

Intergovernmental Policy Advisory Committee

MEMORANDUM

TO: Kim S. Frankena, Assistant Director, International Affairs and Trade, GAO
FROM: Kay A. Wilkie, Chair, Intergovernmental Policy Advisory Committee (IGPAC)
DATE: September 8, 2008
SUBJECT: IGPAC Comments for GAO Report on Impacts of Free Trade Agreements

State and local governments have generally supported multilateral, regional and bilateral efforts to expand market access, both for resident businesses reaching out to global markets, and for international investors engaged in the local economy and creating employment. Trade liberalization successes of recent years, achieved by the coverage and scope of Free Trade Agreements (FTAs) and WTO agreements, have increasingly extended US commitments beyond the federal level, and in turn, have expanded impacts on state and local laws, practices and regulations.

In the current decade, IGPAC members have consistently expressed views about the impacts of certain FTA provisions – notably those related to procurement, investor-state dispute mechanisms, and the domestic regulation of services, while also making broader recommendations for improving trade policy consultations, trade capacity building and trade development programs.

IGPAC and Services Working Group members welcome your August 1st letter of invitation by GAO to provide comment for the report on FTA impacts currently being prepared. This document updates our submission of 7/15/08. We would also very much appreciate the opportunity to arrange a group meeting with GAO staff in order to share our state/local perspectives on trade agreement impacts, and to confer generally about federal-state trade policy consultation. Thank you for this opportunity to share IGPAC and Services Working Group observations on FTA impacts, and please advise if a group meeting may be possible in the near future.

Governance and Regulation

- IGPAC members believe firmly that FTAs -- like all trade agreements -- should be drafted, implemented, and interpreted, to respect and give due consideration to existing state and local regulatory, tax, and economic development policies, and to support the social, economic, and environmental values that those policies promote. The Trade Act of 2002 included the directive that **trade agreements be negotiated so as to not “weaken or reduce the protections afforded in domestic environmental and labor laws”** and the Act makes **“ensuring that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States”** a critical trade policy negotiating objective. IGPAC members remain concerned that foreign investors are still afforded greater “procedural” rights under trade agreements than domestic investors (e.g., the ability to initiate challenges governmental actions including court decisions before ad hoc international arbitration panels).

- The principle that the United States **may request, but not require**, states to alter their regulatory regimes in areas over which they hold constitutional authority must be maintained. Full and effective coordination and consultation should include requesting authority from the appropriate state or local authority before a state or local rule, regulation, or statute is listed in – or otherwise implicated by – a trade agreement, offer or other binding commitment. States’ **preemption concerns related to insurance regulation** have been heightened recently due to US Treasury support for Congressional action on **HR 5840**, which was drafted without sufficient consultation with state officials.
- IGPAC members would prefer that trade commitments be derived via a process based upon “positive lists,” that are based on the affirmative, informed consent from affected state and local entities, rather than upon a system of “negative list” opt-outs. The recent WTO tribunal ruling against the US in the **GATS internet gambling case** brought by Antigua & Barbuda illustrates the inherent peril of the “negative list” approach, which risks covering matters that were expected to be excepted, either by inadvertence or by lack of knowledge of relevant laws and regulations.

Services Provisions in FTAs and WTO Agreements

- Many IGPAC members are particularly concerned about ongoing efforts within negotiations to impose trade disciplines on domestic regulation. FTAs services provisions typically specify that amendments will be made to render such FTAs consistent with any results under GATS negotiations of **Article VI:4 on domestic regulation**. In light of the importance of GATS negotiations to domestic regulation provisions in FTAs, IGPAC applauds the traditional US stance at the WTO in **opposition to necessity tests, and in support of transparency**.
- IGPAC urges that **US core principles respecting the right to regulate at all levels of government** be enshrined in all FTAs and that necessity tests in such agreements be eliminated through substantial modifications to their domestic regulation provisions. The NAFTA provides a useful model for explicitly recognizing the state and provincial basis for setting regulatory objectives in the context of national treatment that could be incorporated into FTAs. IGPAC looks forward to further comprehensive discussions with the USTR on this and other issues in the context of negotiations by the WTO Working Party on Domestic Regulation and under the Doha Development Round.
- Negotiations on WTO General Agreement on Trade in Services (GATS) and related provisions on services in FTAs should strive: 1) for requirements that are sufficiently limited and consensual that they *can* be applied across the board (non-discrimination is such a policy, limits on numbers of providers are not), and 2) for *clarity* in the provisions to which parties agree.
- IGPAC perspectives on three significant issues related to the 1/23/08 draft Chair’s Text from the GATS Working Party on Domestic Regulation include:
 - Active opposition to the extremely objectionable omission of any mention of subfederal policy objectives, rendering the WPDR draft text entirely unacceptable. The statement to be re-inserted: "***National policy objectives include objectives identified at national or sub-national levels.***"
 - Serious concern about the implications that regulations "...shall be pre-established, based on objective criteria and relevant..." given the potential for unacceptable constraints on the scope and exercise of state/local regulatory authority, particularly related to complex and emerging industries.

- Strong reservations about extensive requirements related to transparency, given insufficient consultation with subfederal governments to ascertain whether such requirements would conform to existing practice and be acceptable, or do not and could be needlessly burdensome.

- **Services sectors** warranting analysis on potential GATS and FTA impacts on states' regulations:
 - Gambling case: compensation offer following withdrawal of commitment
 - Energy and electricity: transmission, distribution, storage, transportation
 - Insurance regulation, esp. in light of legislative proposal HR5840
 - Health care, health insurance, health facilities
 - Prescription drug benefits, retail/wholesale distribution
 - Business services
 - Zoning, e.g. commercial; retail, acquisition, coastal zone regulation (LNG terminals)
 - Licensing of professionals; e.g. legal services, professional services
 - Construction
 - Desalination facilities, waste water
 - Financial law enforcement, insurance and consultancy
 - Hazardous materials, wholesale distribution, solid/hazardous waste management
 - Higher education
 - Library services
 - Municipal telecom franchises, information, other communications

Procurement Provisions

- Procurement provisions in FTAs, and in the WTO Government Procurement Agreement, impact selected states, and some IGPAC members have detailed concerns about process, language and implementation issues under the USTR's "**reciprocity policy**" pertaining to some FTAs. Federal officials' interaction with states on procurement matters seems insufficiently cognizant of complex state-level procurement processes, including separation of powers in policymaking.
- Some states have raised concerns about ensuring that procurement policies related to **core labor standards**, and to "**green**" policies on energy efficiency and environmental protection, be safeguarded.
- Awareness of the benefits of US firms winning international procurement contracts, and of the contributions of foreign direct investment and foreign affiliate employment to the US economy, seems less evident than is fear of offshoring. Relevant federal agencies need to **provide data** to the public and technical assistance to US firms regarding the value, benefits and strategies for improving market access to contract opportunities in newly opened **international procurement markets at the federal and subfederal level**. One example would be the identification of **Australian states' procurement opportunities** opened by the FTA.

Investment Provisions

- IGPAC members remain concerned about **investor-state dispute settlement provisions** in FTAs. Three particular issues warrant highlighting: 1) the problematic and **overly broad definition of investment**, as it is far more expansive than the investment definition in the NAFTA, includes concepts of “investment authorization”, licenses and permits, and is less linked to business enterprises; 2) the **“minimum standard of treatment” language**, seeming to codify the *Loewen* case holding that state court actions are subject to review by international investment tribunals, thus giving such tribunals, which are not directly accountable to any democratic institution, extraordinary discretion and expansive power; and 3) the **due process standards**, based on unclear international norms rather than reflecting US constitutional norms of substantive due process, as required by the Trade Act of 2002.
- In addition, IGPAC members recommend **strengthening the forced choice provision**, included in the Colombia and some other FTAs, that would require investors to choose between the courts and international arbitration for all disputes regarding governmental actions, not just very limited categories of such disputes.
- The ruling in the *Methanex* dispute established an important precedent for safeguarding important principles of federalism and state sovereignty. However, since such tribunal judgments are not formally precedential, IGPAC members recommend that the case’s finding that ***“as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted with due process and which affects...a foreign investor or investment is not deemed expropriatory and compensable....”*** be codified as a formal Interpretive Note in NAFTA and all other existing FTAs, and that corrected language be included in all future trade agreements. Ongoing investment disputes -- such as the NAFTA Chapter 11 arbitration claim filed by Glamis Gold Ltd. that challenges California’s environmental and extractive industry regulations, and the claim filed by Grand River Enterprises Six Nations Ltd., that implicates state and local regulation of the tobacco industry (including settlements of litigation) -- continue to be troubling.
- While aware investor-state challenges cannot directly or automatically overturn local, state, or federal laws, regulations, or court decisions, IGPAC would prefer to clarify and limit the circumstances in which these types of challenges may be raised, not the least because they impose significant demands on state agencies’ time and resources, cause confusion about the scope of state and state/local authority under FTAs, and unnecessarily dampen state and local policy innovations.
- IGPAC also recommends that the federal government commit to seeking compensation for legal costs, including staff time, incurred by states and localities when assisting the federal government to defend investor-state disputes. At the close of the *Methanex* dispute, for instance, the federal government was awarded full payment of the millions of dollars in fees and costs that it incurred while defending the case, however California was not similarly compensated.

Improvements to Trade Development Programs and Data

- At the same time that the US pursues market access initiatives, IGPAC also stresses the importance of expanding America's trade promotion capacity and improving the process of collecting and disseminating trade data. Resource constraints confronting US trade development and investment attraction programs and services overseas threaten to undermine the ability of small businesses to take advantage of new market opportunities around the world.
- IGPAC members applaud the recent actions undertaken by the US Department of Commerce (USDOC) to improve the quality of state and local-level trade information by re-introducing zip code specificity to merchandise export data. However, as the US economy is increasingly driven by the services sector, it is vital that state-level *services export data* collection be improved. Similarly, states and regions will continue to have difficulty assessing their trade balances and relative global competitiveness unless the federal government makes significant progress in collecting state-level merchandise and services *import data*. While IGPAC recognizes the challenges inherent in collecting such data, Canadian data track product exports and imports by province, country and US state, offering an impressive example to be emulated:
(website: http://strategis.gc.ca/sc_mrkti/tdst/tdo/tdo.php?lang=30&headFootDir=/sc_mrkt).

US International Investment Attraction Efforts and FTAs

- Since the USDOC has launched intensified efforts to attract foreign direct investment (FDI) into the US, it would be useful to have **improved and detailed data at the state-level on new investment flows from FTA partner countries and regions**. States would then be able to assess the favorable job creation, productivity, technology transfer and R&D implications of FTAs through tracking new flows of FDI.

Workforce Adjustment Assistance

- States have repeatedly called for action to substantially **transform, expand and fully fund the Trade Adjustment Assistance** program, more appropriately renamed as the "Workforce Adjustment Assistance" program. Rather than trade flows, advances in technology and productivity, in an increasingly integrated and competitive global context, create opportunity, while often challenging the prospects for many industries, communities and workers.
- New initiatives, funding and programmatic flexibility are needed to adapt workforce assistance to these challenges, to meet varying states' needs, and to accomplish effective outreach to impacted workers, employers and communities. The redistribution of a small portion of the national gains from technology, productivity and trade growth to dislocated workers and communities might foster more public understanding of, and support for, investments in education, research, technology, and an agenda of trade liberalization in the future.

Capacity for Federal-State Trade Policy Consultations

- IGPAC members have recognized that enhanced intergovernmental dialogue on FTAs and other trade policy issues is necessary to strengthen future agreements. With that objective in mind, IGPAC has offered the USTR a number of recommendations to strengthen the intergovernmental consultation process since 2004.
- Specifically, IGPAC recommended the **creation of a Federal-State International Trade/Investment Policy Commission** to provide institutional structure for continuous bipartisan consultation about US federal-state trade policy. In order to ensure its effectiveness, such institutional capacity should be guided by the principles of US **constitutional federalism** and **nonpartisan independence**. The Commission would be designed to:
 - Foster consultations among federal/state/local government officials on trade and investment concerns;
 - Provide objective trade policy, trade data, trade law analysis, and other trade and investment policy resources, with expert staff and technology providing research and information;
 - Create reports and recommendations for consideration by federal, state and local governments.
- Note that this IGPAC recommendation spans the decades. IGPAC, chaired by Wisconsin Governor Tommy Thompson in 1994, issued its Report on the Uruguay Round (UR) and also called for creating new capacity for federal-state trade policy consultation, stating: *“The changes that the UR Agreements will bring in US trade policy will require that the Federal Government enter a new partnership with state and local governments. This partnership will require establishing and funding adequate organizational capacity within the Federal Government to assist state and local governments in the implementation of the UR and other trade agreements.”*
- IGPAC, and its constituent members and organizations, have other ideas and recommendations for improving consultation that merit GAO review and consideration. Comprehensive consultation and informed dialogue remain the most effective means for both improving trade and investment efforts and for mitigating unintended or undesirable impacts of FTAs, WTO commitments and other trade agreements.