A Finger in the Dike? An Examination of the Efficacy of State and Federal Attempts to Use Law to Stem Outsourcing

Beverley Earle
Geralk A. Madek
Christina Madek

Follow this and additional works at: http://scholarlycommons.law.northwestern.edu/njilb

Part of the International Trade Commons, Labor and Employment Law Commons, Legislation Commons, and the State and Local Government Law Commons

Recommended Citation
A Finger in the Dike? An Examination of the Efficacy of State and Federal Attempts to Use Law to Stem Outsourcing

Beverley Earle, Gerald A. Madek & Christina Madek*

I. INTRODUCTION

Something is happening when IBM holds its annual investor briefing in 2006 in Bangalore, India rather than in an American city.1 IBM has increased staffing in India and China from 13,200 employees in 2003 to 50,200 in 2006, which is almost a 400% increase.2 If these numbers were isolated then perhaps the response would be more muted. But amid great publicity, both Cisco and Microsoft announced similar expansions. Bill Gates, CEO of Microsoft, promised to “invest $1.7 billion and create 3,000 jobs.”3 Cisco pledged a $1.1 billion investment in India as well.4 Nor is

---

* Beverley Earle has a B.A. from the University of Pennsylvania and a J.D. from Boston University School of Law. She is a Professor in the Law, Taxation and Financial Planning Department at Bentley College and the McCallum Graduate School of Business. She is a fellow at the Bentley Center for Business Ethics. Gerald A. Madek has a B.A. from Boston College, a J.D. from Suffolk University School of Law and an LL.M. from Boston University School of Law. He is a professor in the Law, Taxation and Financial Planning Department at Bentley College and the McCallum Graduate School of Business. Christina Madek has a B.A. from Boston College and a J.D. from Suffolk University School of Law. She is an associate with Jantzen & Associates, P.C., Boston, MA.

1 Steve Hamm, Big Blue Shift, BUS. Wk., June 5, 2006, at 108 (discussing IBM’s new strategy of expanding to developing countries).
2 Id. (noting, however, that centers are being maintained in Tulsa, Oklahoma for clients who want “the tasks done in the U.S.”). IBM will actually triple its investment in India. Id.
3 Brier Dudley, Gates Touts New Jobs in India, SEATTLE TIMES, Dec. 8, 2005, at E1 (discussing expansion plans in India). Gates carefully points out that although the percentage increase in Microsoft’s workforce is larger in India than in the United States (19% versus 4%, respectively), Microsoft is still adding more jobs in absolute terms in the United States. Only about 750 jobs are being added per year in India, whereas 1,600–2,000 jobs were added in the United States in 2005 alone. However, Dudley also notes that Microsoft has been selling software in India since 1990 and developing products in the
India the only destination for outsourcing—China has also become a center of outsourcing for many companies.5

Many people, not just in the United States, are concerned about the implications of this growth in outsourcing for the future of business. State governments in particular are trying to stop outsourcing and are using the law as a means to do so. However, are these attempts, which are variants of the old “buy American” programs, doomed to be ineffective and ultimately protectionist, without really protecting American business? This paper will examine the developments of offshoring, outsourcing, and insourcing in Part II. Part III examines both state and federal legal efforts to restrict this growth. Part IV examines the WTO and international responses to these developments. Part V examines the Supreme Court’s analysis of tax incentives as a way to attract business to U.S. states. Part VI concludes with an analysis of what might be more efficacious ways to address outsourcing than the misguided attempts to date.

II. THE DILEMMA OF OUTSOURCING

Thomas Friedman, author of the seminal book, The World is Flat, defined outsourcing as “taking some specific, but limited, function that your company was doing in-house—such as research, call centers, or accounts receivable—and having another company perform that exact same function for you and then reintegrating their work back into your overall operation.”6

Many confuse the words “outsourcing” and “offshoring.” Friedman defines offshoring: “Offshoring . . . is when a company takes one of its factories that is operating in Canton, Ohio, and moves the whole factory offshore to Canton, China. There, it produces the very same product in the very same way, only with cheaper labor, lower taxes, subsidized energy, and lower health-care costs.”7

Both of these practices are of grave concern to the United States in the 21st Century. The Director of McKinsey China stated that: “Two-thirds of California’s manufacturing will move to China and India.”8 While this figure may be shocking, the pressures of finding low cost production are not the only forces pushing manufacturing overseas. World demographics suggest there may be another interest. For example, the median age in India is only twenty-four, while in the United States it is thirty-seven, in China it

Indian city of Hyderabad since 1998. Additionally, Microsoft is beginning to open retail outlets in India. Gates is revered in India and even has a rap song in his honor. Id.

4 Id.
5 See Watch Out India, ECONOMIST, May 6, 2006, at 69.
7 Id.
is thirty-four, and in Europe it is thirty-nine. India has seventeen percent of the world's population and this will be at the age when consumption is peak. Wal-Mart sourced from China for both global and local markets $18 billion in 2004 and expects to source $30 billion in 2008. As Ronald Haddock of the global consulting firm Booz Allen Hamilton stated: "China is not a question of whether to participate, but of how."

Individuals and companies who believe they can stop time or somehow insulate the United States and its people from these forces are woefully misinformed. People who harbor the belief that China is still part of the Third World have not visited Shanghai recently. Yes, there are problems of traffic and pollution, but one cannot help but be struck by the energy and hunger of people to move forward. The iron rice bowl appears dead. It seems like all workers—from professors to tour guides and hotel clerks—care deeply about their jobs and how they are evaluated. Compared to how it was under the strict Communist regime of the past, workers now know that they could lose their positions in the more open modern regime. As a result, market surveys are everywhere—at baggage claim, at the hotel and at the airport. Ten percent growth per year over ten years has led to an extraordinary transformation of Chinese cities.

More importantly, the cost of wages in the United States coupled with the cost of pensions and health care have made the U.S. business environment decidedly unattractive. No one can argue that it is bad for workers to have the safety net of such programs, but how sustainable are these costs given the availability of less expensive alternatives abroad? While the United States is not alone in struggling with this dilemma, newer economies without traditions of worker welfare programs have more flexibility to innovate. Thomas Friedman noted:

_Virtually every entrepreneur I talked to for this book cited soaring

---

9 Sumit Majumdar, _The Dynamics of Institutional Change in India, in 48TH ANN. MEETING OF THE ACAD. OF INT'L BUS._ (June 25, 2006).

10 Ronald Haddock, Vice President & Dir., Booz Allen Hamilton Greater China, Presentation at the Academy of International Business [AIB]: Global Sourcing (June 24, 2006) (noting also that "regulatory changes will continue to drive China's economic expansion") (slides/notes on file with the author). _But cf. Mei Fong, Chinese Rules May Tie Up Foreign Retailers,_ WALL ST. J., July 17, 2006, at A6 (discussing how China's draft regulations putting additional restrictions on the location of big stores in China would affect expansion plans of foreign retailers).

11 Haddock, _supra_ note 11. _Compare Friedman, supra_ note 7, at 114 (identifying ten forces that flattened the world, including: the fall of the Berlin wall, when Netscape went public, work flow software, uploading, outsourcing, offshoring, supply chaining, insourcing, in-forming the steroids (chips etc.). Friedman also discusses what he calls the "triple convergence": global, horizontal, and the new people from all the developing countries.

12 Interview with group of professors, Jiatong University, Antai School of Management (June 27, 2006) ("One half of salary is based upon incentives.") (notes on file with author).
and uncontrolled health-care costs in America as a reason to move factories abroad to countries where benefits were more limited, or nonexistent, or where there was national health insurance... In a flattening world, where worker security can no longer be guaranteed by Fortune 500 corporations with top-down pension and health plans, we need more collaborative solutions—among government, labor, and business—that will promote self-reliant workers but not just leave them to fend for themselves.13

The current myth suggests that only low cost jobs are being outsourced—such as the shoe factory from Maine whose viability ended long ago. Yet that too is misguided. Both China and India, or "Chindia," are poised to move up the value chain by offering professional services in research and development as well as professional devices like accounting, law, tax, and engineering at a lower cost and equally high quality.14 Outsourcing results in changes to the entire business process that can result in enormous efficiencies. This is also known as "transformational outsourcing."15 As Pete Engardio wrote:

Many executives are discovering outsourcing is really about corporate growth, making better use of skilled U.S. staff, and job creation in the U.S., not just cheap wages abroad. True, the labor savings from global sourcing can still be substantial. But it's peanuts compared to the enormous gains in efficiency, productivity, quality, and revenues that can be achieved by fully leveraging offshore talent.16

There are some real efficiencies with outsourcing. One commentator noted "[Companies that try offshoring] are keen to liberate expensive [talent]... so they can spend more time innovating."17 Noted areas of

13 FRIEDMAN, supra note 7, at 371. But cf. Paul Krugman, Divided Over Trade, N.Y. TIMES, May 14, 2007, at A23 (discussing how international trade can be a threat to U.S. jobs. He also noted, "But if Democrats really want to help American workers, they'll have to do it with a pro-labor policy that relies on better tools than trade policy. Universal health care, paid for by taxing the economy's winners, would be a good place to start."); accord Milt Freudenheim, New Urgency in Debating Healthcare, N.Y. TIMES, Apr. 6, 2007, at C1 (quoting J. Randall MacDonald, Senior Vice President of Human Resources, IBM (stating "[f]ive years from now this problem [of health insurance] will have to be cured, or the competitiveness of the United States will be dramatically affected")).

14 Peter Marsh, A New Manufacturing Mantra, FIN. TIMES, May 16, 2006, at Business Life 12 (discussing the "tear-down" center in Chennai that reverse engineers cars).

15 See Pete Engardio, The Future of Outsourcing, BUS. Wk., Jan. 30, 2006, at 50 (discussing the brutal impact of outsourcing and how companies adjust, compete, or go bankrupt).

16 Id. at 51.

17 Id. at 55.
outsourcing are: Human resources, Engineering, Info tech, Analytics, Customer care, Manufacturing, Finance and accounting, Logistics and accounting. Many people underestimate both China’s and India’s business acumen, preferring to believe that “American know-how” will be sufficient to maintain an edge in business growth.

In fact, the campaign against outsourcing has a familiar historical antecedent. The English Parliament, concerned about the woolen merchants, prohibited cotton from being used in all but the summer months: “[A]ll persons whatsoever to wear no garment . . . but what is made of sheep’s wool . . . from the feast of All Saints to the Feast of the Annunciation.” This may sound like a laughable proposal, yet in 1699, another English law required judges and professors to wear woolen robes. Even the dead, who could least object, were the subject of legislation requiring burial in woolen garments. Desperation about job loss and financial ruin prompted even more legislative action in 1701. The new law required that “all calicos . . . imported [from Persia, China or the East Indies]. . . shall not be worn or otherwise used within the Kingdom of England.” Yet this still allowed plain cotton to be imported, which ultimately stimulated the British dying and printing business. In 1722 it even became illegal to wear or use cotton cloth.

In a global world, even in the 1700’s, Great Britain’s approach could not erect a fence to trade. Britain’s business moguls ultimately found a way to prosper in the cotton business and their country was freed from the itchy strictures of wool.

Yet this positive view of outsourcing and an acceptance of its inevitability is best countered by an unlikely protectionist—the former free trader and former candidate for President, Senator John Kerry. In a campaign stump speech, Kerry infamously labeled CEOs as Benedict Arnolds. He reportedly stated that America seeks:

[A] prosperity where we will reduce poverty of millions rather than reducing the taxation of millionaires. A prosperity where we create jobs here at home and where we shut down every loophole, every incentive, every reward that goes to some Benedict Arnold CEO of a

18 Id. at 54–55. These were some of the biggest sectors in terms of global spending in 2005.
20 Id. (citing BEVERLY LEMIRE, FASHION’S FAVOURITE: THE COTTON TRADE AND THE CONSUMER IN BRITAIN 25 (1992)).
21 Id.
22 Id. at 155 (quoting LEMIRE, supra note 23, at 31).
23 Id. at 156 (discussed in LEMIRE, supra note 23, at 31).
company that takes the jobs overseas and sticks America with the bill.\footnote{NewsWatch, ST. LOUIS POST-DISPATCH, Feb. 1, 2004, at B5.}

This was a good media sound bite but it underscores a view held by many that there should be punitive sanctions on companies that globalize their production and operations.

Yet it is not just outsourcing that has caused the loss of jobs. As one expert noted, technology may be the bigger culprit:

While employment is falling, production is steady or even rising . . . While the textile trade regime has had some effect in keeping \textit{production} in the United States by increasing the price of imports, the stated goal of the regime—to save manufacturing jobs—has been undermined much more by mechanization and technological progress than by foreign competition.\footnote{RIVOLI, supra note 22, at 141 (emphasis in original) (examining the impact of globalization on trade by following a t-shirt around the world as it is made and marketed).}

However, it may be easier to blame the Benedict Arnolds than to face how the global revolution has forever affected the world and that the 20th Century, with the hallmark of unchallenged American superiority, is over.

\section*{III. STATE AND FEDERAL RESPONSES: ATTEMPTS TO RESTRICT OUTSOURCING}

While globalization is based on the premise that free trade will increase prosperity for all participating economies in the long term, the clear short-term result of this policy for some U.S. workers is distress. Predictably, these displaced workers, and their political representatives, are not soothed by the promise of future national and global gain. In fact, the short-term pain caused by globalization has aroused strong chauvinistic responses on both the state and federal level. This chauvinistic impulse to protect American workers and promote American goods has resulted in myriad attempts by both state and federal legislators to prevent outsourcing or offshoring of American jobs. This mass of legislative proposals, some of which have actually become law, pulls strongly against the natural effect of globalization. In part, this protectionism is wrongheaded, but, in part, it is a response to the inadequacy of our current statutory framework for effectively regulating the new global economy. The existing statutes were written for a simpler time and need to be systematically and coherently updated to coalesce more logically with today's free trade climate. Unfortunately, however, the current rash of state and national legislation does not accomplish this task in a way that is logical—or, in some cases,
A Finger in the Dike
28:89 (2007)

constitutional. A look at the types of legislation proposed on the state and national level will show the ways in which these laws converge around several anti-outsourcing strategies. Most of the state legislation will not likely prevail because of jurisdictional and constitutional issues. Much of the federal legislation will not likely prevail because this legislation clashes with international trade agreements that the United States has signed. The following analysis will illustrate these realities.

For the two-year span that ended in October 2005, 327 bills aiming to restrict outsourcing in direct or indirect ways, were introduced in forty states.26 Twelve such bills actually became law, while governors vetoed seven such laws.27 In addition, three laws requiring establishment of commissions to study the problem of outsourcing were passed and seven governors issued executive orders limiting outsourcing.28 From these many bills, one can identify five basic approaches to curtailing the loss of American jobs. Most of these approaches can be found in the successful bills—now laws. These same approaches are mirrored in the pending bills. In addition, many of these strategies for curtailing outsourcing are also found in existing federal statutes and in pending legislation. A review of these strategies, as illustrated in the laws passed to date, will give a clear picture of what shape America’s protectionist backlash has taken.

A. Outright Bans on Outsourcing at the State Level

Only one state to date has passed a law that establishes an outright ban on outsourcing. In May 2005, New Jersey’s governor signed what is

---


currently the nation’s most restrictive protectionist measure. This bill flatly prohibits state contract work from being performed outside the United States. Despite a vehement effort by lobbyists for the Indian government, public pressure seemingly forced passage of this law, suggesting that angry constituents are a significant force behind this protectionism. However, while New Jersey’s law effectively eliminates outsourcing or offshoring of government contracts, this statute obviously does not prevent private companies operating in New Jersey from outsourcing work. Interestingly, of the 127 bills introduced in state legislatures in 2005, twenty-six bills also propose an outright ban on outsourcing state contract work. Some of these proposed bans in fact have more restrictive twists, such as the South Dakota bill that proposes that work on state contracts can only be performed by persons authorized to work in the United States.

B. Legal Validity of State Bans on Outsourcing

In a legal sense, outright bans on outsourcing for state contracts are likely doomed because they interfere with both the U.S. Government’s foreign affairs power and the Foreign Commerce clause of the U.S. Constitution. Legal precedent holds that the U.S. Constitution grants to the President and Congress the power to create and uphold a coherent foreign affairs policy. Thus, any state statute that interferes with this federal right would be preempted by the federal government’s prerogative to set foreign affairs policy.

The outright bans on outsourcing for state contracts all appear to contravene this federal right for two reasons. On one hand, the federal

30 Mark B. Baker, "The Technology Dog Ate My Job": The Dog-Eat-Dog World of Offshore Labor Outsourcing, 16 FLA. J. INT’L L. 807, 827 (2004). Upon discovering that the company which processed benefits cards for New Jersey welfare recipients had moved its customer service operations to Mumbai, New Jersey Senator Turner introduced a bill to ban such outsourcing. See id. at 828–29. After unanimous approval from the Senate, pressure from lobbyists for India stalled the bill in the state assembly. See id. at 829. Public pressure, however, not only resulted in ultimate passage of the bill, but also caused the company in question, eFunds, to move its call center back to New Jersey to avoid losing state contracts in the future. Id.
33 See KLINGER & SYKES, supra note 35, at 6.
34 Id. at 4.
35 Id. at 6.
government has signed onto many free trade agreements, including the World Trade Organization’s Uruguay Round Agreement on Government Procurement.\textsuperscript{36} State laws that create policies banning outsourcing will clearly interfere with the federal right to create a foreign affairs policy that supports free trade. On the other hand, even if the federal government did not presently have a formal policy on outsourcing, formulating such a policy is clearly a federal right. In this context, states that ban outsourcing would be setting a policy that contradicts the federal government’s silence on this issue, interfering with the federal government’s “dormant foreign affairs presumption,” described in \textit{Zschernig v. Miller}.\textsuperscript{37} In essence, deciding trade policy is simply not a state prerogative.

Judicial precedent supports this analysis of federal prerogative. Three Supreme Court cases uphold the principle that a state law that contravenes federal foreign affairs power will be preempted by this power.

The most recent Supreme Court case to emphasize the preeminence of federal foreign affairs power, \textit{American Insurance Association v. Garamendi},\textsuperscript{38} was decided in 2003. In \textit{Garamendi}, the Court held that California’s Holocaust Victim Insurance Relief Act was preempted by the federal government’s foreign affairs power. Here, the California law mandated that insurance companies doing business in the state report to the state Insurance Commissioner details about policies they sold during the Holocaust. The Court found that this disclosure requirement was at odds with agreements made by the executive branch of the government—and so were preempted by federal foreign affairs powers.

In 2000, the Supreme Court ruled similarly in \textit{Crosby v. National Foreign Trade Council}.\textsuperscript{39} In \textit{Crosby}, the Court struck down a Massachusetts statute that prohibited state entities from doing business with anyone who had financial dealings with Burma. At the time this statute was enacted, there were no federal sanctions against Burma. As suggested


\textsuperscript{37} 389 U.S. 429 (1968); see also Baker, supra note 33, at 826 (discussing Zschernig).

\textsuperscript{38} 539 U.S. 396 (2003); see also KLINGER & SYKES, supra note 35, at 6 (illustrating Garamendi).

\textsuperscript{39} 530 U.S. 363 (2000); see also Baker, supra note 33, at 825–26 (examining Crosby).
above, however, in the absence of a specific federal policy on an issue, a
dormant federal foreign affairs presumption still exists. In fact, several
months later, the federal government did invoke sanctions that were less
severe than the Massachusetts sanctions. Thus, the Massachusetts statute
interfered with the federal government’s ability to set a uniform foreign
policy towards Burma. Although the Massachusetts statute did not overtly
contradict the federal policy, the Court found “implied preemption”\(^40\) in the
fact that the more severe Massachusetts sanctions could undermine the
federal government’s ability to speak authoritatively on this subject.

The oldest Supreme Court precedent that is relevant to these state bans
on outsourcing is the 1968 case, Zschernig v. Miller.\(^41\) In Zschernig, the
Court struck down an Oregon statute that forced people living in foreign
countries to agree in writing not to assign their inheritance of property in
Oregon to a third party. A product of the Cold War, the Oregon statute was
meant to keep Oregon wealth out of Communist hands. As such, the
Supreme Court found that, because the Oregon probate law promulgated a
certain foreign policy and so had the potential to affect international
relations negatively, this statute was preempted by the federal government’s
foreign affairs power. As suggested above, in this case, the Oregon statute
fell victim to a dormant foreign affairs presumption, where state laws
cannot articulate foreign policy—even if no federal law exists on the issue.

An analysis of the Court’s decisions on state statutes that infringe on
federal foreign affairs power shows that there are several key factors that
the Supreme Court considers in such cases: (1) whether the state statute is
meant to interfere with the affairs of a foreign country; (2) whether the state
statute has the intent and ability to actually affect another country; (3)
whether the state’s action might spur more states to formulate statutes
usurping federal powers; (4) whether the state law contradicts federal law
on the issue in any way; and (5) whether targeted countries have
complained.\(^42\)

Given this analysis, it seems clear that state statutes that purport to ban
outsourcing for state contracts will, if challenged, most likely be found
unconstitutional as a usurpation of federal foreign powers. One
commentator has suggested, given the clear legal analysis on this issue, that
the rush to introduce bills to ban outsourcing actually represents a series of
political moves meant to pander to public outrage over the loss of American
jobs—regardless of whether any of these bills, should they become law, can
survive a constitutional challenge.\(^43\) In fact, this political motive sometimes

\(^{40}\) Crosby, 530 U.S. at 388; see also Baker, supra note 33, at 825.
\(^{41}\) 389 U.S. 429; see also Baker, supra note 33, at 826.
\(^{42}\) KLINGER & SYKES, supra note 35, at 6 (analyzing considered factors).
\(^{43}\) Baker, supra note 33, at 827 (noting there is a political angle to be had from trying to
take action to protect domestic workers and the domestic economy).
produces results. In the case of the New Jersey ban on outsourcing, even before the statute had beaten back intense lobbying efforts by India, the company involved moved its call center back to New Jersey to avoid the fallout from making such an unpopular move—and to preserve its ability to win state contracts in the future. It should be noted, however, that if the United States should ever articulate by statute a clear policy on outsourcing bans, state laws that do not contradict or go beyond this policy, though redundant, would likely be upheld.

A subset of federal power over foreign affairs is federal power over foreign commerce. In fact, the Foreign Commerce Clause of the U.S. Constitution gives Congress the power to regulate foreign commerce. In addition, legal precedent makes clear that federal law trumps state law on issues of foreign commerce. When a case involves foreign commerce, the courts routinely subject the state statutes involved to heightened scrutiny to make certain that the statute does not interfere with national concerns about foreign commerce. This heightened scrutiny emphasizes the importance, to the courts and to the federal government, of maintaining uniform foreign commerce practices. The premise here is the same as in the analysis of federal foreign affairs powers: the country benefits from a uniform foreign commerce policy. If states promulgate laws that attempt to meddle with foreign commerce, the United States as a whole may suffer retaliatory negative economic effects. Given this analysis, a state law that bans outsourcing is very likely to be declared unconstitutional for interfering with federal power over foreign commerce.

Another unresolved issue involving state attempts to ban outsourcing involves the constitutional prohibition of national origin discrimination, as well as Title VII's prohibition of such discrimination. Private contractors who outsource state or federal contract work to American workers in other

44 Id. at 828.
45 U.S. CONST. art. I, § 8, cl. 3.
47 See KLINGER & SYKES, supra note 35, at 7 (citing Antilles Cement Corp. v. Calderon, 288 F. Supp. 2d 187, 195 (D.P.R. 2003)).
48 See id. at 8.
49 To apply overseas, United States labor statutes must contain a clear statement of congressional intent to extend the reach of the law overseas. See Justin Kent Holcombe, Solutions for Regulating Offshore Outsourcing in the Service Sector: Using the Law, Market, International Mechanisms, and Collective Organizations as Building Blocks, 7 U. PA. J. LAB. & EMP. L. 539, 577 (2005). In fact, the Civil Rights Act of 1991 specifically inserts such a statement of congressional intent into Title VII. See id.
countries might be seen as violating this country’s ban on national origin discrimination if they are found to be discriminating against American workers because they are American. This may suggest a way in which federal outsourcing bans conflict with both the U.S. Constitution and with federal labor laws, and may provide an avenue for displaced workers to seek redress in the future. One state court case has already upheld such a claim. In Goyette v. DCA Advertising, Inc., an American subsidiary of a Japanese company fired twenty-two American workers and replaced them with Japanese workers. In this case, the court found that the American workers were clearly protected by Title VII against discrimination on the basis of their national origin. This avenue of redress, however, is unlikely to become a serious threat to outsourcing bans since most U.S. work is outsourced to non-American workers at the outset.

C. Outright Bans on Outsourcing at the Federal Level

At the federal level, there is no statute that mandates a total prohibition on outsourcing federal contracts, comparable to New Jersey’s ban on outsourcing state contracts, despite several attempts at enacting such a ban. In 2004, the United States Workers Protection Act was introduced in both the House and the Senate but failed to pass. This Act prohibited any federal contract work from being performed overseas, except for cases where the President decided that such outsourcing was necessary for national security reasons. The same bill was reintroduced in 2005, but again failed to become law. Likewise, the American Manufacturing Jobs Retention Act of 2003 proposed a more limited ban on outsourcing jobs under federal contracts. This bill required that at least 50% of workers on projects done for U.S. agencies be employed in the United States. As with both incarnations of the U.S. Workers Protection Act, the American Manufacturing Jobs Retention Act failed to make it out of congressional committees.

50 828 F. Supp. 227 (S.D.N.Y. 1993). The “market participant” doctrine was developed in the context of interstate commerce to distinguish between situations where a state was acting like any private individual who participated in the market and situations where the state was wielding its power to regulate the market. In Trojan Technologies, Inc. v. Commonwealth of Pennsylvania, the Third Circuit transmutes this interstate commerce principle into a foreign commerce principle, holding that Pennsylvania was simply expressing a preference for a product from specific sources, as any private market participant might, rather than using the power of the state to influence policy. 916 F.2d 903 (3rd Cir. 1990).

51 Goyette, 282 F. Supp. at 232.


One partial ban on outsourcing for federal contracts has been signed into law—the Thomas-Voinovich Amendment to the 2004 Omnibus Spending Bill. This statute mandates that an "activity or function of an Executive agency . . . may not be performed by a contractor outside the United States." The only time when such work can be done outside of the country is when federal employees have previously completed this work outside of U.S. borders. The purpose of this ban is to prevent offshore workers from providing services in a more cost-effective manner than government workers in this country. The Thomas-Voinovich statute is, however, very limited in scope since it only covers work done for the U.S. Treasury Department and the Department of Transportation.

Another attempt at a large-scale ban on outsourcing federal service contracts also resulted in a watered-down prohibition. The Dodd Amendment to the JOBS Act, which makes the Thomas-Voinovich Amendment permanent, was originally written to require that only U.S. workers perform work for all federal service contracts. However, after much opposition from Senate Republicans, the amendment as passed excluded most federal agencies from the outsourcing ban, most notably all military agencies and homeland security agencies.

D. Legal Validity of Federal Bans on Outsourcing

Federal bans on outsourcing are obviously analyzed differently than are state bans. Since the federal government has preeminence in foreign affairs and foreign commerce, the Thomas-Voinovich Amendment and the Dodd Amendment do not interfere with federal powers as the New Jersey outsourcing ban does. Rather, these federal statutes are simply exercising powers that the Constitution confers on the federal government.

The most important problem for federal bans on outsourcing, however, is that such bans put the United States in violation of several trade agreements to which it is a signatory, including the North American Free Trade Agreement, the Uruguay Rounds Agreement, and the World Trade Organization Agreement.
Trade Organization Government Procurement Agreement ("GPA"). The most important of these, in the context of this paper, is the GPA. The GPA obligates its signatories to treat foreign suppliers, goods, and services comparably to domestic suppliers, goods, and services. This agreement further prohibits discrimination against domestic suppliers who might have foreign owners or who supply foreign goods and services. If signatories pass domestic statutes that conflict with these trade obligations, these signatories can be found in violation of the GPA.

In recognition of this problem, the Dodd Amendment excludes signatories of the GPA from its outsourcing prohibitions. However, the Thomas-Voinovich Amendment does not exclude these signatories, and so runs afoul of the GPA in several ways. First, the Amendment's mandate to use domestic workers does not treat foreign firms comparably to domestic firms, as required by the GPA. Although Thomas-Voinovich requires both foreign and domestic firms to use domestic workers, the cost of doing so is much greater for firms whose workers are all based outside of the United States. Thus, the cost of complying with this statute clearly increases for firms located outside of the United States, putting these firms at a competitive disadvantage.

The second way in which the Thomas-Voinovich Amendment violates the GPA is by discriminating against U.S. firms who outsource. By prohibiting contract work from being performed by contractors outside of the United States, this Amendment excludes American firms who outsource work from competing for these federal contracts. This type of discrimination, as explained above, is expressly prohibited by the GPA. Thus, federal bans on outsourcing will likely put the United States in violation of the GPA, which will cause both negative political and negative economic fallout.

Interestingly, while the main problems for proposed state outsourcing bans are constitutional, as described above, these state statutes may also violate the GPA in the same ways as does the Thomas-Voinovich Amendment. Klinger and Sykes point out that "because the federal government has the constitutional authority to act on behalf of the states in the international arena, and certainly to the extent that states receive federal monies . . . all states are arguably required to comply with the federal statutory requirements incorporating the GPA."

61 Uruguay Round Agreements Act, supra note 39.  
62 GPA, supra note 39; Uruguay Round Agreements Act, supra note 39.  
63 GPA, supra note 39, art. 3(1).  
64 Id. art. 3(2).  
65 See KLINER & SYKES, supra note 35, at 19.  
66 Id.  
67 See id. at 18.
In fact, thirty-seven states have explicitly agreed to abide by GPA requirements, under a provision that allows sub-national governments to opt in to the GPA. On the other hand, two recently-enacted state statutes actually prohibit the governor from agreeing to bind the state by trade agreements. While these statutes attest to a level of frustration with outsourcing, they may, as suggested above, be moot in light of federal authority to act on behalf of the states in these matters.

Clearly, outright bans on outsourcing, on both the state and national levels, are vulnerable to challenge on a variety of grounds. That so few outsourcing bans, on either the state or federal levels, have actually become law is clear evidence that many legislators know this. However, a tug of war appears to be taking place here. Many Americans instinctively want to protect American jobs, thinking that this is the way to protect our economy. The pressure, described above, that was put on the New Jersey legislature to pass an outright ban on outsourcing for state contracts is a clear example of this grassroots protectionism. On the other hand, proponents of globalization see this protectionism as short-sighted, likely to result in retaliatory action by trade partners and so ultimately harmful to the American economy. This battle is apparently being fought at both the state and federal levels, with the proponents of globalization keeping most of these proposed bans from becoming law. If this first round of state and federal outsourcing bans faces successful legal challenges, this should blunt the onslaught of proposed outsourcing legislation. If, on the other hand, these first statutes remain unchallenged or are challenged unsuccessfully, many more versions of outsourcing bans will likely find their way out of committees and onto governors’ desks.

E. Indirect State Bans on Outsourcing Through Preferences

Another popular approach to limiting outsourcing involves statutes that express preferences for in-state or in-country goods and services. This particular approach to limiting outsourcing does not, at this point, have any counterparts on the federal level. While New Jersey’s outsourcing ban is the only one to actually become law in the last two years, within that same time period, seven states have actually enacted statutes that include preferences for local goods and services. In addition, legislation...
mandating preferences is pending in three states. Finally, on the executive level, the governors of Indiana and Minnesota have issued Executive Orders calling for preferences for state goods and services.

A look at the state statutes mandating preferences will outline the concept behind these initiatives. The basic principle of "preference" statutes is to favor local goods and services over non-local goods and services. Most of these statutes define "local" as in-state. However, some statutes define "local" as in-country. Sometimes the state statute requires preferences on specific products, as the Colorado statute that mandates an in-state preference for agricultural products. Again, Tennessee's statute mandates an in-country preference for data entry and call center services. Another variable involves the strength of the preference. For example, Illinois requires a preference in procurement decisions for goods manufactured in the United States, while Alabama simply "encourages" a preference for professional services based in Alabama, rather than mandating such a preference. Since these "preference" statutes involve the award of state contracts, several statutes use the contract process as the basis for preferences. Thus, Indiana provides price preferences of between one and five percent for Indiana companies when awarding state contracts, while North Dakota prefers state contracts over others when the bids are equal. While less direct than outright bans, the purpose of these "preference" statutes is the same as the purpose of the bans: to keep American jobs from going overseas.

F. Legal Validity of State Bans on Outsourcing Through Preferences

As with state statutes that require an outright ban on outsourcing, state statutes that attack outsourcing more indirectly through the use of preferences will likely be found invalid if challenged in courts. While these "preference" statutes do not apparently interfere with federal foreign powers rights, as a class, they clearly violate the Constitution's Foreign

74 See 2005 Ill. S. 1723; N.C. H. 1414; Tenn. S. 2344.
75 See Tenn. S. 2344.
76 See 2005 Ill. S. 1723.
77 See Ala. S.J. Res. 234.
In addition, those statutes that require preference not just for American goods, but also for goods from a particular state run the danger of violating the Privileges and Immunities Clause and the Full Faith and Credit Clause of the Constitution.

Since the Foreign Commerce Clause also gives the federal government authority to regulate interstate commerce, all state “preference” statutes whether they require the use of in-state goods and services or in-country goods and services may easily be seen as interfering with interstate commerce. The Foreign Commerce Clause, in giving authority over interstate commerce to the state, suggests that states cannot make laws restricting commerce outside their borders, whether the law restricts commerce with other states or with a foreign country. In cases involving the Foreign Commerce Clause and interstate commerce, the Supreme Court has, in fact, established a “per se” rule that state statutes which require outright protectionism are invalid even though the state may be pursuing a legitimate local economic interest. The Court’s guidance here is explicit and suggests that these “preference” laws are not legally viable.

There is one approach, however, that may render some state “preference” laws viable under the Foreign Commerce Clause. This approach was used in a recent Third Circuit decision. Trojan Technologies, Inc. v. Pennsylvania considered whether state statutes can mandate that companies performing work for state contracts “Buy American.” The Third Circuit upheld a Pennsylvania statute that required that all state contracts include a provision that any steel used in public works construction projects must be made in the United States. Here, the court found that this statute did not interfere with the federal government’s foreign affairs power. In reaching this conclusion, the court extended the “market participant” exception, formulated for interstate commerce cases, to foreign commerce. Using this construct, the court found that the Pennsylvania statute merely allowed the state to operate as any private market participant might, rather than giving the state unwarranted regulatory control. Whether or not the “market participant” exception can, in reality, be applied in this context to either interstate or foreign commerce is, at this point, uncertain. In fact, a

---

79 U.S. CONST. art. I, § 8, cl. 3.
80 Id. art. IV, § 2, cl. 1.
81 Id. art. IV, § 1, cl. 1.
82 Id. art. I, § 8, cl. 3.
83 See KLINGER & SYKES, supra note 35, at 12.
85 916 F.2d 903 (3d Cir. 1990).
86 See id.
87 Inc. Vill. of Rockville Ctr. v. Town of Hempstead, 196 F.3d 395, 399 (2d Cir. 1999).
California circuit court, in *Bethlehem Steel Corp v. Board of Commissioners*, reached an opposite conclusion about "Buy American" statutes, striking down the California statute as unconstitutional because it encroached on the federal government’s power to create uniform foreign commerce policies. The Supreme Court has not yet definitely resolved whether or not the "market participant" doctrine can actually be applied to foreign commerce cases. If, however, the Supreme Court decides to allow the Third Circuit’s analysis to stand, the "market participant" strategy might provide a concept on which to build state anti-outsourcing laws that will pass constitutional muster.

For state statutes that require in-state preferences, the possible legal challenges go beyond the Foreign Commerce Clause. In fact, when these statutes involve restricting commerce with other states, they may also potentially violate the Privileges and Immunities Clause of the Constitution. This clause prohibits a state from discriminating against residents of other states by denying them the same privileges and immunities granted to its own citizens. Under the terms of this Clause, a state may discriminate against non-residents in hiring for state jobs, but may not discriminate against non-residents working for private companies who are fulfilling state contracts.

Judicial history in cases involving the Privileges and Immunities Clause suggests that to prevail, these state statutes would have to meet two conditions. First, these statutes would need to address a situation where the non-residents represented a "peculiar source of evil" which was not simply related to economic protectionism. This condition underscores the judiciary’s concern that the evil being addressed be shown concretely to actually exist. Next, the remedy proposed in the state statute would have to be narrowly tailored to the purported evil being addressed. A survey of the state statutes establishing preferences for in-state goods and

---

89 See Connecticut *ex rel.* Blumenthal v. Crotty, 346 F.3d 84, 95 (2d Cir. 2003) (illustrating that a New York statute which discriminated against non-resident holders of valid New York lobstering permits by denying them access to New York waters violated the Privileges and Immunities Clause of the Constitution).
90 See A.L. Blades & Sons, Inc. v. Yerusalim, 121 F.3d 865, 871 (3d Cir. 1997).
91 See W.C.M. Window Co. v. Bernardi, 730 F.2d 486, 497 (7th Cir. 1984).
92 See *Crotty*, 346 F.3d at 97 (striking down a statute which placed residency requirements on insurance consultants because the state did not provide any evidence to prove that these non-resident consultants represented any possible harm to state residents).
93 See *Hicklin* v. Orbeck, 437 U.S. 518 (1978) (holding that an Alaska statute favoring in-state workers was unconstitutional under the Privileges and Immunity Clause because the preference established did not bear a clear relationship to the "evil" against which it was defending). The *Hicklin* court stated that for "a policy which may present serious constitutional questions" to be valid, the means by which it addresses the perceived evil "must be more closely tailored to aid the unemployed the Act is intended to benefit." *Id.* at 528.
services suggests that these statutes may not meet the threshold for validity established by the Privileges and Immunities Clause since the "evil" addressed is uniformly economic competition.

Another legal hurdle for in-state "preference" statutes is the Constitution's Full Faith and Credit Clause. This clause mandates that states respect each other's policies. It also establishes that no state need honor another state's policy which conflicts with its own policy.\textsuperscript{94} Klinger and Sykes give a relevant example of possible problems these statutes might create under the Full Faith and Credit Clause.\textsuperscript{95} Indiana's "Buy Indiana" policy might well clash with the policy of another state, perhaps Wisconsin. If a Wisconsin resident sues Indiana in Wisconsin for damages caused by the policy, Wisconsin will not be required to violate its own policy in order to uphold Indiana law. In fact, this example suggests a fundamental problem that exists with these laws.

The intent behind the three constitutional clauses discussed in this section is to maintain a coherent framework of commerce policy that will prevent a patchwork of state laws that contradict each other and could well lead to increasingly hostile relations between the states. In fact, the perceived "enemy" in the outsourcing issue is the foreign worker who takes American jobs. But, in reality, some of these state preference laws in a real sense cast the "enemy" as the residents of the state next door. To avoid these interstate problems, state "preference" statutes might follow the lead of the statutes described above which define "local" as in-country rather than in-state.

G. Indirect State and Federal Bans on Outsourcing Through Limits on Data Transmission

Privacy is an important concern in the United States today, and outsourcing appears to present another substantial threat to privacy. When service jobs are outsourced, the data the workers need to perform their work must follow. Thus, as outsourcing mushrooms, so does the amount of financial, health, and other personal data that leaves the country. Not surprisingly, then, bills which attempt to limit outsourcing by controlling the transmission of personal data to overseas destinations have proliferated on both the state and federal levels. While none of these bills has yet been enacted into law, there are at least ten such bills pending in state legislatures\textsuperscript{96} and at least five high-profile bills pending in Congress.\textsuperscript{97} In

\textsuperscript{94} U.S. CONST. art. IV, § 1, cl. 1; see also Nevada v. Hall, 440 U.S. 410, 422 (1979) (explaining the parameters of the Full Faith and Credit Clause).

\textsuperscript{95} See KLINGER & SYKES, supra note 35, at 15.

general, these bills prohibit entities from sending private information overseas without express permission from the consumer. Most often, the information these bills seek to protect is financial information or healthcare information, but one bill actually prohibits the transmission of voter data overseas.98

Sponsors of these anti-outsourcing bills often cite privacy concerns as their sole motivation,99 but limits on data transmission are, in reality, a major deterrent to outsourcing. In particular, if health and financial data cannot be transmitted overseas without permission, call centers in foreign countries will have a difficult time retrieving the data needed to provide the services they were hired to provide. In fact, such limitations on data transmission could serve as a powerful motivator for companies to return such call centers to the United States.100

H. Legal Validity of Proposed Limits on Overseas Data Transmission

State and federal opponents of outsourcing have found, in these bills calling for limits on transmitting data overseas, a potentially potent tool for curtailing outsourcing of service-based jobs. However, as with the other types of legislation discussed above, there are legal impediments to this type of legislation. The first problem is that both state and federal bills to ban transmission of data overseas without permission may well violate the GPA and other trade agreements to which the United States is a party,' similarly to the way in which the Thomas-Voinovich Amendment violates

---


98 See Global Sourcing Information, supra note 29 (citing California Bill).

99 Letter from Edward J. Markey, Congressman from Massachusetts, to Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System et. al. 3 (Feb. 23, 2004) (on file with author) (voicing strong distrust of outsourcing personal information: "In their rush to cut costs and increase their bottom line . . . companies may be sacrificing the privacy protections the law affords to American citizens by transferring sensitive information to offshore companies.").


101 See GPA, supra note 39.
these trade agreements—by failing to give treaty signatories treatment comparable to the treatment received by domestic entities. If service providers in the United States can more easily access the financial and health information necessary to perform their duties than services providers outside of the United States can retrieve this data, then these two classes of service providers are not being treated comparably, as required by the GPA. In effect, the promise that all GPA signatories will be treated equally will have been broken and the United States may be found in violation of this trade agreement. State laws that transgress international trade agreements may also be impermissibly interfering with federal foreign policy power.

In addition to potential trade agreement violations, proposed state bans on overseas data transmission must clear another hurdle that proposed federal bans do not face. These state bills, if enacted into law, may well be preempted by several federal privacy laws already in force: the Fair Credit Reporting Act ("FCRA"),\textsuperscript{102} the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"),\textsuperscript{103} and the Gramm-Leach-Bliley Act of 1999 ("GLB").\textsuperscript{104} In fact, the FCRA has recently been amended to specifically preempt any attempts by state agencies to tighten controls on sharing credit information beyond what the FCRA allows.\textsuperscript{105} HIPAA allows the sharing of health information between business associates within established parameters with specified consents.\textsuperscript{106} Likewise, GLB allows the sharing of financial information between affiliates, again within established parameters and with specified consents.\textsuperscript{107} The key point here, however, is that none of these federal privacy laws makes a distinction between business associates or affiliates that are located within the United States and business associates or affiliates that are located outside the

\begin{footnotes}
\item[106] 45 C.F.R. § 164.502(e)(1)(i) (2002) provides that covered entities may “disclose protected health information to a business associate, and may allow a business associates to create or receive protected health information . . . if the covered entity obtains satisfactory assurance that the business associate will appropriately safeguard the information.”
\item[107] 15 U.S.C. § 6802(b)(2) (1999). The conditions imposed on such transmission by GLB require full disclosure to consumers that this information will be shared with third parties as well as contracts with the third parties that require confidentiality.
\end{footnotes}
United States. Thus, state laws that make such a distinction may be found to be in conflict with their federal counterparts and so preempted by the federal laws.

It is important to note here that both HIPAA and GLB explicitly state that they do not preempt state laws that provide stricter standards for protecting transmitted information. However, even when the federal law explicitly limits its own preemptive power, a state statute will be preempted if it actually conflicts with the federal law. One might clearly argue that state laws that make a distinction between affiliates located in the United States and those located outside the United States are in definite conflict with federal laws that make no such distinction.

In fact, one clash between a state privacy law and federal privacy laws has already been resolved by the courts in favor of the federal law’s preemptive power. In American Bankers Association v. Lockyer, the Bankers Association sought a ruling that the FACT Amendment to the FCRA specifically preempted a California statute that imposed stricter standards on international data transmission than did the federal law. The lower court found that FACT preempted only part of the California law, the portion dealing with credit report information. However, the opt-out provision which gave consumers more control over the use of their information was upheld by the lower court. Here, the court noted that the GLB specifically allows states to pass more restrictive privacy laws regarding financial information than those enacted on the federal level.

The Bankers Association immediately appealed to the Ninth Circuit. Interestingly, the Federal Trade Commission joined the Bankers Association in this appeal, suggesting the strong interest the federal government has in preserving its power to create a coherent policy on outsourcing, which will not be diluted by the states. The Ninth Circuit reversed the lower court’s decision and found that FACT did indeed preempt the California statute. This decision appeared to turn on the issue identified above—whether the states have the right to distinguish the kinds of information that will be available to affiliates inside the United States and the kinds of information that will be available to affiliates outside of the United States. In the first skirmish over this issue, then, federal preemptive power has prevailed. However, California is appealing this decision. Until the Supreme Court resolves this issue, the skirmishing will no doubt continue. However, the Ninth Circuit’s decision in Lockyer

108 Health Insurance Portability and Accountability Act § 264 (c); Gramm-Leach-Bliley Financial Modernization Act § 6802(b)(2).
109 See Holcombe, supra note 52, at 566.
111 See Am. Bankers Ass’n v. Gould, 412 F.3d. 1081 (9th Cir. 2005).
112 See id.
suggests that the analysis that sees these state restrictions on overseas data transmission as different in kind from the federal privacy laws, rather than merely stricter versions of the same policy, may ultimately prevail.

As suggested by the debate in Lockyer, these proposed state privacy laws also seem to interfere with the federal power to maintain a uniform foreign affairs framework. In addition, interfering with outsourcing under the cloak of protecting privacy might also be seen as touching on the foreign commerce arena and so violating the Foreign Commerce Clause. Privacy concerns are pressing and legitimate concerns in today's climate. These concerns are not likely, however, to trump federal interest in supporting globalization, given the variety of legal obstacles facing laws that propose restrictions on transmitting data overseas.

I. Indirect State and Federal Bans on Outsourcing Through Disclosure Requirements

1. Disclosure of Outsourcing

Attempts to regulate disclosure requirements take two forms: requirements that contractors reveal where work will be done and requirements that workers in call centers disclose their locations. One state, North Carolina, has actually enacted a statute of the first type. This statute requires all vendors bidding for state contracts to disclose where the contract work will be performed, specifically whether the work will be performed outside the United States. Four states have such laws pending and one state governor has vetoed a statute which would mandate disclosure of outsourcing. In addition to the pending legislation that would force disclosure, three states have enacted laws that mandate creation of commissions to study outsourcing, with the clear intent of emphasizing the extent of the practice. One of these statutes, the New Jersey statute, actually sets out to "study ways to reduce outsourcing and offshoring in the State." Finally, five governors have issued executive orders mandating the study of outsourcing, again, with the clear intent of highlighting the extent to which outsourcing has affected their state. Thus, the states

---

have attempted to heighten public awareness of outsourcing through use of several tactics.

On the federal level, a similar bill is pending in Congress. The Jobs for America Act of 2004 amends the Worker Adjustment and Retraining Notification Act. This amendment requires that, when jobs are being moved offshore, covered entities provide notice of how many jobs are being outsourced, the location to which they are being outsourced and why these jobs are being outsourced. Clearly, both state and federal legislators see mandatory disclosure that workers are being outsourced as a method for arousing public awareness of outsourcing and generating pressure to ban or limit such movement of jobs overseas.

2. Disclosure of Call Center Locations

The motivation behind the bills pending that would require workers in call centers to identify their location on the state and federal level is similar. Presently, there are no actual statutes enacted on either the state or federal level that would mandate disclosure of the location of call centers. However, there are fourteen state bills pending that would require that workers in call centers disclose their location. Some of these bills also include more specific restrictions. For example, the Minnesota, Illinois, Oregon, and Florida statutes require not only that the call center worker reveal his or her location, but also that the worker switch the call back to the United States if the caller so demands. Mississippi’s statute also requires that the call center location be disclosed at the very start of a call. Finally, Iowa’s statute includes a preference for awarding state contracts to entities whose call centers will be located in the United States.

On the federal level, Senator Kerry introduced a bill that is pending in the Senate, entitled Call Center Consumer’s Right to Know Act of 2003. Similar to the state bills described above, this bill mandates that a call

119 Id. at 2(e).
122 See H. 214, 120th Sess. (Miss. 2005).
124 Call Center Consumer’s Right to Know Act, S. 1873, 108th Cong. (2003).
center employee disclose the location of the center at the beginning of every call. Interestingly, this bill defines a "call center" as "a location that provides customer-based service and sales assistance or technical assistance and expertise to individuals located in the United States via telephone, the Internet or other telecommunications and information technology." Clearly, the Kerry bill is looking forward to the various permutations call centers may experience in the near future. This bill also includes reporting requirements and penalties for non-compliance.

3. Legal Validity of State Disclosure Requirements

The pending federal legislation mandating outsourcing disclosure does not run the risk of interfering with federal foreign affairs and foreign commerce powers. However, as with other state anti-outsourcing approaches, the state measures described in this section may be invalidated by the courts because they interfere with federal foreign affairs power and the Foreign Commerce Clause. There has been no significant judicial challenge to such laws, so the effectiveness of this particular anti-outsourcing strategy is unknown. These bills do not actually ban outsourcing, which puts them on sounder legal footing than the bills that propose outright bans and preferences. However, the intent of these bills is to arouse public sentiment against outsourcing with the hope that such public anger will result in companies relocating workers and call center functions back to the United States. If a number of these bills become law and do in fact create a backlash that forces a significant number of workers and call centers to relocate back to this country, an argument could be made that these mandates for disclosure are infringing on federal foreign affairs power. Such a result would prevent the federal government from constructing a consistent economic policy that supports globalization.

J. Indirect State and Federal Bans on Outsourcing Through Subsidy Incentives

The final category of anti-outsourcing bill attempts to use state and federal subsidies and tax incentives to counter outsourcing. The significant fact about this type of legislation is that it potentially affects private companies working on private contracts with the help of state or federal subsidies. Thus, the reach of these proposals is potentially broader than the previously discussed legislation that only reaches to companies working on public contracts.

There have been no such bills actually enacted on the state level, but

125 Id. at 2(d).
126 Id. at 2(b)–(c).
there are five incentive bills pending in state legislatures. The following examples summarize the nature of this category of bill. New York’s proposal would prohibit any entity that received assistance from the State to move its workers from New York. This bill would also require companies to return any state assistance they had already received in the event that they did leave New York. Finally, recipients of New York aid that offshore jobs would not be eligible for aid from New York for five years from the date the outsourcing was discovered. Similarly, Connecticut has a pending bill that proposes to cut off any state aid for seven years to companies that outsource more than 100 jobs. Other bills, like Washington State’s anti-outsourcing bill, use tax incentives to discourage outsourcing. Washington’s bill stipulates that tax incentives will only be awarded to companies who agree to create more jobs within the State of Washington than they export out of the state. In addition to bills pending in the state legislature, Michigan’s governor has issued an executive order following this same tactic. This order seeks to encourage companies to keep workers in the United States by issuing a prohibition on the use of certain state funds to aid in outsourcing workers from the United States.

This type of legislation obviously uses financial incentives to encourage companies not to outsource. Since none of these bills have actually become law yet, the success of this strategy is not yet known. However, should such a bill become law, affected companies will clearly calculate whether they will make more money by accepting state subsidies or by moving workers and operations to a locale where the cost of doing business is significantly cheaper.

On the federal level, there is one pending bill and one actual statute in this category. The pending bill, the United States Workers Protection Act of 2005, discussed above, contains a financial incentive to discourage outsourcing. This bill prohibits federal aid to a state unless that state certifies that it will not use the federal money to procure any goods or

---

128 See Assemb. 9567, 2004 Leg., 227th Sess. (N.Y. 2004); S. 6040, 2004 Leg., 227th Sess. (N.Y. 2004). The New York bill runs the danger of causing tension with other states since the wording of the bill provides financial disincentives for moving to “an outside locality.” This could conceivably cause interstate friction as described in the discussion of bills proposing preferences for in-state goods and services.
services coming from overseas. The federal "incentive" legislation, which has actually been signed into law by President Bush, uses a somewhat different "financial incentive" strategy. Rather than tying federal aid to local jobs, the American Jobs Creation Act of 2004 implements changes in the tax code that protect American manufacturing jobs.\footnote{American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (codified as amended in scattered sections of 26 U.S.C.).}

This statute is, in actuality, a response to a retaliatory action by the European Union. The EU believed that certain U.S. tax frameworks violated international trade agreements, and, in retaliation, imposed sanctions that hurt the competitiveness of U.S. products in world markets. This loss of competitiveness, in turn, threatened U.S. jobs. To enhance the competitiveness of American products and increase the economic rewards for keeping operations in the United States, the American Jobs Creation Act revamped the offending tax frameworks. Senator Hutchinson described the motivation behind this bill as follows: "We have to act to give our manufacturers every possible advantage we can to be competitive with Europe. That is what the heart of this bill is. It is very important for jobs in our country. It is very important for the manufacturers who are trying to keep jobs in our country to be able to have that level playing field."\footnote{CONG. REC. S. 11202 (online ed. Oct. 11, 2004) (Senate Floor Speech of Sen. Kay Bailey Hutchinson).}

In spite of Senator Hutchinson's supportive words, however, there is an interesting irony here. This financial incentive for keeping American jobs in the United States was, in reality, forced on the United States by its global trading partners. The American Jobs Creation Act is a clear example of how globalization works. In a global economy where the United States has agreed with its trading partners on certain conditions, failure to adhere to those conditions hurt U.S. competitiveness in the world market. Thus, the United States was forced to honor its treaty obligations in order to maintain its competitiveness. In this case, then, it was the European Union, not the United States, who motivated this favorable tax structure change that makes it easier for American industry to keep doing business in the United States. In this case, globalization itself appears to have prevented outsourcing.

K. Legal Validity of State Use of Financial Incentives to Discourage Outsourcing

Again, the federal legislation in this area faces no obvious legal hurdles since this legislation cannot run counter to federal foreign affairs power or the Foreign Commerce Clause. While the legal validity of pending state anti-outsourcing measures is less clear, in reality, this
financial incentive strategy for discouraging outsourcing is less problematic than are some of the previously discussed strategies. In all contexts, the decision on how to use state monies is a prerogative that rightly belongs to state governments. Even if this particular use of the prerogative tends to resemble bribery, state governments have the right to set their own parameters for disbursing state money. However, this type of bill clearly has the potential for interfering with federal predominance in foreign affairs and foreign commerce. As with all of the anti-outsourcing measures described in this paper, these “financial incentive” measures, especially if enacted by a large number of states, could threaten the U.S. Government’s ability to construct and maintain a coherent economic policy based on globalization, and so could be subject to judicial challenge.

L. Conclusions About State and Federal Attempts to Limit Outsourcing

The legislative rush to protect American workers has been more aggressive on the state level than on the federal level. However, while many bills have been proposed in both the state and federal arena, only a few of these bills have actually been enacted into law. Many continue to spend a long time in committees. This suggests that America’s legislative bodies are well aware of the challenges, likely successful in many cases, that such enacted statutes would face. As long as the federal government supports an economic policy based on globalization, state statutes clearly face preemption by the federal government’s constitutional right to power over foreign policy and foreign commerce. In addition, state statutes face preemption by existing state laws in some instances. Federal statutes will not run afoul of the federal government’s prerogatives in foreign affairs and foreign commerce. However, these statutes will often violate the international treaties that the United States has signed. In such cases, application of these statutes could result in economic sanctions that could hurt the U.S. economy.

Of the strategies represented in these various bills, the one which is least likely to be upheld, and most likely to cause destructive negative retaliation by other countries, is the attempt to ban outsourcing on state and federal contracts, either directly or indirectly through enforcement of preferences. These bills represent the most direct attack on outsourcing—and on federal prerogatives in foreign affairs and foreign commerce—because they attempt to thwart the results of a free trade policy that the federal government supports. They also represent the most direct attack on various trade agreements to which the United States is a party. Limiting data transmission abroad, while popular with a public concerned with privacy, is a strategy that is highly susceptible to preemption by federal privacy laws already in effect. On the other hand, the strategy most likely to result in viable laws, is the use of financial incentives in the form of state aid or tax preferences. State and federal bills that encompass this strategy
are based on a power that governments clearly possess—the power to control disbursement of their funds. How effective this strategy would be at curtailing outsourcing, however, is unclear. The strategy of mandating disclosure of outsourcing plays to public indignation at the loss of American jobs and national pride. By themselves, state and federal disclosure bills will not save American jobs, but they will cause the extent of the problem to be disclosed, which may foment enough public pressure on corporations to stem the tide of outsourcing a bit.

In short, the current spate of anti-outsourcing legislation seems largely fueled by politics rather than sound jurisprudence. However, the concerns this legislation addresses are legitimate. Outsourcing has led to current hardship for many Americans. American jobs are being lost, in part, because American workers have more rights and foreign workers demand less money. Thus, in one sense, corporations who are increasing profits through outsourcing are lining their pockets by taking advantage of substandard labor conditions.

 Likewise, while American workers are more highly paid, the standard of living is higher in this country, as is the cost of living. On the other hand, economists are quick to point out that globalization may well strengthen the U.S. economy in the long term. The federal government should take the lead in addressing the conflicts caused by its support of free trade, since state laws are all subject to preemption by federal policy. Congress must design a coherent set of statutes that will support globalization's positive effects while discouraging its negative effects. Such legislation must go beyond the protectionism evident in the current spate of state and federal bills and grapple with ways to use globalization to strengthen our economy.

IV. THE WTO RESPONSE

The equilibrium in international trade and the efforts to level the playing around the world can be traced to the General Agreement on Tariffs and Trade ("GATT") in 1947 and the successive rounds now administered by the World Trade Organization ("WTO") based in Geneva. One commentator noted that:

Although the international trading regime is not directed to addressing the rights of foreign investors on an individual basis, the WTO framework is significant for creating a level playing field for trade. For instance the WTO Agreements retain two key principles from the original 1947 GATT Agreement—national treatment and most favored nation (MFN) treatment. These concepts are particularly important for offshore outsourcing arrangements because

135 See Holcombe, supra note 52, at 596 (discussing the history of the WTO).
each ensures a baseline level of fairness.\textsuperscript{136}

However, it is not surprising that the WTO solution is a kind of after-the-fact remedy that may take years to enforce. There is no immediate solution. The problem will develop if each country retreats into a protectionist mode that will trigger a wave of counter protectionism and culminate in a death spiral for free trade.

An example of the disagreement about free trade centers on gambling. The United States claims that gambling was clearly excluded from the scope of any WTO agreement and intent to free up regulation. The WTO announced that on July 19, 2006 it would establish a panel “to investigate whether United States restrictions on Internet gambling comply with international trade rules.”\textsuperscript{137} A previous ruling had found that the U.S. laws were not in compliance with WTO standards. The panel would be able to issue a decision in ninety days but it could be appealed. Antigua, in the Caribbean, filed a case in 2003.

The office of the United States Trade Representative (“USTR”) issued a report on April 21, 2006 in which it updated its position on the gambling dispute. The USTR stated that in their view the sole dispute was over whether “US laws do not discriminate against foreign suppliers of remote gambling on horse racing.”\textsuperscript{138} The United States claims that it is in compliance.\textsuperscript{139} They claim that the measure “to protect public morals or and to maintain public order is provided for under Article XIV (a) of GATS.”\textsuperscript{140} Antigua and Barbuda won against the United States.\textsuperscript{141}

A further example of the divergent views on gambling can be seen in the United States arrest of the CEO of BetOnSports, a British company. He was arrested during a layover in Dallas-Ft. Worth as he was traveling from Great Britain to Costa Rica.\textsuperscript{142} Subjecting executives to criminal

\textsuperscript{136} Id. at 597 (citations omitted).
\textsuperscript{138} Press Release, Office of the U.S. Trade Representative, Statements by Ambassador Peter Allgeier, U.S. Representative to the WTO, at the meeting of the WTO Dispute Settlement Body (DSB) (Apr. 21, 2006), \textit{available at} http://www.ustr.gov/Document\_Library/Press_Releases/2006/April/Statements_by_Ambassador_Peter_Allgeier_US_Repr esentative_to_the_WTO_at_the_meeting_of_the_WTO_Dispute_Settlement_Body_(DSB).html?ht-.
\textsuperscript{139} See id.
\textsuperscript{140} See id. at 1E(4) (quoting General Agreement on Trade in Services art. XIV, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, Legal Instruments—Results of the Uruguay Round, \textit{33 I.L.M. 1168} (1994)).
\textsuperscript{141} See Holcombe, \textit{ supra} note 52, at 598–99.
\textsuperscript{142} Matt Richtel, \textit{An Arrest in Internet Gambling}, \textit{N.Y. Times}, July 18, 2006, at C1 (discussing Mr. Carruthers arrest and how he had not thought that the United States could do anything about this situation). GATS stands for “General Agreement on Trade in Services,
charges and incarcerating an executive of a publicly traded British company will certainly generate antipathy towards the United States and might spur retaliatory action.

Divergent views about regulation are not new in the international community. For example, China currently is considering regulations that will make it difficult for large retailers to open stores like Wal-Mart. Japan has been a market with many regulations making it more difficult for foreign entities to do business there. If the current situation intensifies where the United States discourages foreign investment, there will be an escalating problem that will make the Wal-Mart in China problem seem small. These disputes will no doubt land at the WTO as well.

V. SUPREME COURT CASES: TAX BREAKS TO KEEP BUSINESS INCENTIVES V. PENALTIES

While the methods outlined in Section III do not seem to be effective, tax incentives to encourage businesses to locate in a particular region appear to help spur an insourcing surge. While some may question the efficacy of tax breaks for businesses and whether that ultimately leads to states losing businesses and their jobs because they compete with one another, others argue it is an effective way to compete and to counterbalance outsourcing. The Supreme Court in *DaimlerChrysler v. Cuno* addressed this issue in 2006. The lawsuit, like many, has a circuitous path. Initially the case was filed in state court alleging that the "state tax credits and local property abatements that were granted to Daimler Chrysler Corporation as an inducement to expand . . . discriminates against interstate commerce." The district court dismissed the action for failure to state a claim, however the Circuit Court reversed in part in 2004.

---

143 Fong, *supra* note 11 (noting that China is drafting new "rules to regulate large scale shopping outlets which may benefit local companies at the expense of Wal-Mart and Carrefour").

144 *See also* Editorial, *The Don't Invest in America Act*, WALL ST. J., July 19, 2006 at A12 (editorial discussing the erection of barriers to insourcing as a result of the Dubai ports fiasco).

145 *See* Eileen McNamara, *Jobs Don't Negate Losses*, BOSTON GLOBE, June 4, 2006, at B1 (complaining about tax credits in Massachusetts used to attract Bristol Myers Squibb to construct a plant at Fort Devins, bringing 550 new jobs). McNamara also notes the irony that no effort is being made to save the 400 jobs lost when Gillette closed its manufacturing plant at Fort Devins, calling it "corporate blackmail." *Id.*


and held: "We reverse that portion of the district court’s judgment upholding as constitutional the investment tax credit provision of Ohio Rev. Code Ann. § 5733.33 and we enjoin its enforcement." 148

The Supreme Court, in a unanimous decision, vacated in part and remanded, holding that the taxpayers who objected to Toledo’s granting of the credit do not have standing and “therefore can proceed no further.” 149

In the Court’s opinion, Justice Roberts noted:

State policymakers, no less than their federal counterparts, retain broad discretion to make “policy decisions” concerning state spending “in different ways . . . depending on their perceptions of wise state fiscal policy and myriad other circumstances.” Federal courts may not assume a particular exercise of this state fiscal discretion in establishing standing; a party seeking federal jurisdiction cannot rely on such “[s]peculative inferences . . . to connect [his] injury to the challenged actions of [the defendant].” Indeed, because state budgets frequently contain an array of tax and spending provisions, any number of which may be challenged on a variety of bases, affording state taxpayers standing to press such challenges simply because their tax burden gives them an interest in the state treasury would interpose federal courts as “‘virtually continuing monitors of the wisdom and soundness’” of state fiscal administration, contrary to the more modest role Article III envisions for federal courts. 150

Thus the parties are left to the state court system to seek redress of their claims. Businesses responded happily to the Court’s ruling stating, “we are pleased the court recognizes that a state’s ability to provide these important economic development incentives should not be vulnerable to lawsuits by those not directly affected by the issue.” 151 However, the opposition by the plaintiff’s attorney, Peter Enrich of Northeastern Law School, noted that the decision “casts no doubt on the long line of court rulings striking down discriminatory tax breaks as unconstitutional.” 152

If the Supreme Court had followed the Sixth Circuit opinion and struck down a state’s right to offer incentives, the United States would be

148 See id. at 750.
149 DaimlerChrysler, 126 S. Ct. at 1859.
150 Id. at 1863–64. (citations omitted).
151 David G. Savage, Big Corporate Tax Breaks Upheld, L.A. TIMES, May 16, 2006, at A4 (quoting Dorothy Coleman, Vice President of the Nat’l Ass’n of Mfrs.); see also Jack Torry, Supreme Court Ruling: Tax Breaks Can Be Used to Attract Companies, COLUMBUS DISPATCH, May 16, 2006, at 1A (discussing the positive impact of business and noting that “the . . . decision could have a significant effect nationally because nearly every state uses billions of dollars in tax breaks to attract companies”).
152 Savage, supra note 154, at A4.
uncompetitive with the rest of the world, which has aggressively offered tax breaks for new factories. For example, Ireland staged its economic resurgence in the 1990’s in part based upon an incentive package it offered to businesses willing to locate there.¹⁵³ China, too, has utilized the Special Economic Zone (“SEZ”) to stimulate growth and is considering expanding this formula to revitalize and spur development in a number of secondary cities inland.¹⁵⁴ While it remains to be seen what Ohio’s state court will do with the case, had the Supreme Court ruled otherwise, that coupled with the high wage rates in the United States would have further sounded the death knell for creation of new domestic jobs and fanned the flames for increasing the pace of outsourcing of manufacturing and other jobs overseas. There is a fundamental difference between tax incentives to locate new business in the United States and the measures outlined in Section III.

VI. CONCLUSION

Congress and state legislatures may be trying to fix a problem by restricting outsourcing, but the cure may spark retaliation around the world that ultimately hurts American citizens’ interests.¹⁵⁵ The anti-business rhetoric of political parties, particularly recent Democratic candidates, has polarized the debate. Benedict Arnold CEOs are not the problem.¹⁵⁶ In this flat world that Thomas Freidman has described, competition is fierce.¹⁵⁷ It is the business entrepreneur, like Bill Gates in India, who by expanding the company overseas will also preserve the economic health of the company and ultimately the future of jobs in the United States.¹⁵⁸ It will also be critical to attract the Toyotas of the world to locate plants in the United States. The United States, like many other countries, needs to find solutions that create incentives for both American and foreign corporations to locate within the States, thus stimulating job growth and economic development.¹⁵⁹

¹⁵³ See infra Part VI and note 164.
¹⁵⁴ See infra Part VI and note 167.
¹⁵⁵ See *The Don’t Invest in America Act, supra* note 148, at A12 (editorially criticizing Senators Shelby and Sarbane’s proposal to require more scrutiny of foreign investment in United States).
¹⁵⁶ See Gail Russell Chaddock, *Outsourcing Resonates in Virginia Race*, CHRISTIAN SCI. MONITOR, July 21, 2004, at USA 2, (discussing the presidential race noting that “Kerry, who has dubbed outsourcers ‘Benedict Arnold CEOs’ calls for ending tax credits for companies that send jobs overseas and whenever possible, granting federal contracts to US workers”); Glenn Hubbard, *Outsourcing is Good for America*, FIN. TIMES, Mar. 24, 2004, at 17 (discussing Senator Kerry’s proposals to deal with Benedict Arnold CEOs on the Foreign Tax Credit as well as Heinz’s use of overseas sites).
¹⁵⁷ See generally FRIEDMAN, supra note 7.
¹⁵⁹ See also David Wessel & Bob Davis, *Pain from Free Trade Spurs Second Thoughts:*

121
Ireland’s government has seized on this strategy and used tax incentives to entice a number of businesses to locate facilities in its country. In the early 1980’s, Ireland introduced a 10% corporate tax rate for manufacturing facilities.\(^\text{160}\) Numerous other incentives exist as well. This is a key component that the tax policy is “geared toward the promotion of a job friendly environment in order to facilitate robust employment growth.”\(^\text{161}\) While outsourcing can affect any environment, even Ireland, the government of Ireland is funding “R&D and higher education at an unprecedented level” to insure Ireland’s continued prosperity.\(^\text{162}\)

The Chinese models of SEZ have been very successful in spurring economic development and job creation.\(^\text{163}\) This includes five SEZ in Shenzen, Xiamen, Zhuhai, Hantou, and Hainan as well as fourteen coastal cities and Pudong as Economic and Technical Development Zones (“ETDZ”).\(^\text{164}\) This has lead to impressive economic results placing China fourth on a recent list of the world’s biggest economies, behind the United States, Japan, and Germany in 2005.\(^\text{165}\) Yet this economic and legal plan that attracts foreign direct investment is also projected to hurtle China to the number one position of GDP in 2040, followed closely by the United States, and then followed by India with less than half as much.\(^\text{166}\)

The United States may have a difficult time competing with foreign sites as possibilities when individual companies must individually shoulder

---

\(^{160}\) Suzanne Carter, Republic of Ireland: Not Quite So Taxing, LEGAL WK., Apr. 28, 2005.

\(^{161}\) Id.


\(^{163}\) Anyuan Yuan, China’s Entry into the WTO: Impact on China’s Regulating Regime of Foreign Direct Investment, 35 INT’L L. LAW. 195, 202 (Spring 2001).

\(^{164}\) Id.

\(^{165}\) Id. See also Jo Johnson & Edward Luce, India Pushes for Big Manufacturing Expansion: Delhi Plans to Give States Special Economic Status to Aid the Sector’s Global Competitiveness, FIN. TIMES, Mar. 18, 2005, at 2 (discussing India’s recent moves to adopt China’s successful development strategy).
the health care cost. If the United States were to find a solution so that health care costs were not shouldered by business alone, this would greatly increase the attractiveness of the locations in the United States for business. Thus tax incentives play a critical role in making an environment attractive to investors. The United States must face the challenge to competitiveness by being creative with incentives and not resort to knee-jerk reactionary responses. For example, Vermont offers tax breaks for Vermont-based insurers called "captives," which has made Vermont aggressively competitive with many offshore financial havens like the Cayman Islands.\textsuperscript{167} Similarly, closing loopholes that encourage outsourcing would also be a good first step.\textsuperscript{168}

The appeal of outsourcing bans is reminiscent of the British ban on cotton. We must learn from history that these forces for change cannot be fenced out. The attempt to make outsourcing illegal is like putting a finger in the dike against the changes caused by the waves of globalization. Providing incentives to attract business is the only realistic and possible solution. We need to learn from Ireland and China that giving businesses tax breaks does not mean losing money, but rather investing in future economic growth will rebound to the benefit of all workers.

\textsuperscript{167} See generally Lynnley Browning, Vermont Becomes Offshore Insurance Haven, N.Y. TIMES, Apr. 4, 2007, at C1 (noting that over 560 companies have taken advantage of this and making "captives" the 10th largest employer in the state).

\textsuperscript{168} On May 3, 2007 Senator Byron Dorgan (Democrat from North Dakota) introduced Senate Bill 1284, along with Senators Mikulski, Durbin, Stabenow, Rockefeller, Levin, Feinstein, Johnson, Harkin, Feingold, Leahy, Kohl, and Kennedy, which "would end tax deferral for the 'imported property' income of controlled foreign corporations." S. 1284, 110th Cong. (2007). In his message to Congress, Dorgan claimed "When a U.S. company closed down a U.S. manufacturing plant, fires its American workers, and moves those good paying jobs to China or other locations abroad, U.S. tax laws allow these firms to defer paying any U.S. income taxes on the earnings from those now foreign-manufactured products until those profits are returned, if ever, to this country." CONG. REC. S. 5571 (online ed. May 3, 2007) (Senate Floor Speech of Sen. Byron Dorgan).