40, at 1987.

184. *See* Lewis A. Kornhauser, *An Introduction to the Economic Analysis of Contract Remedies*, 57 U. COLO. L. REV. 683, 694 (1986) ("A rule of expectation damages, for instance, completely insures the promisee against loss . . . .").

185. *Id.* at 701. In other areas of the law, different damages rules are designed to accomplish the same purpose. Punitive damages, for example, can be understood as an effort to impose efficient damages on a tortfeasor that likely does not face liability for each individual tort committed. *See generally* A. Mitchell Polinksy & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869 (1998) (discussing the deterrence rationale for the imposition of punitive damages). If the tortfeasor commits ten torts that each cause $1,000 worth of harm but only one victim brings suit, an efficient damages award compensates the victim $1,000 and also awards punitive damages of at least $9,000 to guarantee that the tortfeasor does not profit from the tortious actions. Faced with an efficient damages award, the tortfeasor must take into account the social costs of those tortious actions. *See id.* In civil procedure, aggregate litigation performs this function. Class actions allow small claims to be brought in a single suit so that a defendant cannot escape liability simply because the harms it causes individual victims is too small to justify a lawsuit. *See generally* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 677–79 (outlining economic and social justifications for class action suits).

1. Internalizing Costs

Direct liability best fulfills the regulatory purpose of litigation. It forces the actor actually breaching an obligation to internalize the costs of its actions.[186] The mechanism through which direct liability forces cost internalization differs between trade and investment law. In investment law, dispute resolution is between a private party on the one hand, and a state on the other.[187] Moreover, an award in an investment dispute results in monetary damages that impose the costs of discrimination on the local government.[188]

Trade law is more complicated. Trade disputes are between two states and do not result in financial penalties.[189] Instead, under trade law a successful claimant suspends concessions.[190] For example, a claimant might receive permission to raise tariffs on computers from the violating state above the level permitted by the relevant WTO Agreement (here, the General Agreement on Tariffs and Trade) or the goods chapter of a free trade agreement such as the TPP.[191]

These concessions, in turn, are made at the national level. California, for example, will not specifically receive concessions from Japan if and when the United States joins the TPP. In principle, this could make targeting the suspension of concessions at a local government, as direct liability would require, difficult. Japan could not raise tariffs on computers from California specifically, only on computers from the United States. Nevertheless, a trade agreement

186. *Cf.* Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine*, 78 N.Y.U. L. REV. 30, 37 (2003) (noting in the context of land use cases that the "fact that liability [under NAFTA] for violations of the agreements is imposed on the signatory state, rather than directly on its local governments or regulatory agencies, makes such internalization especially unlikely").

187. *See* ICSID Convention, *supra* note 30, art. 25 ("The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State . . . and a national of another Contracting State . . . .").

188. *See* 2012 U.S. Model Bilateral Investment Treaty, *supra* note 103, art. 24.

189. *See* Understanding on Rules and Procedures Governing the Settlement of Disputes art. 22, ¶ 1, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, 1869 U.N.T.S. 401 [hereinafter DSU] ("The WTO shall provide the common institutional framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal instruments included in the Annexes to this Agreement.").

190. *Id.*

191. *Id.* ("If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance[,] . . . any party having invoked the dispute settlement procedures may request authorization from the [Dispute Settlment Body] to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.").

could initially permit only the suspension of concessions that would predominantly affect the offending local government.

Only if those concessions were inadequate would a foreign government be permitted to suspend concessions that affect the nation more broadly. This geographic approach to trade retaliation has precedent in current trade law. Under the WTO's Dispute Settlement Understanding ("DSU"), suspended concessions should come from the same sector as that in which the violation occurred.[192] If the claimant believes limiting its suspending concessions in this fashion would be impractical or ineffective, it may look first to other sectors under the same agreement, and then to retaliation under other agreements (e.g., services or intellectual property), a concept known as cross-retaliation.[193]

Faced with the costs of its action through these mechanisms, a local government should only take the action if the benefits it gets from breaching exceed the costs it imposes on others. Moreover, knowing in advance that they can be called to account for their actions, local governments will be more likely to educate themselves both about their legal responsibilities and about the costs of their actions on others outside their jurisdictions.[194] Under vicarious liability, local governments are often rationally ignorant of international law. Lacking direct accountability under international law, many local governments have little reason to invest resources in learning what international law requires of them.[195] Indeed, national governments sometimes step in to educate local governments about their responsibilities in the hopes of reducing violations.[196] For example, following the *Avena* decision, the U.S. State Department undertook a campaign to educate local police forces about the Vienna

192. *Id.* at art. 22.3 (setting forth the rules on what concessions may be suspended).

193. *Id.*

194. International law increasingly requires nations to inform themselves of the cross-border impacts of their actions. *See* Daniel Kazhdan, Note, *Precautionary Pulp:* Pulp Mills *and the Evolving Dispute Between International Tribunals over the Reach of the Precautionary Principle*, 38 ECOLOGY L.Q. 527, 547 (2011). The ICJ declared in the *Pulp Mills* case that a customary international law norm exists requiring countries to undertake an environmental impact assessment ("EIA") when economic activity might have cross-border effects. *Id.* The effectiveness of this emerging substantive norm, however, is limited by the fact that the international law of state responsibility provides that only the nation is liable for a breach of this norm. Local governments are thus not themselves directly incentivized by international law to comply with the substantive rules on performing cross-border EIAs.

195. *See* Johanna Kalb, *Dynamic Federalism in Human Rights Treaty Implementation*, 84 TUL. L. REV. 1025, 1036–37 (2010).

196. *Id.* at 1039.

Convention on Consular Relations' ("VCCR") requirements.[197] Direct liability would solve this problem by providing local governments with an incentive to proactively review their laws and regulations to ensure their compatibility with international law.

Vicarious liability is second best from an internalization standpoint. Under vicarious liability, local governments externalize the costs of their actions onto national governments. Whether liability deters breaches thus depends on whether national liability incentivizes national governments to prospectively regulate unlawful local programs. For example, when the United States lost a WTO dispute about the legality of the U.S. State of Washington's subsidies for Boeing, the State of Washington—the actual breaching party—received no direct penalty.[198] Instead, the federal government risked retaliation by the EU if it did not get Washington to come into compliance or if it did not otherwise reach agreement with the EU.[199] Consequently, U.S. states need not consider the costs of their actions on others because the vicarious liability imposes the loss on a different government, the United States.

In principle, several existing methods impose liability on the local actor within a vicarious liability scheme. The first method is that the national governments may be able to impose the loss or liability on the subnational government. In the United States, however, no rule allows the federal government to recoup financial liability it incurs as a result of state or local government action, nor can it pass along the costs of defending the claim to the local government.[200] The same is true in Canada.[201] However, after Canada settled the *AbitibiBowater* NAFTA case for $130 million, in which Newfoundland and Labrador expropriated an American company's water and timber rights, Canadian Prime Minister Stephen Harper stated,

197. *Id.* ("[T]he executive branch has generally adopted a deferential posture towards the states' VCCR enforcement efforts, limiting itself to educating state and local officials as to what the VCCR entails and to encouraging the states to comply with its mandates . . . .").

198. *See U.S.—Aircraft*, *supra* note 24, ¶ 1352.

199. *See id.* ¶¶ 4–6 (outlining the EU's arguments regarding the existence and effect of U.S. federal and state-level subsidies).

200. *See* David I. Spector, Note, *Trade Treaty Threats and Sub-National Sovereignty: Multilateral Trade Treaties and Their Negligible Impact on State Laws*, 27 HASTINGS INT'L & COMP. L. REV. 367, 385–86, 395–96 (2004).

201. Lawrence L. Herman, *Federalism and International Investment Disputes*, INV. TREATY NEWS (July 12, 2011), http://www.iisd.org/itn/2011/07/12/federalism-and-international-investment-disputes/ [https://perma.cc/5V6A-VSSC].

> [While] I do not intend to get back the monies expended in this case from the government of Newfoundland and Labrador[,] . . . I have indicated that in future, should provincial actions cause significant legal obligations for the government of Canada, the government of Canada will create a mechanism so that it can reclaim monies lost through international trade processes.[202]

The European Commission's proposal regarding the administration of EU investment law envisions a similar mechanism.[203] Although the EU would have exclusive competence for investment law and investment disputes, member states could be responsible for defense costs and any resulting liability if the claim arose from their actions.[204]

Second, in some situations, a claimant may be able to impose some of the loss directly on the subnational government even if it cannot sue the subnational government directly. For example, under WTO rules on retaliation, a party that is authorized to withdraw concessions in response to an ongoing violation has a great deal of discretion as to which concessions it withdraws.[205] Consequently, a savvy foreign government can craft a package of concessions to withdraw that will principally hurt the relevant local government. Returning to the Boeing example, the EU won a judgment declaring that a package of subsidies for Boeing, including state and local subsidies in Washington, Kansas, and Illinois, violated WTO rules.[206] In 2012, the EU requested authorization to suspend concessions worth approximately $12 billion annually in response to an alleged failure by the United States to remove the unlawful subsidies.[207] Although the EU has not yet named the goods on which it might suspend concessions, it might consider withdrawing concessions on, for example, computer or technology products in order to hurt companies such as Microsoft and Amazon that are located in Washington. Such sanctions might be more effective at inducing local government compliance than would countermeasures targeting the United States generally.

Third, national governments can engage with local governments to induce them to change their unlawful measures, even if they cannot

202. Marotte & Ibbitson, *supra* note 77.

203. *See Comprehensive European Investment Policy*, *supra* note 168, at 10.

204. *Id.*

205. *See* DSU, *supra* note 189, art. 22.3.

206. *U.S.—Aircraft*, *supra* note 24, ¶¶ 479, 1350.

207. Appellate Body Report, *United States—Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, at 1, WTO Doc. WT/DS353/17 (Oct. 2, 2012).

compel them to do so directly. In *Canada-Renewable Energy*,[208] the WTO DSB found that Ontario's local content requirements in its renewable energy feed-in tariff unlawfully discriminated against foreign products.[209] The Canadian government prevailed upon the Ontario government to remove most of its local preferences, but Canada was forced to confess to the WTO that it had failed to get Ontario to remove all of them.[210] In other cases, governments may be able to more directly influence or even preempt local action.

Finally, vicarious liability can also incentivize governments to nationalize actions with international effects in order to avoid liability. The federal government might, for example, preempt the local law, as the United States has the authority to do when U.S. state laws conflict with WTO rules.[211] Preemption has significant limitations, however. In federal systems, national governments may lack the ability to direct subnational governments to change their behavior. For example, if the federal government is one of limited and enumerated powers, as the United States government is, the federal government may not be able to direct subordinate governments to act on matters outside of those enumerated areas. The "federalism" reservations that have been attached to the UN Convention Against Corruption or the heretofore unsuccessful efforts to ratify the UN Disabilities Convention is predicated on the view that the U.S. federal government's supervisory powers are indeed limited.[212]

208. Appellate Body Report, *Canada—Certain Measures Affecting the Renewable Energy Generation Sector*, ¶ 6, WTO Doc. WT/DS412/AB/R (adopted May 6, 2013); Appellate Body Report, *Canada—Measures Relating to the Feed-in Tariff Program*, ¶ 6, WTO Doc. WT/DS4426/AB/R (adopted May 6, 2013).

209. *Canada—Measures Relating to the Feed-in Tariff Program*, *supra* note 208, ¶ 6.

210. *See* Communication from Canada, *Canada—Certain Measures Affecting the Renewable Energy Generation Sector*, ¶ 6, WTO Doc. WT/DS412/19 (June 6, 2014) (informing the DSB that, despite termination of proposed amendments to the FIT program, Ontario still complied with the recommendations and rulings of the DSB); Status Report by Canada, *Canada—Certain Measures Affecting the Renewable Energy Generation Sector*, at 1, WTO Doc. WT/DS412/17 (Feb. 14, 2014) (reporting that Ontario tabled legislation to remove domestic content requirements from the feed-in tariff program).

211. *See* Uruguay Round Agreements Act, 19 U.S.C. § 3512(c)(2) (2012); *see also* Been & Beauvais, *supra* note 186, at 135–36 (noting that the federal government could preempt local land use regulations that violate NAFTA).

212. *See* S. REP. NO. 109-4, § 2(1), at 6–7 (2005) ("The United States of America reserves the right to assume obligations under the Convention in a manner consistent with its fundamental principles of federalism . . . ."); *see also* Thomas D. Grant, *The U.N. Convention on the Rights of Persons with Disabilities (CRPD): Some Observations on U.S. Participation*, 25 IND. INT'L & COMP. L. REV. 171, 232 (2015).

Even when nations have the legal power to regulate their states or provinces, the political costs in countries with a strong tradition of federalism may prohibit such regulation. Several examples illustrate the point. In the United States, federal preemption of state laws that are concededly unlawful under international law is highly controversial. Following the *Avena* judgment, legislation requiring state-level compliance with the Vienna Convention on Consular Relations could not get through Congress.[213] Similarly, the federal government has not taken action to preempt state subsidies for Boeing even though such subsidies have created international responsibility under the WTO agreements.[214] Indeed, foreign nations insist that Quebec participate directly in negotiations, knowing that Canada itself often cannot compel Quebec's compliance.[215] In the negotiations between the EU and Canada on the CETA, for example, Quebec participated through its own delegation that it maintains in Brussels and the appointment of its own chief negotiator.[216] More prosaically, national governments are not staffed to review all legislation or administrative regulations coming from local governments. National governments, even in developed countries, may therefore have limited capacity to prospectively avoid liability through preemption.

These possible methods of influence mean that vicarious liability does create some incentives to avoid local violations of international law. These incentives will vary by country. In countries in which national governments have more influence over local policy, these techniques may be relatively more effective. In systems with strong local government, on the other hand, the incentives for local governments to worry about violating international law will be fairly minor.

Immunity completely fails to incentivize governments to consider the social costs of their actions. If neither the local nor the national government faces potential liability for an action, then the self-interested reasons to avoid violations of international law are minimal. National governments have reputational considerations that may push them to comply with international law for self-interested

213. Steve Charnovitz, Editorial Comment, *Correcting America's Continuing Failure to Comply with the* Avena *Judgment*, 106 AM. J. INT'L L. 572, 576–77 (2012).

214. *Impact of Illegal European Subsidies on the U.S. Aerospace Industry*, BOEING, http://www.boeing.com/company/key-orgs/government-operations/wto.page [https://perma.cc/658E-NSDB].

215. Johnson et al., *supra* note 181, at 561, 566.

216. *Id.*

reasons, even in the absence of liability.[217] Local governments, however, likely do not have reputations for compliance with international law that matter to them, making the complete absence of liability even more troubling from a compliance perspective.[218]

In the immunity context, therefore, the relevant actor does not even have the weak incentives it has in the vicarious liability context to consider the social costs of its actions. To give but one example, the TPP's immunity rule does not provide either the United States or California, which on its own would be the sixth largest national economy in the world,[219] with an incentive to ensure that their existing environmental regulations are nondiscriminatory.[220] Instead of providing an incentive to take precaution, immunity rules operate, in a sense, as a subsidy for government action. Rather than having to pay liability out of the public fisc, the loss borne by government actors is absorbed directly by the victims. In effect, immunity rules create a concentrated loss for the victim rather than a distributed loss among the polity.

2. The Likelihood of Claims

While direct liability may cause a violator to internalize the consequences of its action, the respondent must first be held in violation. Such a holding, in turn, requires that claimants be willing to bring claims. Of the three liability rules, immunity of course creates the lowest probability of claims—zero. Direct liability and vicarious liability create similar claims in investment law, although vicarious liability will produce more claims in trade law. This difference, as explained below, results from the different structure of dispute resolution in trade and investment.

Direct liability is intuitively appealing because it places the burden most squarely on the party actually in breach. However, international disputes are expensive to litigate. A claim must be sufficiently valuable before it becomes worthwhile for a challenger to

217. *See* ANDREW T. GUZMAN, HOW INTERNATIONAL LAW WORKS: A RATIONAL CHOICE THEORY 33–42, 77–111 (2008) (setting forth a reputational theory of compliance with international law).

218. Governments might comply with international law for reasons other than self-interest, of course. *See* ABRAM CHAYES & ANTONIA HANDLER CHAYES, THE NEW SOVEREIGNTY: COMPLIANCE WITH INTERNATIONAL REGULATORY AGREEMENTS 3–9 (1995) (espousing a theory under which states have a predisposition to comply with international law).

219. *Compare* 2015 State GDP, *supra* note 117, with 2014 World GDP, *supra* note 117, at 1.

220. *See* TPP, *supra* note 10, arts. 9.12, 10.7.

bring a claim. Any individual local government might face such a low threat of litigation that direct liability would provide it relatively little incentive to improve its efforts to comply with international norms. The U.S. State of Maine or the Australian province of Western Australia, both of which contain only small percentages of their nation's populations, might not present significant enough targets to justify a claim. They therefore might escape review under a direct liability scheme. With this in mind, the case for direct liability is less obvious.

Consider, for example, renewable energy subsidies that require the energy producer to purchase its equipment locally. International tribunals have held these local content requirements to violate trade and investment rules.[221] Moreover, India has identified a number of these programs in U.S. cities such as Austin, Texas, and Los Angeles, California.[222] But the effect of Austin's discrimination is seemingly not large enough to justify the political, diplomatic, and financial costs of bring a WTO claim against the United States. India has therefore complained about the local programs in the United States,[223] but to date has foregone a formal complaint within the WTO's dispute settlement system.

By contrast, vicarious liability may make challenging local programs more viable. Vicarious liability acts as a kind of class-action vehicle in which a series of local claims can be brought as a single claim against the national government. Claimants can thus take advantage of economies of scale under vicarious liability that are lost under direct liability. Because of this, vicarious liability might lead to more litigation than direct liability, even if the litigation that does occur is less effective at inducing change than hypothetical litigation against a local government. In *United States-Gambling*, for example, Antigua and Barbuda challenged a set of U.S. federal measures that restricted the provision of remote (i.e., online) cross-border gambling services.[224] Along with the federal measures, Antigua and Barbuda challenged state measures in all fifty of the U.S. states.[225] Antigua

221. *See Canada—Renewable Energy*, *supra* note 23, ¶ 5.85 (holding that Ontario's feed-in tariff violates the national treatment obligation under the Agreement on Trade-Related Investment Measures).

222. Questions by India to the United States, *Certain Local Content Requirements in Some of the Renewable Energy Sector Programs*, ¶¶ 2–6, WTO Doc. G/TRIMS/W/117 (Apr. 17, 2013).

223. *Id.*

224. Request for Consultations by Antigua and Barbuda, *supra* note 88, Annexes I & II.

225. *Id.*

would likely not have challenged all these state programs had it been forced to do so individually. Similarly, a claimant may challenge a local measure to establish the unlawfulness of a particular kind of regulatory action practiced throughout a country. Under vicarious liability, establishing a precedent based on a local program can have liberalizing effects throughout the country by forcing the country to review similar programs.

In investment law, these concerns about scale are not likely to depress the number of claims significantly. Investment agreements such as chapter 9 of the TPP or chapter 11 of NAFTA allow private investors to bring claims.[226] The viability of investment claims is subject to a different calculus than trade claims, which must be brought by a government. A private investor should be willing to bring any claim that has positive economic value. Investors have thus challenged even relatively small-scale programs, such as the regulation of funeral homes in Mississippi[227] or efforts to build a new, publicly owned bridge between Detroit, Michigan, and Windsor, Ontario.[228]

On the other hand, these considerations about economies of scale would likely result in fewer trade claims under direct liability. In trade cases, remedies do not take the form of monetary damages that can fund litigation efforts.[229] Whereas a private citizen could monetize the possibility of a cash award to pay the costs of litigation (such as through a contingency fee arrangement), governments cannot. Governments may therefore face capacity constraints that prevent them from even bringing cases with positive economic value, forcing them to focus on claims with higher expected payoffs.[230] Moreover, a

226. TPP, *supra* note 10, art. 9.10 ("This Article does not preclude enforcement of any commitment, undertaking or requirement between private parties."); NAFTA, *supra* note 59, arts. 1116–17 (allowing a private investor to prosecute a case against NAFTA).

227. *See* Loewen Grp., Inc. v. United States, ICSID Case No. ARB(AF)/98/3, Award, ¶ 3 (June 26, 2003), 7 ICSID Rep. 442 (2005).

228. *See* Detroit Int'l Bridge Co. v. Canada, PCA Case No. 2012-25, Award on Jurisdiction, ¶ 14 (Perm. Ct. Arb. 2012), http://www.italaw.com/sites/default/files/case-documents/italaw4255.pdf [https://perma.cc/V8LH-NZUX].

229. *See* Robert Hudec, *The Adequacy of WTO Dispute Settlement Remedies: A Developing Country Perspective*, *in* DEVELOPMENT, TRADE, AND THE WTO: A HANDBOOK 81, 84 (Bernard Hoekman ed., 2002) (proposing payment of monetary damages to developing countries as a means of improving trade case remedies).

230. *See* Andrew T. Guzman & Beth A. Simmons, *Power Plays and Capacity Constraints: The Selection of Defendants in World Trade Organization Disputes*, 34 J. LEGAL STUD. 557, 591 (2005) (finding that capacity constraints cause states to choose larger defendants due to the greater beneficial consequences of liberalizing larger markets).

state may decline to bring a good trade case for diplomatic or political reasons that would not affect a private investor's decision.

Even within trade law, though, one would expect these effects to be moderated by the trade repercussions of local violations. On the one hand, measures in particularly large subnational governments that create large trade effects seem just as likely to be targeted under direct liability as under vicarious liability. Regional governments like California, New York, or Ontario would therefore face a similar risk of claims under either direct or vicarious liability. At the other end of the spectrum, under either regime many small, local violations will go unchallenged, as they do under the current vicarious liability regime. Under any liability rule, small programs that create only small discriminatory effects may not be worth challenging. These measures are thus unaffected by the choice of a liability rule. Again, India and China have both identified a series of state- and city-level renewable energy support measures in the United States that they believe violate WTO rules.[231] Yet neither has formally pushed for the establishment of a WTO panel to consider these measures, possibly because none of the measures are sufficiently restrictive, given their small geographic scope.

B. The Availability of Relief

Liability rules can also be assessed based on the extent to which they provide relief to a successful claimant. Dispute resolution is, after all, not only about providing prospective incentives for respondents to regulate their conduct. It also should provide compensation to victims of breaches that have occurred.

Here, vicarious liability has an edge over direct liability, while immunity once again performs the worst among all three rules. Immunity, of course, fails to offer any relief to a claimant. Thus, a claimant's ability to get relief depends on what level of government behaved in a discriminatory fashion. If a local government is the culprit, relief also depends on whether the discriminatory act in question can be related to a discriminatory act that existed at the time the economic treaty came into force. If those two conditions are met, immunity affords claimants no relief.

Vicarious liability may provide better relief than direct liability in at least two ways. First, in investment arbitrations in which the remedies are monetary awards, national governments may have deeper pockets than local governments. Indeed, local governments

231. *See* Meyer, *supra* note 40, at 1940.

may be judgment proof in the same way that individual defendants in civil suits may be.[232] Moreover, enforcing an award against a national government will be easier, all else equal, because enforcing an arbitration award that a government (or its courts) refuses to honor requires attaching assets in a foreign country pursuant to a treaty regime such as the New York Convention.[233] For example, successful foreign investors have sought to attach Argentinian government assets abroad to satisfy their awards.[234] Local governments, though, are less likely to have assets located outside of their own borders. As a result, enforcement of monetary awards against a local government may be more difficult if courts in the local government's jurisdiction refuse enforcement. Direct liability may increase the likelihood that a defendant can avoid paying an award, leaving the successful claimant with only a hollow victory.

The fact that direct liability tends to be joint and several under international law does somewhat reduce the risk of hollow victories. National governments remain responsible for local governments. Thus, if a local government cannot satisfy an award against it, the national government remains on the hook. In at least some circumstances, however, jurisdiction may not exist over the national government. For example, in *Cable Television*,[235] the Nevis Island Administration—a local subdivision of the St. Kitts national government—agreed to arbitrate disputes with Cable Television.[236] An investment tribunal found, however, that the St. Kitts national government had not consented to claims against the local

232. In the domestic context, part of the rationale for vicarious liability is that a hierarchically superior entity may have deeper pockets than the perpetrator of an offense. A company, for example, will typically have more money than an employee, who might be judgment proof. In constitutional tort litigation in the United States, suits formally proceed against individual officers, but in fact governments routinely indemnify such officers, again shifting liability to the government. *See* Joanna C. Schwartz, *Police Indemnification*, 89 N.Y.U. L. REV. 885, 890 (2014) (finding that officers are "virtually always indemnified" in police misconduct cases); Gregory C. Sisk, *Official Wrongdoing and the Civil Liability of the Federal Government and Officers*, 8 U. ST. THOMAS L.J. 296, 319 (2011) (noting that individual government employees are likely to fear substantial personal responsibility despite the fact that most are indemnified).

233. *See* Convention on the Recognition and Enforcement of Foreign Arbitral Awards art. 3, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 (stating that each party to the convention "shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon") .

234. *See* Republic of Argentina v. NML Capital Ltd., 134 S. Ct. 2250, 2252 (2014) (holding that the Foreign Sovereign Immunities Act does not protect a debtor nation from discovery requests during a proceeding to enforce an arbitration award).

235. Cable Television of Nevis Ltd. v. Fed'n of St. Kitts & Nevis, ICSID Case No. ARB/95/2, Award (Jan. 13, 1997), 5 ICSID Rep. 106 (2002).

236. *Id.* ¶¶ 2.21–.22.

government; in other words, St. Kitts had not consented to direct liability for its localities.[237] Moreover, St. Kitts itself had not agreed to arbitrate disputes with Cable Television.[238] Thus, while St. Kitts would have been responsible for the local government's violation, jurisdiction prevented effective liability.[239] In similar situations, the risk of an unenforceable award is real.

Second, in trade disputes, foreign governments may have an easier time retaliating in a way that hurts national governments.[240] Under WTO law, if a government does not bring itself into compliance with a recommendation of the DSB the successful complainant can get permission to suspend concessions.[241] It can, for example, raise tariffs above the level permitted by its WTO commitments. As discussed above, governments have wide discretion in choosing which concessions to suspend.[242] They will choose which concessions to withdraw with an eye toward increasing the political pressure on the violating government to bring itself into compliance. For example, in 2002, President Bush imposed safeguards on steel imports that were designed to curry favor with voters in Midwestern states that feared the loss of manufacturing jobs.[243] The WTO DSB found the safeguards unlawful.[244] After President Bush indicated he intended to leave the safeguards in place notwithstanding the DSB's

237. *Id.*

238. *Id.*

239. *Id.*

240. Remedies in trade are principally regulatory, rather than compensatory, while remedies in investment are both. The Dispute Settlement Understanding makes clear that the purpose of suspending concessions is to induce the breaching party to bring itself into compliance. DSU, *supra* note 189, art. 22. Moreover, suspending concessions is harmful to both countries, as it limits the availability of cheap products or services in the claimant's own country, making it an odd form of compensation.

241. *Id.* ("If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance[,] . . . any party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.").

242. Decision by the Arbitrators, *European Communities—Measures Concerning Meat and Meat Products (Hormones)—Recourse to Arbitration by the European Union Under Article 22.6 of the DSU*, ¶ 81, WTO Doc. WT/DS26/ARB (July 12, 1999) ("[T]he U.S. is free to pick products from the proposed [suspension] list as long as the total trade value is lower than or equivalent to the amount of nullification and impairment we have found . . . .").

243. *See* David E. Sanger, *Bush Puts Tariffs of as Much as 30% on Steel Imports*, N.Y. TIMES (Mar. 6, 2002), http://www.nytimes.com/2002/03/06/us/bush-puts-tariffs-of-as-much-as-30-on-steel-imports.html?pagewanted=all.

244. Mark Tran, *Bush Lifts Steel Tariffs to Avert Trade War*, GUARDIAN (Dec. 4, 2003), https://www.theguardian.com/world/2003/dec/04/usa.wto1 [https://perma.cc/T4EL-BM3P].

judgment, the EU threatened to impose tariffs on Florida oranges and Michigan automobiles, among other products.[245] The EU chose these specific products to hurt the Bush administration and the Republican Party in key electoral states.[246] Its calculus was successful, as President Bush lifted the safeguards shortly thereafter.[247]

Such mechanisms might not work as well against local governments, however. Local jurisdictions may have smaller or less diversified economies. In principle, the effect of a smaller, less diversified economy can cut either way. In some instances, the result could be that local governments are more vulnerable than they might otherwise be. If the complaining foreign government is a primary market for the local jurisdiction's goods, for example, the local government may come into compliance faster than a national government that is diversified. A locality with an economy heavily dependent on agriculture, for example, might quickly remove a discriminatory measure if a major market like the EU raised tariffs on one of its staple products. The consequences of the foreign government's countermeasures are magnified, in effect, by the small or undiversified nature of the local economy.

On the other hand, in many other cases the foreign government may have no economic leverage over the local government. The discriminating local jurisdiction might not export products (or services) to the complaining foreign country, for example. Or even if it does, the discriminatory measure might protect one of the major producers in the local jurisdiction. Finally, in some instances the complaining nation might need the violator's exports more than the violator needs the particular market. For example, oil-exporting nations have never been targeted in the WTO even though many nations claim that countries like Saudi Arabia violate WTO rules in restricting the production and export of oil.[248] In any of these situations, identifying countermeasures that pressure the local government into changing its behavior may be more difficult than identifying such countermeasures for the national government. For

245. *Id.*

246. William Neikirk, *EU Targets U.S. Goods as Retort to Steel Tariffs*, CHI. TRIB. (Apr. 5, 2002) ("To make a point, Europe has decided to fight politics with politics."), http://articles.chicagotribune.com/2002-04-05/business/0204050259_1_trade-promotion-authority-foreign-steel-products-trade-war [https://perma.cc/2DBM-STKU].

247. Tran, *supra* note 244.

248. For example, Representative Peter DeFazio introduced a resolution in the U.S. House of Representatives urging President George W. Bush to "file a complaint in the World Trade Organization against oil-producing nations for violating their obligations under the rules of that organization." H.R. Con. Res. 276, 106th Cong. (2000).

both of these reasons, the availability of relief—with its associated incentives to change one's behavior in response to an adverse judgment—suggests that vicarious liability may be the superior rule.

* * *

Immunity, as this discussion makes clear, does a poor job of fulfilling the goals of a liability rule. It provides governments with no incentive to prospectively regulate their conduct and no relief for aggrieved claimants. Vicarious liability versus direct liability is a closer call, but ultimately direct liability is the better rule. As currently conceived, direct liability does a better job of providing incentives for local governments to consider the costs of their actions on others. It also provides an equal incentive to bring claims in investment law, although it may lead to fewer claims in trade law. Strict vicarious liability, however, likely provides more effective relief to the successful claimant and may do as well at encouraging monitoring. As explained in Part V, a system of joint and several liability could capture the benefits of both direct and strict vicarious liability.

III. VICARIOUS LIABILITY LEADS TO IMMUNITY

Before turning to what a more robust direct liability regime might look like, however, this Article turns to unlocking a puzzle. If direct liability is the best liability rule and immunity the worst, why are states moving towards immunity? Vicarious liability is a long-standing rule embraced by all states as recently as the founding of the WTO and NAFTA twenty years ago. Moreover, many states are centralized, making it unclear why they would agree to immunity rules that largely benefit federal states.

This Part shows that national governments increasingly eliminate vicarious liability for local government action because (1) of disparities in bargaining power among federal and non-federal nations and (2) the structure of remedies in international economic law—especially investment law—which pushes national governments to emphasize their role as potential respondents over their role as potential claimants. Section A discusses the general conditions under which states will negotiate for immunity rather than vicarious liability, the default rule. Sections B and C analyze how states will negotiate in two bargaining situations: negotiations between states that are both either centralized or decentralized, and negotiations between a centralized state and a decentralized state. Section D concludes that decentralized states will drive the empirical trend towards immunity

due to the economic importance of federal countries in the world today.

A. *Immunity and Vicarious Liability from a State's Point of View*

Consider the following illustration: Under the international law of state responsibility, vicarious liability is only a default rule.[249] Under the default rule, liability for local action is reciprocal. State A receives some positive benefits from being able to challenge local action in State B. The ability of State B to challenge State A's local action is, however, costly to State A. We can thus think of a state's utility from the status quo under vicarious liability as

$$U_i^{SL} = X_i - Y_i$$

where X_i equals the ith state's utility from being able to target local action in another state, and Y_i equals the costs created by responsibility for one's own local governments. X, in other words, is the expected value one gets as a potential claimant under vicarious liability. Y equals the expected costs one faces as a respondent under vicarious liability.

Y can also be thought of, in part, as a function of the centralization of a country. Decentralized countries will have high values of Y, while centralized countries will have lower values of Y. To see why this is so, consider that a state subject to international economic law will take precautions to avoid liability up until the point at which the precautions are costlier than the benefits they create. These precautions—essentially forcing local governments to bring their measures into conformity with international rules—create both costs and benefits for the national government. This Article shall refer to these precautions as "liberalizing" because they typically involve removing barriers to trade and investment. Liberalization is beneficial to a national government for two reasons. First, it reduces its exposure to foreign claims. Second, it benefits domestic consumers by giving them access to the best available prices on international markets.

At the same time, liberalization creates two sets of costs. First, domestic producers prefer protectionism to liberalization.[250] They will

249. *See* Draft Articles on State Responsibility, *supra* note 34, at 42 ("In applying this test, of course, each case will have to be dealt with on the basis of its own facts and circumstances.").

250. *See* Carl J. Green, *The New Protectionism*, 3 NW. J. INT'L L. & BUS. 1, 11–13 (1981) (describing the United States' efforts to achieve protectionist goals through enforcement of unfair trade laws).

therefore put pressure on their governments to refuse to liberalize.[251] Second, overriding local governments can be costly in both legal and political terms. For example, in a federal state such as the United States, the federal government might pass a law automatically preempting any local law that an international tribunal found inconsistent with international law. Or a national government might preempt state laws in areas that are particularly likely to raise discrimination concerns, such as environmental and health regulations. Such actions, however, would surely be challenged in the courts as inconsistent with the federal constitutional structure of the United States.[252] Moreover, even if such actions are constitutional, they are politically tenuous in a country that prides itself on strong local government.[253] In more centralized states, such as China, this second set of costs will be lower. Such countries have fewer legal and political barriers to national preemption of local action. Indeed, in some centralized countries, especially small ones, all meaningful power may be centralized in the national government.

Under vicarious liability, states will liberalize up until the point at which the marginal costs of liberalization exceed the marginal benefits in terms of reduced liability and political benefits from consumers. In principle, states perform the same calculus at the national level, liberalizing up until the point that the costs of liberalization exceed its benefits. The difference, however, is that liberalizing at the local level may be costlier in some states than liberalizing at the national level. States with high costs of liberalizing at the local level (decentralized states) will liberalize more at the national than the local level. States with low costs to eliminating non-conforming local programs (centralized states) may not have to distinguish their liberalization efforts based on the level of government. Thus, high costs to liberalizing leads to a high Y, while, all else equal, low costs to liberalizing local programs will produce a lower Y.

Now consider immunity. Under immunity, states cannot bring claims. Thus, their expected claims and expected liability are both

251. *See id.*

252. *See, e.g.*, Bond v. United States, 134 S. Ct. 2077, 2088–90 (2014) (upholding a federalism challenge to a federal statute implementing the Chemical Weapons Convention).

253. JOHN SAMPLES & EMILY EKINS, CATO INST., PUBLIC ATTITUDES TOWARD FEDERALISM: THE PUBLIC'S PREFERENCE FOR RENEWED FEDERALISM 1 (2014), https://object.cato.org/sites/cato.org/files/pubs/pdf/pa759_web.pdf [https://perma.cc/96BC-98PA] (concluding from surveys that "Americans support a more decentralized federalism than in the past both on particular issues and as a general matter of institutional confidence").

zero. However, because immunity is not the default rule, states must agree to change from vicarious liability to immunity. A state's utility under immunity thus depends on the costs and benefits of agreeing on immunity. A state will only agree to change the liability rule to immunity if the marginal benefits of immunity are greater than or equal to the marginal costs ($U_i^{Immunity} \geq U_i^{SL}$). Let C equal the value of a concession offered to shift from vicarious liability to immunity. If accepted, a state's utility from immunity is

$$U_i^{Immunity} = C_i$$

where C_i is positive if a state accepts a concession to agree to immunity and negative if it must offer a concession. Therefore, state i will only offer or accept a concession in exchange for changing the rule if

$$C_i \geq X_i - Y_i .$$

Moreover, this equation must be true for all states that must consent to the change in liability. In other words, there must be some concession that at least one state can make that makes it better off than it would be under vicarious liability (because the concession is less costly than its net expected liability under vicarious liability) and that compensates those states that have positive expected utility under vicarious liability.

A simple numeric example illustrates the point. Imagine that the United States obtains utility of 5 (X_{US}) from being able to challenge discriminatory local acts in South Korea but faces expected liability of 10 (Y_{US}) from South Korea or South Korean investors challenging local acts in the United States. Plugging these values into the equation above, the United States would be willing to make a concession worth up to 5 ($C_{US} \geq -5$ because the United States is making the concession) in order to induce South Korea to agree to immunity.

Imagine that for its part, South Korea obtains 4 (X_{SK}) from being able to challenge local acts in the United States and suffers only 1 (Y_{SK}) in terms of expected claims because it is a relatively centralized state. Under strict vicarious liability, South Korea's utility is therefore equal to 3. South Korea, however, would be willing to agree to immunity so long as the United States makes a concession worth at least 3 ($C_{SK} \geq 4 - 1$). As the United States would pay up to 5 to avoid vicarious liability, the two states can agree to change the default rule. By contrast, if $X_{SK} = 7$, no agreement is possible. Then, $C_{SK} \geq 7 - 1$. Since the United States cannot justify compensating South Korea more than 5, vicarious liability will remain in place.

B. Bargaining Among Similar States and the Unintended Consequences of Investor-State Dispute Settlement

How realistically likely is it that states will bargain around the default rule? Consider the four basic bargaining scenarios that may arise. In the first situation, two centralized states negotiate an economic agreement. This situation is fairly straightforward. The parties here have similar incentives as both claimants and respondents. Moreover, neither expects to incur significant liability as a result of local action (*Y* approaches zero). Because local governments in centralized states retain little independent authority, centralized states can liberalize local measures at costs similar to those they incur liberalizing national measures. They will therefore see little need to change the default vicarious liability rule.

In the second situation, two decentralized nations negotiate an agreement. Each decentralized government expects to be targeted as a respondent based on local action (each has a high value of *Y*). Significant local lawmaking powers, coupled with high costs to overriding local governments, means that both states face high expected liability from local action. A state's utility from vicarious liability depends, of course, both on its own expected liability as well as its own expected gains from its role as a potential claimant (that is, it depends also on the value of *X*). Two decentralized states thus might reasonably agree to maintain vicarious liability so long as both states face high expected claims. One state's liability is another state's gain.[254] As it turns out, however, decentralized nations are likely to increase their use of immunity over time, especially in the investment context,[255] thus insulating a growing portion of regulation from international review. They may also do so in the trade context where, as in the case of trade in services, regulation is highly local and protectionist.

To see why, consider the differing structure of dispute resolution in investment and trade. In investment law, remedies are typically monetary awards, but private parties, rather than national governments, bring claims.[256] As a consequence, national

254. Moreover, maintaining liability may increase overall welfare, as it leads to greater liberalization over time. An increase in the expected liability means a state is more likely to take costly action to liberalize local law. These gains from liberalization, though, may not be as directly captured by the national government, for reasons discussed below.

255. *See supra* Section I.B.

256. Organisation for Economic Co-Operation and Development [OECD], *Investor-State Dispute Settlement: Public Consultation: 16 May–9 July 2012*, ¶ 11 (July 9, 2012),

governments have high expected liability under investment law because they are the respondents faced with the prospect of financial liability. Moreover, private parties might be expected to bring more claims than governments because diplomacy and politics do not deter claims. By definition, decentralized states also have little ability to reduce their liability for local government acts. Finally, since private parties bring claims, states are not themselves claimants in investment law. They therefore do not capture significant value from their role as claimants. The result is that decentralized states overwhelmingly face negative utility from claims challenging local acts in investment law. They pay all the costs of being a respondent, have little ability to avoid or reduce those costs, and do not benefit reciprocally from direct role as a claimant ($X < Y$).

To be sure, businesses that expected to be claimants under investment regimes—for example, companies in the extractive sector—provide political support for investor-state dispute resolution, meaning that national governments do capture some political support from their nationals' role as claimants. But they do not capture the gains directly, even though they experience the losses—both financial and political—directly. X is therefore smaller than Y *for both countries* under an investment regime. Consequently, moving from vicarious liability to immunity makes both parties better off. Little is necessary in the way of concessions from one side to the other (C can be small or zero).

This fact exposes an unintended consequence of the investment law regime. By privatizing claims, states created a mechanism that weakens their long-term commitment to investor-state dispute resolution in areas in which avoiding liability is costly ex ante. When they are unable to take precautions to reduce liability—as decentralized nations are unable to do in the investment context—they will immunize themselves from liability altogether. In other words, ISDS is politically unstable under a vicarious liability regime because over time its structure encourages national governments to adopt a defense counsel mentality.

The evidence of this instability is pervasive. The growing use of immunity provisions[257] provides some evidence. But increasingly loud attacks on ISDS sound in the same tones. Politicians like Senator Elizabeth Warren,[258] and officials in Australia,[259] Germany,[260]

http://www.oecd.org/investment/internationalinvestmentagreements/50291642.pdf [https://perma.cc/7UDQ-652L].

257. *See supra* Section I.B.

258. *See* Warren, *supra* note 14.

France,[261] and the European Parliament[262] openly wonder what their governments get out of allowing private parties to influence government policies through international arbitration. The fact that their own nationals can bring investment claims to influence policies in other countries counts little to them. Multinational enterprises—the kinds of companies most likely to use ISDS—do not necessarily have policy interests aligned with their own governments.[263]

The situation in trade is different. There, national governments are both claimants and respondents. The expected gains from being a claimant are thus much more likely to equate to the expected losses as a respondent. Governments can bring claims in order to gain political support from domestic exporters and consumers, and they face political costs from anti-import interests in their role as respondents. Given the gains from long-term liberalization that governments believe accrue from trade, it is more likely that the utility from vicarious liability is positive for both countries ($X > Y$, and therefore $U^{SL} > 0$).

Interestingly, governments appear to have settled on vicarious liability for trade in goods but immunity for existing discriminatory measures in trade in services.[264] This fact suggests that expected gains as a claimant exceed expected losses as a respondent in goods but not services, despite the reciprocal nature of dispute resolution. One possible explanation for this phenomenon is the strongly local and often protectionist nature of laws governing the provision of services, such as licensing rules in federal countries like the United States. As Aaron Edlin and Rebecca Haw Allensworth observe, professional licensing is done primarily at the state level in the United States.[265] Moreover, professional licensing is both deeply protectionist, raising antitrust concerns domestically, and so politically entrenched that

259. *See* Kyla Tienhaara & Patricia Ranald, *Australia's Rejection of Investor-State Dispute Settlement: Four Potential Contributing Factors*, INV. TREATY NEWS (July 12, 2011), http://www.iisd.org/itn/2011/07/12/australias-rejection-of-investor-state-dispute-settlement-four-potential-contributing-factors/ [https://perma.cc/D9VA-6WNC].

260. *See* Barbiere, *supra* note 16.

261. *See id.*

262. *See* Aline Robert, *European Parliament Backs TTIP, Rejects ISDS*, EURACTIV.COM (July 9, 2015), http://www.euractiv.com/section/global-europe/news/european-parliament-backs-ttip-rejects-isds/ [https://perma.cc/XZ52-DA5T].

263. *See* Warren, *supra* note 14 ("Agreeing to ISDS in this enormous new treaty would tilt the playing field in the United States further in favor of big multinational corporations. Worse, it would undermine U.S. sovereignty.").

264. *See supra* Section I.B.

265. *See* Edlin & Haw, *supra* note 114, at 1096.

national regulation has proved elusive.[266] Together, these factors may mean that federal states face higher expected liability for local action than expected gains. In the trade in goods context, by contrast, border measures such as tariffs—which are under the control of the national government—are relatively more important in determining the ease with which foreigners can access markets. Liberalizing to avoid liability thus does not tread on politically important local protectionism to the same degree.

C. Bargaining Among Decentralized and Centralized Nations

Two other bargaining situations involve a mix of centralized and decentralized states. In the third situation, a powerful decentralized state negotiates with a weaker centralized nation. In this situation, we can again expect states to alter the default rule in favor of immunity, all else equal. The powerful decentralized nation, such as the United States, stands to lose under the default rule because it becomes liable for the actions of its local governments but is not easily able to avoid that liability by liberalizing local acts (Y is high). At the same time, the other nation is centralized, meaning that local powers are weak and easily overridden by the center should it wish to avoid international liability. Therefore, the decentralized nation receives little from vicarious liability (X is low).

The reverse is true for the centralized nation, which has high expected value as a claimant and low expected liability. In other words, the vicarious liability rule favors the centralized state. In this situation, a concession will be necessary to induce the weak state to agree to immunity. The question is thus whether there is a concession that makes both states better off. Will the decentralized state be able to offer something that costs less than its expected liability but compensates the centralized state for its foregone liability?

The structure of remedies in trade and investment law once again makes this result more likely. From the standpoint of the two governments involved, liability in any given case is likely negative-sum,[267] meaning the state that loses the case (likely the decentralized state) loses more than the state on the prevailing side. As explained above, this result occurs in investment cases because the claimant is not actually the state in question. One state thus loses and the other state receives only diffuse political benefits from having established

266. *Id.*

267. Andrew T. Guzman, *The Design of International Agreements*, 16 EUR. J. INT'L L. 579, 605 (2005).

the system that allows its investors to bring claims. In trade cases, this result is less obvious because states are on both sides. However, because remedies in trade are only prospective, they do not make the complaining party whole.[268] They are thus costly to the respondent and fail to completely compensate the complainant. For this reason, states may eliminate jurisdiction ex ante over those trade claims that are especially difficult for the complainant to comply with. Doing so creates a net gain for the parties by eliminating the unavoidable losses that come from local programs that decentralized states cannot easily liberalize.

The fact that removing liability for local acts creates gains for the parties combined does not tell us what the parties will trade to agree on immunity. After all, the centralized state loses from immunity while the decentralized state wins. The decentralized state must therefore offer some of its gains to the centralized state.

Game theory predicts here that the parties will agree to a relatively small concession in exchange for immunity for local claims.[269] The intuition behind this prediction flows from the notion of opportunity costs. To take a concrete example, consider negotiations between the United States and Uruguay on a BIT. The opportunity cost of failing to reach an agreement in February differs greatly for the two states. For the United States, Uruguay is just one relatively small market among many. If the two countries cannot agree until June or February of the following year, the United States has lost little. For Uruguay, the stakes are higher. The United States has the fourth largest stock of foreign investment in Uruguay.[270] Failure to reach agreement thus risks costing Uruguay a significant portion of its foreign investment. In bargaining, the United States is thus able to wait out Uruguay, using the greater benefit to Uruguay as part of the concession to induce Uruguay to agree to immunity.[271] In a

268. Rachel Brewster, *The Remedy Gap: Institutional Design, Retaliation, and Trade Law Enforcement*, 80 GEO. WASH. L. REV. 102, 110 (2011) ("[T]he WTO rules are widely understood by scholars and WTO arbitration panels to permit only prospective remedies . . . .").

269. *Cf.* Jack L. Goldsmith & Eric A. Posner, *A Theory of Customary International Law*, 66 U. CHI. L. REV. 1113, 1120–33 (1999) (using game theory concepts to explain cooperation and decision-making by and between nations).

270. U.S. DEP'T OF STATE, URUGUAY: INVESTMENT CLIMATE STATEMENT 2015, at 3 (2015), https://www.state.gov/documents/organization/241998.pdf [https://perma.cc/3N7Z-NFHL].

271. One could formalize this result using a basic Rubinstein bargaining model. In such a model, parties make sequential offers to divide a pie. In each round, the offeree can accept the offeror's proposed division of the pie and realize its payoff, or it can reject the offer and proceed to the next round where it gets to make an offer. Success in the next

multilateral context, such as the TPP negotiations, the invitation to participate in the negotiations at all might be part of the concession. Countries can, after all, join the TPP after it is complete, provided that current members agree.[272] When doing so, they have little ability to alter its rules, a situation in which South Korea now finds itself.[273]

In other words, by controlling the terms of participation, a country like the United States can avoid having to make significant concessions on the substantive rules contained in the agreement. The powerful state has the ability to effectively exclude the less powerful state from a trade agreement, either through delay or outright exclusion. The weaker state's choice, in effect, is no agreement today or agreement today with immunity for local provisions. If market access is important to the weaker state, it will prefer to agree today, even on terms that it finds suboptimal.

The fourth situation involves a powerful centralized state and a weaker decentralized state. The analysis of winners and losers is the same as in the third situation: a move to immunity favors the decentralized state, while retaining vicarious liability favors the centralized state. Here, though, the power disparities suggest that the centralized state will be difficult to move off of its preferred rule. Of course, international negotiations are complicated. Powerful states may be willing to give up their preferred liability rule if sufficient offsetting concessions are put on the table. But the logic of opportunity costs discussed above cuts the other way in these situations. Now the weaker decentralized state is pressured to agree to future liability for local measures (i.e., retaining vicarious liability) in order to induce agreement. Consequently, it is expected that vicarious liability would remain in more situations. The weaker state simply cannot come up with a big enough concession to compensate the more powerful state.

Chinese economic treaties provide the clearest example of this dynamic. As discussed in Section I.B, China includes a provision in its agreements exempting *all* of its existing non-conforming measures, not only local ones.[274] It includes such a provision even in agreements

round, however, is less valuable than success in the current round because parties discount the future. Knowing this, rational parties will agree in the first round but take into account their respective discount rates. A state with a higher discount rate receives a smaller share of the gains. In effect, the concession the more patient state must make to get an agreement shrinks as the opportunity cost of failing to agree rises for the other state.

272. TPP, *supra* note 10, art. 30.4 (describing the procedures for accession to the TPP).

273. *See* Jun, *supra* note 3.

274. *See supra* Section I.B.

with federal states such as Australia that only request exemption for their regional and local measures.[275] Access to the Chinese market on preferential terms is valuable to states such as Australia and Canada, and certainly to smaller economies with whom China enters into agreements. China is thus able to extract much broader immunity as the price of any local immunity in federal states.

D. Empirical Trends

These bargaining dynamics suggest that, in theory, we should see immunity in some situations but vicarious liability in others. Empirically, however, good reasons exist to think that immunity will continue to replace vicarious liability if another approach is not identified. First, many of the most important economies in the world are federal: Australia, Brazil, Canada, the European Union, India, Mexico, Russia, and the United States, to name only a handful. If just these countries began uniformly immunizing existing local measures from discrimination challenges in their future agreements, a wide range of regulatory activity will escape international review.

Second, the number and importance of these countries to the global economy suggests that powerful decentralized states negotiating with weaker centralized states—a situation that produces immunity—will occur more frequently than the reverse situation. For the same reason, negotiations among federal countries also capture a much greater share of the global economy than negotiations among centralized countries. NAFTA, for example, is an agreement entirely among federal countries, and four of the five largest economies in the TPP are federal countries (Australia, Canada, Mexico, and the United States).[276]

Finally, China is perhaps the largest centralized economy that could push back against immunity. Instead, however, it appears that China is willing to accept local immunity in exchange for comprehensive immunity for its own existing discriminatory measures.[277] Far from pushing back on immunity, China is expanding the trend.[278] This bargaining dynamic suggests a significant limitation on the liberalizing effects of potential future trade agreements between China and the United States or the EU. Permanently

275. *See supra* Section I.B and text accompanying note 135.
276. *See* 2014 World GDP, *supra* note 117.
277. *See supra* Section I.B.
278. *See supra* note 138 and accompanying text.

grandfathering existing discriminatory programs in China is a high price to pay for protecting local governments.

More generally, observers should be greatly concerned that the immunity provisions in current economic treaties will expand. At present, they apply only to existing discriminatory measures and any renewal, amendment, or modification thereof. The prominence of federal economies in the world, combined with China's position on grandfathering, suggests that broader immunity provisions could easily be the way of the future. Such provisions might, for example, immunize all local measures, existing or future. The immunity provisions might also expand beyond the nondiscrimination rules, providing protection for challenges based on investment law on fair and equitable treatment, for example. The TPP's provision granting immunity from any claims challenging tobacco control measures suggests that the possibility of broader immunity is not far-fetched.[279]

IV. IMMUNITY'S THREAT TO INTERNATIONAL ECONOMIC LAW

Governments and policymakers thus find themselves in a difficult position. Vicarious liability and direct liability each have benefits, but governments increasingly replace vicarious liability with immunity. Moreover, this trend is accelerating and could threaten to undermine the liberalizing effects of international economic agreements. Dani Rodrik, a highly regarded Harvard trade economist, has noted that economic models showing that the TPP will increase real incomes in member states depend on assumptions that may be unrealistic.[280] The gains from the TPP depend on reducing non-tariff barriers and loosening restrictions on foreign investment, including by eliminating discrimination.[281] The findings of this Article further underscore Rodrik's concerns. By insulating large swaths of discrimination from challenge, the TPP and agreements like it reduce the economic benefits of the agreement. Yet economic predictions fail to catch this significant limitation.

This Part provides the missing piece of the analysis, arguing that immunity has dire consequences for international economic law for three reasons. First, immunity reduces the general welfare of the populations in both countries. Second, it has distributional effects that threaten the legitimacy of the international economic system.

279. *See supra* note 19 and accompanying text.

280. *See* Rodrik, *supra* note 9 (noting that assuming "labor markets are sufficiently flexible" to offset job losses in adversely affected parts of the economy by job gains elsewhere is an "inexplicable" conclusion).

281. *Id.*

Specifically, immunity further skews the gains from international economic law toward large economies that tend to be relatively decentralized. Third, immunity for local action insulates localities right at the time that local governments are playing an increasingly important role in international governance.

A. Welfare Effects of Local Immunity

In general, local immunity reduces the economic gains both countries might otherwise expect from an agreement such as the TPP. Given the strong debate among economists about the overall effect of the TPP on welfare,[282] this finding is significant.

The basic theory underlying trade liberalization explains these foregone gains. Discriminating against foreign products or services raises the cost of those foreign products or services in the domestic market. For example, if foreign service providers must pay additional costs to become licensed to provide a service in the United States, they will have to charge more for their services, or may not be able to provide them at all. Domestic consumers thus lose out because they pay prices for goods that are inflated by the government's discrimination. Foreign producers lose out because they lose market share. On the other hand, domestic producers that sell in the domestic market gain market share because they do not have to compete on price. These domestic producers, in turn, confer political benefits on the government that protects them. These benefits, though, normally do not exceed the costs absorbed by foreign producers and domestic consumers.[283] Protectionism thus creates both winners and losers, but overall reduces welfare.[284]

An example illustrates the point. The Canadian province of Ontario put in place a feed-in tariff ("FIT") scheme that paid electricity producers preferential rates for energy generated renewably so long as the renewable generation equipment was locally produced.[285] An American corporation, Mesa Energy, challenged this so-called "local content requirement" as discriminating against

282. *Compare* Petri & Plummer, *supra* note 7, at 1–3 (predicting that the TPP will increase annual U.S. GDP by .5%), *with* Capaldo & Izurieta, *supra* note 6, at 1 (predicting negative effects on growth in the United States and Japan).

283. ANDREW T. GUZMAN & JOOST H.B. PAUWELYN, INTERNATIONAL TRADE LAW 18–20 (2d ed. Supp. 2012).

284. *Id*.

285. Mesa Power Group, LLC v. Canada, Notice of Arbitration, ¶¶ 12, 19–22, PCA Case No. 2012-17 (Oct. 4, 2011), http://www.italaw.com/sites/default/files/case-documents/italaw1203.pdf [https://perma.cc/AW4C-7JTT].

foreign investors in violation of NAFTA.[286] In essence, Mesa claimed (as the United States, the EU, and Japan successfully did within the WTO)[287] that it lost sales of its renewable energy equipment within Ontario because Ontario electricity producers were able to purchase locally produced equipment more cheaply as a result of the Ontario subsidy.[288] Without the subsidy, the locally produced equipment might have been more expensive than Mesa's turbines. Thus, Mesa Energy lost market share within Ontario, while Ontario citizens shouldered the fiscal burden of providing a subsidy to local renewable energy equipment producers.

By immunizing local governments from the pressure to liberalize their discriminatory practices, agreements like the TPP thus reduce the overall welfare gains from economic agreements. Under the TPP, a program like Ontario's FIT program could not be challenged by private parties. While American producers could proceed, as Mesa did, under NAFTA, TPP members such as Japan without another investment agreement with Canada would be out of luck. Such producers would continue to lose market share while Canadian consumers of renewable energy equipment would not obtain the most competitive product.

This conclusion needs to be qualified in two respects. On the one hand, economic discrimination against foreign economic interests is more likely at the local level of government than the national level.[289] Insulating local government from discrimination claims thus may protect great swaths of economic discrimination, making immunity even worse than it might otherwise seem. On the other hand, local discrimination also can promote local efforts to provide global public goods, such as climate mitigation efforts.[290] While economic law's nondiscrimination rules cause local governments to internalize the costs of their actions in foreign jurisdictions, the same rules provide no means for those governments to capture any benefits their measures create.[291]

One approach to solving this problem is a complete carve-out in economic agreements for particular areas where possibly discriminatory actions might increase the general welfare. The TPP

286. *Id*. ¶ 73.

287. *See Canada—Renewable Energy*, *supra* note 23, ¶ 5.85.

288. Notice of Arbitration, *supra* note 285, ¶¶ 28–31.

289. Meyer, *supra* note 40, at 1942 ("[D]iscriminatory conditions are more likely at smaller scales of government.").

290. *Id.*

291. *Id.* at 1940.

includes such a carve-out, for example, for tobacco control measures, which can be completely insulated from challenge.[292] Professor Gus Van Harten has similarly argued that regional trade and investment agreements should include a carve-out for climate measures.[293] Both of these approaches, as well as the approach of simply immunizing local conduct, are too broad. They protect too much discriminatory regulation, thereby eliminating many of the gains from economic treaties.

Instead, changes should be made to the doctrines used to evaluate the legality of discrimination. In the context of local discrimination, this means that liability should exist for local acts, but such local acts should be evaluated in light of the specific features of local lawmaking.[294] Put differently, local discrimination can have offsetting benefits and those benefits are worth protecting. But the best way to protect those benefits is not by an overly broad immunity for local governments. It is through a more targeted evaluation of which local programs promote the general welfare by creating positive spillovers and non-economic benefits and which, consistent with standard trade theory, simply create welfare losses for foreign suppliers and domestic consumers.

B. Distributional Effects and the Legitimacy of International Economic Law

Immunity for local measures also creates distributional effects that favor large countries with federal systems. Should the trend toward local immunity accelerate, these effects could call into question the legitimacy of international economic law. Sensitivity to these concerns is especially important at a time when trade and investment agreements such as the TPP, the Transatlantic Trade and Investment Partnership, and CETA are under attack.[295]

The distributional effects of local immunity are clearest if one considers bargaining between large federal states like the United States and weaker centralized states. As discussed above, these situations are empirically more common and cover a greater percentage of world trade than the reverse—a negotiation between a

292. TPP, *supra* note 10, art. 29.5.

293. Gus Van Harten, *An ISDS Carve-Out to Support Action on Climate Change*, *in* 11 OSGOODE HALL L. SCH. LEGAL STUD. RES. PAPER SERIES, no. 38, Mar. 2016, at 4, http://canadians.org/sites/default/files/publications/VanHarten-EN-Mar2016.pdf [https://perma.cc/VQ8Z-QLVG].

294. Meyer, *supra* note 40, at 1992.

295. *See, e.g.*, Warren, *supra* note 14.

large centralized economy and a decentralized smaller economy.[296] For example, TPP negotiations, as well as many bilateral negotiations between Central and South American countries and the United States, fall into this category. As explained, these smaller economies will not agree to immunity unless they are given concessions at least equal to what they stand to lose from the move to immunity.[297] In an absolute sense, these states are not made any worse off by immunity rules.

In a relative sense, however, they are made worse off. States will only agree to immunity if the move makes them better off relative to their alternative. The concessions from federal states to non-federal states ensure that this condition is satisfied. In economic terms, it ensures that immunity is Pareto superior to the alternative. But it says nothing about how, or by whom, that alternative is defined. Because powerful states can link agreement on immunity to the broader market access concessions contained in the agreement, these powerful states will capture a greater share of the surplus from cooperation. For example, by delaying agreement, large federal economies like the EU or the United States could induce agreement on immunity without offering significantly greater concessions in terms of the substance of the agreement. They therefore get the benefit of their preferred rule—immunity—without having to significantly alter the terms of the agreement in their trading partners' favor.

As a result, the terms of economic treaties satisfy the relatively weak Pareto efficiency condition, but they skew the gains towards developed federal countries. These distributional effects cost not only those states that get less in terms of gains from cooperation; they also can cost large economies in the long run. These distributional effects create the perception that the deck is stacked against developing countries. Fearing that international economic law is simply a replacement for the colonial system that ended after World War II, these states may increasingly reject the international economic law system entirely.

In the wake of the 2007–2008 financial crisis, several South American countries did just that. Bolivia, Ecuador, and Venezuela all withdrew from the ICSID Convention, removing that institution's jurisdiction over future investor-state claims.[298] These countries also

296. *See supra* Section I.B.

297. *See supra* Section I.B.

298. U.N. Conference on Trade and Dev. (UNCTAD), *Denunciation of the ICSID Convention and BITS: Impact on Investor-State Claims*, IIA Issues Note, no. 2, U.N. Doc. UNCTAD/WEB/DIAE/IA/2010/6, at 1 (Dec. 2010), http://unctad.org/en/Docs

began denouncing some of their BITs.[299] Other Latin American countries, including Brazil, Cuba, and Mexico, among others, have declined to join the ICSID Convention in the first place.[300] Argentina has threatened to withdraw from ICSID in the wake of a large number of successful investment claims against it following its financial collapse,[301] but has not yet done so.[302]

Although currently confined to Latin America, these trends illustrate the risks of an international economic system that is perceived to favor wealthy nations. Distributional considerations can strain the system's existence, a threat that impacts the interests of both developed and developing states. For this reason, removing an unnecessary carve-out for local measures that favors developed federal states would, in the long run, help preserve the international economic system.

C. Insulating the Future from International Governance

The final difficulty with immunity is that it removes international accountability for local governments at the same time that local governments are increasingly exercising their authority in a way that produces international effects. The reasons for the importance of local governments are multifaceted. Economic interdependence has given many traditionally local powers an international dimension. Economic integration means that local laws can have significant effects on foreign investors or producers. The global nature of many businesses highlights this point. Multinational enterprises often own businesses and property in many different countries, meaning that they are potentially subject to the jurisdiction of many different national and local governments. Local regulation of these enterprises thus has a global dimension simply because of the nature of the

/webdiaeia20106_en.pdf [https://perma.cc/Y267-2XAF] (Bolivia and Ecuador withdrawal); Sergey Ripinsky, *Venezuela's Withdrawal from ICSID: What It Does and Does Not Achieve*, INV. TREATY NEWS (Apr. 13, 2012), https://www.iisd.org/itn/2012/04/13/venezuelas-withdrawal-from-icsid-what-it-does-and-does-not-achieve/ [https://perma.cc/SZ3J-XJGH] (Venezuela withdrawal).

299. U.N. Conference on Trade and Dev. (UNCTAD), *supra* note 298, at 4–5.

300. *Database of ICSID Member States*, ICSID, https://icsid.worldbank.org/apps/ICSIDWEB/about/Pages/Database-of-Member-States.aspx?tab=KtoO&rdo=BOTH&ViewMembership=All [https://perma.cc/Q382-7VN8].

301. *See Argentina in the Process of Quitting from World Bank Investment Disputes Centre*, MERCOPRESS (Jan. 31, 2013), http://en.mercopress.com/2013/01/31/argentina-in-the-process-of-quitting-from-world-bank-investment-disputes-centre [https://perma.cc/AMZ7-D675].

302. *See Database of ICSID Member States*, *supra* note 300.

regulated entities. The size and regulatory authority of local governments in federal countries magnifies this effect.[303]

Additionally, many nation-states have granted significant authority to regional governments in recent years. In October 2016, the Belgian region of Wallonia temporarily blocked the Belgian government's (and therefore effectively the entire EU's) ability to sign the CETA with Canada, relying on features of the Belgian federal structure that give regional parliaments a say in foreign affairs.[304] In the United States, a robust constitutional federalism—one that holds that the states should operate free from national interference across a wide range of issues—provides states with significant independent regulatory authority.[305] More recently, it has given them the basis to act in areas, such as climate change or securities regulation, in which the federal government has declined to regulate aggressively.[306] In other nations, a push for regional autonomy drives devolution. Following Kosovo's declaration of independence in 2008, for instance, autonomy movements have gained traction in Spain and elsewhere.[307]

The United Kingdom has also been a particularly active site for exploring increased powers for localities. In the 1990s, Scotland and Wales received a significant boost in their autonomy, including individual parliamentary bodies with authority over a variety of

303. *See supra* Section I.B (discussing the relative size of state and provincial economies).

304. Barrie McKenna, *What's Wallonia's Deal? A Primer on its Role in CETA's Crisis*, GLOBE & MAIL (Oct. 25, 2016), http://www.theglobeandmail.com/report-on-business/international-business/european-business/explainer-ceta-wallonia-europe-and-canada/article32489554/ [https://perma.cc/GFF7-XP7R] (noting that Wallonia was able to de facto block Belgium's ability to sign CETA, and that the rest of the EU had indicated it would only go forward if its 28 members were unanimous).

305. *See* U.S. CONST. amend. X.

306. *See, e.g.*, Hari M. Osofsky, *Scaling "Local": The Implications of Greenhouse Gas Regulation in San Bernardino County*, 30 MICH. J. INT'L L. 689, 690 (2009) ("[California] used its power over [San Bernadino], through the California Environmental Quality Act and the San Bernadino County Superior Court, to push that local governmental unit to take action . . . ."); J.B. Ruhl & James Salzman, *Climate Change, Dead Zones, and Massive Problems in the Administrative State: A Guide for Whittling Away*, 98 CALIF. L. REV. 59, 63 (2010) ("State and local energy, environmental, and land use agencies must consider how to account for climate change when planning infrastructure and regulating facilities.").

307. Alejandro López, *Spain: Regional Catalan President Calls Early Elections*, WORLD SOCIALIST WEB SITE (Jan. 26, 2015), http://www.wsws.org/en/articles/2015/01/26/cata-j26.html [http://perma.cc/49TQ-DJTE] (discussing pressure for a secessionist vote in the Catalonia region of Spain).

areas.[308] Not satisfied, in September 2014, Scotland held a referendum on full independence.[309] While the referendum failed, an unexpectedly close vote resulted in promises from the United Kingdom for even further autonomy.[310] Calls for devolution within the United Kingdom have received renewed impetus following the June 2016 "Brexit" referendum. Within the United Kingdom, fifty-two percent voted in favor of Britain leaving the European Union.[311] However, majorities in London, Scotland, and Northern Ireland voted in favor of staying within the European Union.[312] In the fallout from Brexit, London—a global financial capital—has called for greater independence from the United Kingdom in order to preserve its global standing,[313] while Scotland has revisited the possibility of secession.[314] Although the outcome of these calls for devolution remains to be seen, they offer a window into how local governments might be allowed more direct interaction with international

308. The British Parliament "devolved" a range of authority onto the Scottish, Welsh, and Northern Irish governments it created. *Devolution of Powers to Scotland, Wales and Northern Ireland*, GOV.UK (Feb. 18, 2013), https://www.gov.uk/guidance/devolution-of-powers-to-scotland-wales-and-northern-ireland [https://perma.cc/D9ES-JCL3] (discussing "how the political and administrative powers of the devolved legislature—Scotland, Wales and Northern Ireland—have changed as a result of devolution"). Scotland received the greatest range of authority, including administration of its own justice system, public works, and some powers over taxation. *What Powers Does Scotland Have?*, BBC NEWS (Jan. 31 2013), http://www.bbc.com/news/uk-scotland-scotland-politics-20314150 [http://perma.cc/9BN5-KBHC]. Devolution differs from federalism in that the statutes devolving authority on local governments are ordinary statutes that can be changed by the central government. As a result, the state is technically still a unitary state, though the political costs of changing the allocation of authority between the center and localities may not differ significantly between a unitary state with devolved authority such as the United Kingdom, and a system of constitutional federalism, such as the United States.

309. Kenan Malik, Opinion, *United Kingdom, Divided People*, N.Y. TIMES (Sept. 26, 2014), http://www.nytimes.com/2014/09/27/opinion/kenan-malik-united-kingdom-divided-people.html [http://perma.cc/K54E-KXLH] (discussing referendum for Scotland's independence).

310. *Id.* ("In the run-up to the vote, as opinion polls suggested that the Yes vote might just prevail, panic-stricken politicians in London promised to devolve, or transfer, more powers to the Scottish Parliament.").

311. Brian Wheeler & Alex Hunt, *Brexit: All You Need to Know About the UK Leaving the EU*, BBC NEWS (Sept. 1, 2016), http://www.bbc.com/news/uk-politics-32810887 [https://perma.cc/NHN7-CBX5].

312. *Id*.

313. Richard Brown, Opinion, *Brexit: It's Time London Took Back Control*, NEWSWEEK (June 24, 2016, 2:58 PM), http://www.newsweek.com/london-brexit-devolution-mayor-london-474417 [https://perma.cc/6C3C-9AHV] (discussing the mayor of London's proposal that London remain within the EU when the UK leaves).

314. *Brexit: Nicola Sturgeon Says Second Scottish Independence Vote 'Highly Likely*,*'* BBC NEWS (June 24, 2016), http://www.bbc.com/news/uk-scotland-scotland-politics-36621030 [https://perma.cc/8S6A-885Z].

institutions. Relationships between localities and international institutions could vindicate different local preferences about the globalization within a single country.

Local government action on climate change provides a concrete example of the international sweep of local action. Cities around the world have come together to negotiate climate change agreements meant to fill in the gaps in the formal international regime.[315] U.S. states have created transboundary carbon trading schemes as a vehicle to reduce carbon emissions.[316] The U.S. Conference of Mayors produced the Climate Protection Agreement, under which hundreds of U.S. cities agreed to take measures to combat climate change, including striving to meet or beat Kyoto Protocol targets within their own communities.[317] Local governments have also been incredibly active in creating different kinds of clean energy support programs. Local governments have, for example, created FITs that pay premiums for electricity produced from renewable sources.[318] Subnational governments have created renewable portfolio requirements, a regulatory measure that mandates that utility companies generate or purchase a certain amount of renewable power.[319] They have also provided financial incentives for distributing renewable energy, encouraging homeowners, for example, to install solar panels on their roofs.[320]

More recently, nations have begun to appropriate this local activity in service of fulfilling their international climate change commitments.[321] On September 15, 2015, the top climate change

315. *See, e.g.*, Michele M. Betsill & Harriet Bulkeley, *Cities and the Multilevel Governance of Global Climate Change*, 12 GLOBAL GOVERNANCE 141, 141–43 (2006) (analyzing the Cities for Climate Protection program, a network of municipal governments working to address climate change).

316. *See* Hari M. Osofsky & Jacqueline Peel, *Litigation's Regulatory Pathways and the Administrative State: Lessons from U.S. and Australian Climate Change Governance*, 25 GEO. INT'L ENVTL. L. REV. 207, 234–35 (2013).

317. *See* U.S. CONFERENCE OF MAYORS, THE U.S. MAYORS CLIMATE PROTECTION AGREEMENT (2005), http://www.usmayors.org/climateprotection/documents/mcpAgreement.pdf [http://perma.cc/5L2F-EPCW] ("We will strive to meet or exceed Kyoto Protocol targets for reducing global warming pollution by taking actions in our own operations and communities . . . .").

318. *See Canada—Renewable Energy*, *supra* note 23, ¶ 5.83.

319. *See* Meyer, *supra* note 40, app. at 2013–25 (describing state level renewable energy support programs in the United States).

320. *Id.*

321. *See, e.g.*, Betsill & Bulkeley, *supra* note 315, at 142 (explaining that the European Union has focused on "cities as a means to address environmental issues" and called on "all local authorities to establish a Local Agenda . . . through participation with their communities").

negotiators from the United States and China met in Los Angeles.[322] They did not meet to discuss their nations' efforts to combat climate change, nor directly to discuss national efforts or commitments with respect to the climate change agreement they hoped to conclude in Paris in December 2015. Instead, they convened with the leaders of about a dozen American and Chinese cities, states, and provinces.[323] The purpose of the meeting was twofold. First, the meeting facilitated discussions among these regional and local leaders about subnational climate change mitigation efforts.[324] Second, the summit concluded with a declaration signed by the officials in attendance stating their joint goal of reducing their governments' impact on climate change, as well as identifying individual framework commitments for each participating locality.[325] Beyond simply enshrining the commitments of local leaders, the declaration also established a policy framework through which the American and Chinese national governments could satisfy obligations undertaken in the forthcoming climate change agreement. In other words, the summit partially delegated compliance with national climate change obligations to local governments.

The delegation of international obligations to local governments raises the possibility that significant action designed to address international problems could avoid international review. Recent research looking only at renewable energy shows that discriminatory renewable energy support programs exist in twenty-three out of fifty U.S. states.[326] Indeed, while recent studies have identified twenty local content requirements in the renewable sector at the national level,[327] my research identifies forty-four such programs at the state level alone.[328] More such programs exist at the truly local level.[329] This evidence from just a single sector suggests that local discrimination is a significant problem that requires international attention.

322. U.S.-CHINA CLIMATE LEADERS' DECLARATION, *supra* note 41, at 1.

323. *Id.*

324. *Id.*

325. *Id.*

326. *See* Meyer, *supra* note 40, app. at 1013–25.

327. SHERRY STEPHENSON, INT'L CTR. FOR TRADE & SUSTAINABLE DEV., ADDRESSING LOCAL CONTENT REQUIREMENTS IN A SUSTAINABLE ENERGY TRADE AGREEMENT 3 (2013) ("Scanning the available data, it appears that perhaps 20 new LCRs affect the renewable energy sector.").

328. Meyer, *supra* note 40, app. at 2013–25 (describing state level renewable energy support programs in the United States).

329. *See id.*

Moreover, the prevalence of local discrimination highlights the risk of undermining the efficacy of international law, and especially international dispute settlement, going forward. If nations can simultaneously put their local governments beyond review and then ask them to carry out international obligations, the successes of the post-Cold War world in legalizing international relations face rollback. Governmental form can, after all, be manipulated. The shifting of power upward within the EU, and downward in countries like Spain and the UK, testifies to the fluid nature of power arrangements within countries. If international law insists that only the nation-states can be liable and then immunizes a broad swath of what the nation does, we can expect power to flow increasingly downward to escape review. The acceleration of this trend will, in turn, exacerbate the welfare and distributional implications of immunity and thereby add to the stress on the international economic system.

V. DIRECT LIABILITY

Immunity threatens the international economic system, yet nations face strong incentives to substitute immunity for vicarious liability. Policymakers need a liability rule that is more stable than vicarious liability but avoids the cost of immunity. This Part argues that direct liability is such a rule. This Part first explains how direct liability would work and then argues that direct liability is a politically feasible alternative.

A. How Direct Liability Would Work

Direct liability should become the default rule under international economic law. This proposal has two components. First, the law of state responsibility should provide that local governments are directly responsible under international law for breaches of international economic obligations. Second, grants of jurisdiction to international tribunals to resolve trade and investment disputes should be understood to include jurisdiction over claims against subnational governments unless otherwise specified. Together, these two rules would ensure that local governments can be held directly accountable for violations of international law. At the same time, national governments should also remain responsible for violations by their subnational governments.

The proposed rule is thus one of joint and several liability. Other versions of direct liability are, of course, possible. For example, one

might adopt a rule that mirrors the ICSID Convention, under which local governments are only amenable to jurisdiction and responsibility if they have been designated in advance by their national government and have themselves consented to the claim. Alternatively, one might imagine a rule that permits claims against local governments to be brought *only* against local governments, absolving national governments of liability.

Joint and several liability has several virtues, however, that better balance the interests of claimants and respondent governments at both the national and local level. First, the availability and adequacy of relief against subnational governments is a major concern. Requiring national governments to remain liable for violations by their subnational governments, as is done under the ICSID Convention,[330] ensures that a successful claimant has access to relief. Second, making local responsibility and jurisdiction the default rules, rather than requiring additional consent from both the national and local government, ensures that the local government has the proper incentives to consider the legality of its actions. If local governments could evade effective international responsibility by refusing to consent to jurisdiction, the incentives for local governments to be law-abiding would be severely undercut.

Procedurally, a claimant would choose whether to bring its claim against the nation, the local government, or both. Presumably, a claimant will select the respondent from which it expects to most easily and effectively obtain relief. For example, in a trade dispute in which the challenging country has little economic leverage over the local government, the claimants may choose to bring a claim against the national government. Alternatively, a claimant might choose to bring a claim against only the local government, because, for instance, a local government may be more willing to settle.

An award against one level of government would not automatically be enforceable against the other government if the other government had not been party to the dispute. The judgment would, however, be persuasive in a subsequent claim against the other government, if for some reason an award against the initial respondent did not result in an adequate remedy. For example, if a local government is unable to pay the damages from an investment arbitration award, the challenger could bring a claim against the national government to have its responsibility established. This proceeding should be fairly brief, requiring only a showing that the

330. *See supra* notes 146–48 and accompanying text.

local entity is in fact a government for which the national government is responsible.

In the trade context, matters are a bit more complicated. Because trade concessions are made at the national level, and the remedy for a failure to comply is the withdrawal of concessions, all relief is necessarily at the national level. For this reason, we might expect that claimants will always bring claims against the national government under trade law. While that may be, claimants may have reasons for bringing claims first against the local government. Bringing a claim against a national government, after all, can have diplomatic and political costs. Those costs are reduced in the event of a challenge to a local government. A claimant may therefore test the legality of a local government's action through, for example, a WTO dispute against only the local government. If the local government continues its unlawful conduct, then the claimant can establish the responsibility of the national government through a separate proceeding, if it wishes to take that step. At that point, the claimant can seek authorization to suspend concessions. As mentioned above, the successful challenger should first suspend concessions that target the local government. Only if those are insufficient should the suspended concession target the respondent nation generally.

National governments would also have a right of intervention in claims against their subnational governments. Thus, if an investment claim challenged the actions of California, the United States could still intervene if the challenger did not choose to include the United States. This feature ensures that the national government can, if it wishes, continue to play a role in shaping international jurisprudence. The decisions of international tribunals bear on the nation's own obligations, as well as the liability of its other local governments. The right of intervention thus ensures that the national government can protect its long-term interests in the interpretation of international obligations, while leaving local governments to defend the run-of-the-mill suits where liability (or the lack thereof) is more straightforward.

Likewise, as a matter of domestic law, national governments would be free to reallocate any loss as they see fit. Nations could impose losses absorbed by the national government on the local governments, or could agree to absorb losses felt by local governments. National governments can already do this, although they rarely seem to do so. Joint and several liability might give national governments a further incentive to think seriously about the relationship between the local and national governments in international affairs.

The right of intervention also provides national governments with the ability to act as counsel for their local governments. Local governments may lack the legal or financial capacity to defend against international claims. Many national governments may also lack this capacity, but national governments are likely in a better position to defend international claims than are local governments. A rule of joint and several liability with a right of intervention ensures that the national government can remain as involved in claims against its local governments as it chooses to be.

Significantly, the form of direct liability proposed here would not expose local governments to a raft of claims. Local governments would continue to be protected by the relatively small value of challenging most local programs. Even under current law, many local acts, especially in the trade context, are not of sufficient magnitude to warrant initiating a dispute. Nothing about a move to direct liability would change this fact. While more claims might be brought in anticipation of a greater chance at obtaining relief, local governments would remain protected by the cost-benefit calculation claimants make. International disputes are expensive and, in the trade context, involve political and diplomatic decisions. Claimants would continue to use the ability to bring these claims sparingly, given their costs and potential rewards. Moreover, in the investment context, in which the fear of disputes as an intimidation tactic is most real, the ability of the national government to intervene should serve as at least a minimal deterrent to frivolous litigation.

B. Direct Liability Increases Welfare and Is Politically Feasible

The proposal outlined above would satisfy two conditions any proposed liability rule should meet: (1) it increases general welfare, and (2) it is politically feasible. From a general welfare perspective, direct liability would create welfare gains that exceed those under either vicarious liability or immunity. Direct liability creates greater pressure on local governments to conform to their international obligations by removing existing discriminatory practices. As discussed in Part IV, removing these discriminatory practices will increase the general welfare by allowing domestic consumers to purchase goods, services and capital at the most competitive rates, while also allowing foreign suppliers with comparative advantage greater access to markets overseas. Going forward, direct liability also establishes a precedent that local governments must comply with their international obligations. Although the international law of state responsibility has long required this, by placing responsibility solely

on the national government the law of state responsibility has failed to establish incentives for local compliance. Direct liability thus improves the incentives for compliance, while at the same time giving claimants better access to relief. Direct liability also alleviates the distributional issues created by immunity. Centralized states can once again bring claims and force liberalization of large local governments.

In addition, direct liability must be politically feasible. After all, vicarious liability is a more efficient than immunity,[331] although states have gravitated towards immunity because it offers them certain advantages that come at the expense of the overall welfare created by economic treaties. As explained below, direct liability is indeed politically feasible. Equally important, it is more stable than strict immunity as a default rule. It is therefore more likely to remain in place.

The push for immunity comes from federal nations that face high costs when avoiding liability for local acts. States take precaution to avoid liability—they liberalize—up until the point at which the marginal costs of liberalization equal the marginal benefits in terms of liability avoided. States with high political costs to liberalization at the local level will prefer liability to liberalization once an agreement is in place. As argued in Part III, this calculus pushes federal states to negotiate for immunity rules ex ante. The reduced liability does come at the cost of reduced gains from trade liberalization. Those gains, however, would not be perfectly captured by the negotiating government. The government is therefore willing to forego some gains from trade in order to reduce its liability.

Direct liability offers national governments a superior resolution to this problem. Direct liability allows national governments to shift responsibility for local action onto local governments in the first instance. From the national governments' point of view, direct liability thus achieves the same liability reduction goal as immunity. To be sure, direct liability of the kind this Article has proposed above does not completely eliminate national responsibility for local acts, as immunity does. Nations can remain on the hook if local governments cannot provide the mandated relief. And claimants can proceed directly against the national government and will continue to do so when effective relief is not available from the local government. Nevertheless, one would still expect a significant reduction in national liability for local acts as measured against vicarious liability. Claimants might well prefer to bring claims against smaller, less

331. *See supra* Section II.B.

staffed local governments than against national governments. As discussed above, obtaining relief (especially in trade disputes) might in some instances be easier and more effective against a local government. And while a national government may intervene, it does not have to if it prefers to let a challenged local government stand on its own two feet.

Moreover, direct liability does not come with the same set of costs as either vicarious liability or immunity. Direct liability continues to give states an incentive to liberalize and successful claimants a viable remedy. Indeed, the incentive to liberalize will be increased because local jurisdictions will internalize the costs of their actions to a greater extent.[332]

Put in terms of the model in Part III, direct liability reduces (but does not eliminate) *Y*, a national government's expected liability for local acts. At the same time, it maintains or even increases the size of *X*, the state's expected utility as a claimant. All claims remain viable (ensuring relief), and the liberalizing effect of those claims will be greater than under either immunity or vicarious liability. Moreover, *C*—the concessions necessary to contract around the default rule—is eliminated by making direct liability the default rule. Because direct liability delivers greater utility to national governments, they have little incentive to contract around it. For this reason, direct liability will be more stable as a default rule than vicarious liability.

The major political objection to direct liability would probably come from local governments themselves. Under current law, local governments can free ride on their national governments. Direct liability would remove this ability. Local governments would now be responsible for the consequences of their actions. In the negotiation of economic agreements, local governments might therefore be expected to oppose direct liability and push instead for immunity. Indeed, U.S. governors have objected to certain provisions of the TPP, such as protections for pharmaceutical companies that effectively increase drug prices.[333]

Although liberalizing trade is politically unpopular at the moment, local governments have often supported trade deals in the

332. *See supra* Part II.

333. *See* Letter from Peter Shumlin, Governor of Vermont, to Barack Obama, President of the United States (June 1, 2011), http://infojustice.org/download/tpp/tpp-government/Letter%20from%20VT%20Gov.%20Shumlin%20to%20President%20Obama%20-%20June%201,%202011.pdf [https://perma.cc/6VUS-BNTT] (discussing Governor Shumlin's support for limitations on intellectual property protections in the TPP based on their effects on state governments).

past. U.S. state governors, for example, overwhelmingly supported NAFTA.[334] Local governments are therefore unlikely to be a long-term obstacle.[335] Indeed, they stand to gain from a move to direct liability. The regime would give local governments—especially large state or provincial governments likely to be involved in international disputes, such as California—a greater say in the obligations imposed upon them. This influence comes in two forms. First, knowing that they are going to be subject to international obligations more directly than they currently are, local governments will assert themselves at the negotiations stage in an effort to influence the substantive terms in economic agreements. This influence can be used to obtain concessions that are especially important to them. For example, California and Minnesota, states that have significant subsidies for renewable energy that are vulnerable under economic law's nondiscrimination rules,[336] might push for specific rules to protect environmental subsidies. Alternatively, they might push for concessions on market access for particular goods produced in-state.

Second, because local governments would be able to participate in dispute resolution directly, they would be able to influence the interpretation of international obligations. To be sure, national governments would continue to play the predominant role here. Trade agreements typically create "commissions" consisting of the member states that are authorized to issue binding interpretative notes, a practice that NAFTA parties have followed to clarify the obligations contained in the investment chapter of that agreement.[337] National governments could also use their right of intervention to control litigation on legal issues of strategic importance to them. Local governments would, however, be able to bring their perspective to international disputes—a perspective that is at present almost totally absent. Indeed, international economic law would be greatly improved through consideration of the unique challenges local governments face in meeting their economic, environmental, and social goals consistent with international obligations.

334. *See* Douglas Seay & Wesley Smith, *Why the Governors Support the NAFTA (and Washington Doesn't)*, HERITAGE FOUND. (June 15, 1993), http://www.heritage.org/research/reports/1993/06/bg946nbsp-why-the-governors-support-the-nafta [https://perma.cc/4V43-98F5].

335. This proposal could also be modified to respond to specific concerns. For example, the direct liability regime might only apply to regional (i.e., state/provincial) governments, and not truly local governments.

336. *See* Meyer, *supra* note 40, at 1962–65.

337. NAFTA, *supra* note 59, art. 1131 ("An interpretation by [the member states] of a provision of this Agreement shall be binding on a Tribunal established under this Section.").

Finally, direct liability is consistent with the demand many subnational governments make for greater power relative to their own national governments. Within the United States, state governments would have a difficult time simultaneously arguing for plenary state police powers (as they are understood to have under the U.S. Constitution) and yet objecting to bearing the responsibilities that come with such a power.

In this sense, direct liability elevates the status of local governments and recognizes the critical role they play in federal systems. Other federal governments with strong subnational units might also find an unexpectedly warm reception from their local governments. The EU is, once again, the clearest example. While EU member states may be content to rest the responsibility for defending certain claims on the EU, they might embrace the notion of a continuing role in investment and trade policy.

In sum, in federal states in which there is a robust push and pull between the center and the periphery, the periphery might well welcome greater responsibilities as a sign of both of its status and as a bargaining chip with the center. In federal states with weak peripheries, the national government may simply impose direct liability as a way to control its localities and avoid liability. In either case, direct liability as a default rule would both facilitate local participation in international economic law, while at the same time furthering the goals of liberalization and accountability that underlie the international economic system.

CONCLUSION

The world is full of a bewildering array of governmental arrangements. Federations like the United States or Germany, confederations like Switzerland, supranational institutions like the EU, and unitary states like the United Kingdom all allocate their powers differently. For many years, international law's approach to these domestic distinctions was to ignore them. That rule, consolidated in the nineteenth century, might well have made sense when the nation-state had only recently emerged as the dominant form of political organization and international trade had not yet captured a significant portion of economic activity.

Today that is no longer the case. Local and regional governments regularly play a role in international affairs. U.S. states negotiate agreements with Canadian provinces and foreign governments; the policies of Mexican states or Canadian provinces affect the value of American investments. Political power also regularly flows both

upward—from member states to the EU—and downward—from the United Kingdom to Scotland and Wales. Moreover, international trade and foreign investment account for more than half of many nations' GDPs.[338]

International dispute resolution and the law of state responsibility need to evolve to take these changing circumstances into account. Unfortunately, the only change has been one that formally preserves the centrality of the nation-state while practically damaging international economic law's ability to drive economic growth and development. The time has come to reorient government's relationship to international law. Trade and investment agreements like the TPP offer the ideal place to start.

338. *See, e.g.*, *Merchandise Trade (% of GDP*), WORLD BANK, http://data.worldbank.org/indicator/TG.VAL.TOTL.GD.ZS [https://perma.cc/7HBS-HVE3].