April 24, 2007

The Honorable Susan C. Schwab
United States Trade Representative
Executive Office of the President
Washington, D.C. 20508

Dear Ambassador Schwab:

Pursuant to Section 2104 (e) of the Trade Act of 2002 and Section 135 (e) of the Trade Act of 1974, as amended, I am pleased to transmit the report of the Intergovernmental Policy Advisory Committee on the US-Korea Free Trade Agreement, reflecting advisory opinions on the proposed Agreement. IGPAC members have also taken this welcome opportunity to express some recommendations with respect to improving the overall process and infrastructure for intergovernmental trade policy consultation. Thank you for your consideration.

Sincerely,

Kay Alison Wilkie

Chair
Intergovernmental Policy Advisory Committee

The US-Korea Free Trade Agreement (FTA)

Report of the

Intergovernmental Policy Advisory Committee

April 24, 2007

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Intergovernmental Policy Advisory Committee

Advisory Committee Report to the President, the Congress and the United States Trade Representative on the US-Korea Free Trade Agreement

I. Purpose of the Committee Report

Section 2104 (e) of the Trade Act of 2002 requires that advisory committees provide the President, the Trade Representative, and Congress with reports required under Section 135 (e) of the Trade Act of 1974, as amended, not later than 30 days after the President notifies Congress of his intent to enter into an agreement.

Under Section 135 (e) of the Trade Act of 1974, as amended, the report of the Advisory Committee for Trade Policy and Negotiations and each appropriate policy advisory committee must include an advisory opinion as to whether and to what extent the agreement promotes the economic interests of the United States and achieves the applicable overall and principle negotiating objectives set forth in the Trade Act of 2002.

The report of the appropriate sectoral or functional committee must also include an advisory opinion as to whether the agreement provides for equity and reciprocity within the sectoral or functional area.

In this case, the USTR notified Congress that it completed negotiations on the Korea-US FTA on April 1, 2007. Unfortunately, the full text of the Korea-US FTA has not been made available to cleared advisors in a timely manner. Despite this, USTR has required IGPAC, and all other advisory committees, to submit their statutorily-required reports on this FTA by no later than April 27th. Many committee members are seriously concerned by these developments. With this in mind, and pursuant to the above requirements, the Intergovernmental Policy Advisory Committee hereby submits the following report, and reserves the right to make additional comments once the FTA's final text is released.

II. Executive Summary of Committee Report

State and local governments play a vital role in advancing America's global competitiveness. IGPAC members affirm that our nation's economic growth and prosperity are best served by embracing trade and economic development policy strategies that:
(1) are developed in a nonpartisan manner in close consultations with relevant stakeholders;
(2) yield significant, measurable economic gains for the country;
(3) create open, transparent, and fair global markets;
(4) commit resources to global market research and trade development assistance for small and mid-sized US businesses, in order that they gain awareness of expanding market opportunities, and increase export sales;
(5) provide comprehensive assistance to workers negatively impacted by technology and changing trade trends;
(6) invest in innovative research and technologies to foster commercialization and job creation in the globally competitive industries and jobs of the future;
(7) safeguard essential federalism principles;
(8) respect basic American values; and
(9) advance, rather than isolate us from, international trade policy dialogue and analysis of competitive forces in our increasingly interconnected world.

The Korea FTA meets a number of these strategic goals. Provided that significant concerns about investor-state dispute mechanisms, domestic regulation of services, and other elements contained in this agreement and previous TPAs and FTAs are addressed, IGPAC members, in principle, support the trade liberalization objectives of the US-Korea Free Trade Agreement (FTA). IGPAC members herewith comment on the Korea FTA as submitted, noting that the document has not yet undergone legal review and that sections related to labor, environmental, intellectual property and possibly other provisions have not been finalized pending USTR negotiations with Congress. Hence, IGPAC reserves the right to provide an addendum to this report. IGPAC members would also like to suggest some

clarifications to certain provisions of the Agreement, and to specifically note that the FTA's objectives of economic growth, employment creation, sustainable development, and market opportunities should be pursued in a manner consistent with the nation's constitutional and public policy obligations to state and local governments and their constituents. Consequently, IGPAC members believe firmly that this FTA -- like all trade agreements -- should be drafted, implemented, and interpreted, to respect and give due consideration to existing state and local level regulatory, tax, and economic development policies, and to support the social, economic, and environmental values that those policies promote.

Statutes and regulations that states and local governments have validly adopted, that are constitutional, and that reflect locally appropriate responses to the needs of our residents, should not be overridden by provisions in trade agreements. These concerns are reflected in the Trade Act of 2002's directive that trade agreements be negotiated so as to not "weaken or reduce the protections afforded in domestic environmental and labor laws" as well as the fact that 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 crucial trade policy negotiating objective. 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. IGPAC members would therefore strongly 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.

Beyond the major importance of the US-Korean trade and strategic relationship, and the potential merits of eventually reaching broader regional trade agreements throughout Asia, IGPAC members would again assert that success in the WTO Doha Development Round of multilateral market liberalization negotiations is of far greater importance to state economic development objectives than any single regional or bilateral trade agreement. Since the broad scope of WTO negotiations creates new challenges for state and local governments, IGPAC would appreciate improved and deepened consultations.

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. Recent decisions by Congress to require the International Trade Administration (ITA) to raise additional revenue from service fees, combined with new infrastructure costs being shifted to ITA from the State Department, threaten to undermine the ability of small businesses to take advantage of new market opportunities in Korea and elsewhere. IGPAC members applaud the recent actions undertaken by the Department of Commerce 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 (website: http://strategis.gc.ca/sc_mrkti/tdst/tdo/tdo.php?lang=30&headFootDir=/sc_mrk).

Some IGPAC members have expressed concerns about certain market access provisions in this agreement. The IGPAC member representing North Carolina indicates that the state is opposed to this FTA on the grounds that it further accelerates the loss of textile jobs without additional protections for North Carolina's workers and communities.

IGPAC members appreciate their consultations with the USTR about the impact of existing trade agreements and the conduct of ongoing negotiations. Often, highly compressed comment periods do not offer sufficient opportunity for IGPAC to make perspectives known to negotiators, nor the opportunity to consult with negotiators sufficiently early in the process to influence certain key provisions of the FTA. In some cases, the accelerating pace of trade negotiations and dispute litigation has strained the limited resources available at both the state and local level and amongst USTR's hard-working staff. This occasionally results in inadequate time and resources being devoted to trade policy analysis and the consultation process; notably the case for the Korea-US FTA.

This FTA's procurement chapter does not reference US states, the USTR's announced reciprocity policy on government procurement, or additional subfederal procurement coverage, since Korea and the US have already covered subfederal procurement through the pre-existing WTO Government Procurement Agreement (GPA). IGPAC members continue to suggest that relevant federal agencies 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, in Korea and elsewhere.

Some IGPAC members remain concerned about certain investor-state dispute settlement provisions in this agreement. Given that the Republic of Korea has a well-developed legal system, some IGPAC members question the need for including any special investor-state dispute resolution provisions in this agreement, and would prefer, like the US-Australia FTA, resolution of these types of disputes be left to the courts. IGPAC members are also concerned that, unlike other recent FTAs, Article 18 of the Korea-US (KORUS) FTA does not contain language that would provide additional sovereignty protection to US courts by precluding certain claims (e.g., those that have been previously been submitted to a national court or subjected to a national administrative review process) from being subsequently raised before an arbitral tribunal. IGPAC members recommend that such a provision be included in this and future trade agreements and that USTR also consider adding language that would preclude a notice of arbitration from being filed involving any dispute that is before a signatory nation's courts until a final appellate decision has been rendered in the matter. In addition, many IGPAC members believe three other concerns warrant highlighting: 1) the problematic and overly broad Article 28 definition of investment, as it is far more expansive than NAFTA, includes concepts of "investment authorization", licenses and permits, and is less linked to business enterprises; 2) the Article 5 "minimum standard of treatment" language, seeming to codify the *Loewen* case holding that state court actions are subject to review by international investment tribunals; and 3) the Article 5 due process standards, based on unclear international norms that could grant foreign investors greater rights than US investors, rather than reflecting US constitutional norms of substantive due process, as required by the Trade Act of 2002. IGPAC appreciates that the US has taken commitments to improve the transparency of proceedings and the disclosure of documents. IGPAC encourages the USTR to actively oppose any proposals that would revise arbitration rules in order to increase the confidentiality of proceedings, and instead to continue to assert US principles of transparency and openness in investor-state proceedings.

The ruling in the *Methanex* dispute established an important precedent for safeguarding important principles of federalism and state sovereignty of concern to this Committee. However, since such tribunal judgments are not formally precedential, IGPAC members have regularly recommended that the *Methanex* 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 other existing FTAs and FTAs, and that corrected language be added to this FTA and 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 trouble many IGPAC members.

IGPAC is aware that these types of challenges cannot directly or automatically overturn local, state, or federal laws, regulations, or court decisions. Still, IGPAC would prefer to clarify and limit the circumstances in which these types of challenges may be raised, not the least because such challenges impose significant demands on state agencies' time and resources, and cause confusion about the scope of state and state and local authority in the context of free trade agreements. Moreover, the possibility that state or local laws may be challenged (by way of an action against the United States) is itself a chilling factor for those governments considering legislative and regulatory action. While the federal government is responsible for defending investor challenges that are lodged against state and local measures, state resources are heavily taxed during the course of such disputes. IGPAC therefore strongly 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.

IGPAC members suggest that GATS negotiations, this FTA and other trade agreements 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. Since ambiguities in the existing GATS language have been brought to light, it should be possible in negotiations to either *eliminate the ambiguity*, or *eliminate the requirement*, in the event that no consensus can be reached on the given requirement. Many IGPAC members are particularly concerned about ongoing efforts within WTO General Agreement on Trade in Services (GATS) negotiations to impose trade disciplines on domestic regulation.

IGPAC members are encouraged that the Services Chapter Article 7 on Domestic Regulation does not include specific necessity test language. However, this article would be further improved were it to refer to "domestic" rather than "national" policy objectives in 7:2, and if 7:2(a) omitted the word "objective." As in other FTAs, domestic regulation provisions of this agreement may be amended in the future to reflect the final results of separate, ongoing negotiations of GATS Article VI:4. Because these GATS negotiations may directly impact the domestic regulation provisions of this and other FTAs, IGPAC applauds the position that the US has taken in these negotiations before the WTO to oppose the adoption of necessity tests, and to instead support transparency disciplines. IGPAC recommends that USTR enshrine the right of governments to regulate services and other sectors of the economy in all trade agreements, and that USTR also seek to eliminate necessity tests that could interfere with this right. The NAFTA provides a useful model for explicitly recognizing the state and provincial basis for setting regulatory objectives under national treatment that could be incorporated into FTAs and FTAs. IGPAC looks forward to further comprehensive discussions with the USTR on this matter.

This agreement contains a comprehensive chapter that is designed to expand trade in pharmaceutical products and medical devices. IGPAC members commend the USTR for ensuring that state-level Medicaid programs are specifically excluded from the coverage of this chapter. This has been an issue of concern to states since the conclusion of the US-Australia FTA. The Korea FTA eliminates ambiguity by noting that "*For greater certainty, Medicaid is a regional level of government health care program in the United States, not a central level of government program.*"

As the US and Korean governments work to implement this FTA, IGPAC members continue to offer their support for remaining engaged with federal and subcentral counterparts to develop trade policy, to collaborate on trade capacity building efforts and to undertake mutually beneficial trade development initiatives.

While IGPAC appreciates the opportunity to comment on this FTA, IGPAC members recognize that an enhanced intergovernmental dialogue on this, and other trade policy issues, is necessary to strengthen future agreements and to help develop a broader consensus on our nation's trade agenda. IGPAC has offered a number of recommendations to the USTR since 2004 that are designed to achieve this goal. IGPAC members respectfully and formally request that the USTR respond to these recommendations by indicating the steps the federal government would be willing to take to strengthen the intergovernmental consultation process.

III. Brief Description of the Mandate of the Intergovernmental Policy Advisory Committee

Established by the United States Trade Representative (USTR), pursuant to Section 135(c)(2) of the Trade Act of 1974 (19C. 2155(c)(2), as amended, the Federal Advisory Committee Act (5 C. App. II) and Section 4(d) of Executive Order No. 11846 dated March 27, 1975, the Intergovernmental Policy Advisory Committee (IGPAC) is charged with providing overall policy advice on trade policy matters that have a significant relationship to the affairs of state and local governments within the jurisdiction of the United States.

IGPAC consists of approximately 45 members appointed from, and reasonably representative of, the various states and other non-federal governmental entities within the jurisdiction of the United States. These entities include, but are not limited to, the executive and legislative branches of state, county, and municipal governments. Members may hold elective or appointive office. The Chair of the Committee shall be appointed by the US Trade Representative, and members shall be appointed by, and serve at the discretion of, the US Trade Representative for a period not to exceed the duration of the IGPAC charter. The US Trade Representative, or the designee, shall convene meetings of the Committee.

IGPAC's objectives and scope of its activities are to:

- Advise, consult with, and make recommendations to the US Trade Representative and relevant Cabinet or sub-Cabinet members concerning trade matters referred to in 19 C. Section 2155(c)(3)(A).
- Draw on the expertise and knowledge of its members and on such data and information as is provided it by the Office of the US Trade Representative.
- Establish such additional subcommittees of its members as may be necessary, subject to the provisions of the Federal Advisory Committee Act and the approval of the US Trade Representative, or the designee.
- Report to the Trade Representative, or the designee. The US Trade Representative or the designee will be responsible for prior approval of the agendas for all Committee meetings.

The United States Trade Representative, or the designee, will have responsibility for determinations, filings, and other administrative requirements of the Federal Advisory Committee Act. The Office of Intergovernmental Affairs and Public Liaison of the Office of the Trade Representative will coordinate and provide the necessary staff and clerical services for IGPAC. IGPAC Members serve without either compensation or reimbursement of expenses.

IV. Negotiating Objectives and Priorities of the IGPAC

State and local governments play a vital role in advancing America's global competitiveness. IGPAC members affirm that our nation's economic growth and prosperity are best served by embracing trade and economic development policy strategies that:
(1) are developed in a nonpartisan manner in close consultations with relevant stakeholders;
(2) yield significant, measurable economic gains for the country;
(3) create open, transparent, and fair global markets;
(4) commit resources to global market research and trade development assistance for small and mid-sized US businesses, in order that they gain awareness of expanding market opportunities, and increase export sales;
(5) provide comprehensive assistance to workers negatively impacted by challenging technology and trade trends;
(6) invest in innovative research and technologies to foster commercialization and job creation in the globally competitive industries and jobs of the future;
(7) safeguard essential federalism principles;
(8) respect basic American values; and
(9) advance, rather than isolate us from, international trade policy dialogue and analysis of competitive forces in our increasingly interconnected world.

The Korea FTA meets a number of these strategic goals. Provided that serious reservations about procurement provisions, investor-state dispute mechanisms, and other elements contained in this agreement and previous FTAs are addressed, IGPAC members, in principle, support the trade liberalization objectives of the US-Korea Free Trade Agreement (FTA). Further, IGPAC members would like to recommend that a number of clarifications be made to certain provisions of the FTA, and to note that this Agreement's objectives of economic growth, employment creation, sustainable development, and market expansion should be pursued in a manner consistent with the nation's constitutional and public policy obligations to state and local governments and their constituents. IGPAC members believe firmly that this FTA -- like all trade agreements -- should be drafted, implemented, and interpreted, to respect and give due consideration to existing state and local level regulatory, tax, and economic development policies, and to the social, economic, and environmental values that those policies promote.

Statutes and regulations that states and local governments have validly adopted, that are constitutional, and that reflect locally appropriate responses to the needs of our residents, should not be overridden by provisions in trade agreements. These concerns were reflected in the Trade Act of 2002's directive that trade agreements be negotiated so as to not "weaken or reduce the protections afforded in domestic environmental and labor laws" as well as the fact that 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 principle trade policy negotiating objective. 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 should 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 a trade agreement, offer or other binding commitment. IGPAC members would therefore strongly 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.

IGPAC members reaffirm that international trade and investment agreements need to be structured in a manner consistent with the principles of US constitutional federalism. To the extent that the USTR may wish to negotiate liberalization of services and other matters under states' sovereign jurisdiction, it is essential to duly confer with

states in order to gain their informed, explicit advice and consent. The general "blanket" exemption for "existing" and subsequent state and local measures that do not increase the degree of non-conformity could leave open a myriad of potential disputes about future changes. At a minimum, this matter highlights the critical need for the USTR to educate and consult with state and local entities so that they remain aware of the constraints that may be imposed upon future legislative actions. If future measures are not covered by current exceptions for existing laws, it would be necessary to fit them within other exceptions, many of which are far narrower and risk being subject to problematic standards, such as being "no more burdensome than necessary." The unintended consequence might be to freeze state and local legislation in ways that prevent it from adapting adequately to changing facts and circumstances. The difficulties that developed under energy deregulation in the Western states, and the discussions about whether to reconsider any aspects of current law in the area are indicative of such potential problems. This is particularly true where the interpretation of many of these terms and concepts continues to evolve and is subject to dispute within the WTO framework, as well as being subject domestically to the US Constitution's Commerce Clause.

Recommendations for Improving Federal-State Trade Policy Consultations

Members of the IGPAC appreciate USTR efforts launched in 2003 to broaden participation in trade policy formulation by state and local government representatives through the expansion of the Intergovernmental Policy Advisory Committee on Trade (IGPAC). Because effective consultation is critical to achieving consensus on essential trade policy matters, IGPAC members remain hopeful that our document submitted to the USTR on August 5, 2004 entitled "**Recommendations for Improving Federal-State Trade Policy Coordination"** may eventually be considered by Congress and the USTR, and implemented in some form. The recommendations in this memorandum grew out of discussions with USTR colleagues, who invited IGPAC members to suggest specific proposals related to procurement policy, federal-state trade policy coordination and capacity-building. Following initial discussions with the USTR, IGPAC has made these recommendations publicly available and has discussed federal-state trade policy issues and ideas with other interested parties. Because the recommendations have not yet been implemented, IGPAC's ability to comment fully on the US-Korea FTA and prior FTAs has been hampered. Hence, it is relevant to summarize below the 8/5/04 memorandum's findings and core recommendation of creating a Federal-State International Trade/Investment Policy Commission.

IGPAC Findings: Current Context and Elements of an Improved State-Federal Trade Policy Framework

State and local government entities are at the front lines of the international marketplace: both by assisting businesses to engage in global competition through trade development assistance; and by working to mitigate the impact of technological change and trade dislocations on communities, businesses and workers through varied adjustment, training and assistance programs. States have typically been innovators in international economic development work that fosters increased export activity by small and mid-sized firms. Though such businesses may turn first to private sector contacts for trade assistance, research shows that the transaction costs associated with this type of trade development assistance generally outweigh the benefits for most private sector service providers. Hence, federal, state and local government trade development agencies play a key role in filling this need by providing information, technical assistance, referrals, and guidance to smaller firms often lacking the internal resources to develop export expertise on their own. Still, the specific export and job creation/retention benefits from informational, capacity-building trade development assistance services remain difficult to measure. Unfortunately, many state and local trade development efforts are constrained by limited resources and competition from other budgetary priorities.

Today as throughout history, the benefits of trade liberalization and its short, medium and long-term costs and benefits are being debated by academics, government leaders and the general public. Our increasing and intensifying

globalization is occurring ever more rapidly, with factors of production more mobile, and international interconnections more profound, than ever before. Resulting advances in technology and productivity are having a major impact on employment trends in a variety of sectors and professions. Given the disparate trade flow and international investment impacts, those communities, businesses and workers gaining from greater international market access tend to be less visible, while those losing to global competitive challenges tend to suffer disproportionately, evoking understandable public concern and calls for greater government intervention. Some industrial and agricultural sectors facing import competition may effectively organize for protection or special treatment, while other sectors may experience comparatively greater damage, given their lack of ability or clout to gain preferential treatment. Public concern about the perceived negative consequences of trade is indicated by recent legislative action against "offshore outsourcing" in government procurement. Some legislation enacted or under review by federal, state and local elected officials would seem to reverse the trend toward further liberalization of national and subnational procurement markets.

Though the involvement of state decision-makers in international trade and investment agreements has increased over the past decade, the structure for federal-state trade policy consultations remains insufficient. State level involvement intensified following trade liberalization efforts launched in the early 1990s, culminating notably in the WTO Uruguay Round agreements and NAFTA. These trade agreements expanded beyond a focus on "at the border" tariffs, quotas and other measures, to "non-tariff barriers" involving government regulation, taxation, procurement and economic development policies – many of which are deployed at state and local levels. These post-1994 agreements also included enforcement provisions allowing lawsuits to challenge non-compliant federal and state measures. Hence, trade agreements, dispute settlement cases and negotiations have an intensified impact on federalism and on the historically established state-federal division of power and responsibility. While aware that such challenges do not directly overturn state or federal laws, the demands on state agencies' resources for legal preparation and barriers to comprehensive policy response remain significant.

State and local governments have generally supported multilateral, regional and bilateral efforts to expand market access, both for local businesses reaching out to global markets, and for international investors engaged in the local economy and creating employment. As trade liberalization efforts progressed in recent decades, however, their coverage and scope have increasingly extended beyond the federal level, increasing the impact on state and local-level laws, practices and regulations. Given the comparative newness of states' involvement in the content of international trade agreement negotiations, and in their implementation and dispute resolution, states often lack a clearly defined institutional structure with experienced staff dedicated to handling requests from trading partners, federal agencies and other interested parties, and for articulating the state's position on trade issues. Yet, at the same time, the accelerating pace of reaching such agreements and their expanding scope has made them ever more salient to state and local governments.

In addition to the legal context for trade policy, state and local governments lack sufficient information to assess the economic impact of trade and investment on their jurisdictions. At present, international trade and investment data at the state level are insufficient; data on the value of international procurement contracts is limited, and reporting on the results of trade agreements at the state/local level is scant. There is no information by state on services or merchandise imports; no detailed data on services exports and no current information on merchandise exports at the zip code level (given the discontinuation by the US Department of Commerce of the Exporter Location data series in 2002); and limited, delayed and highly aggregated international investment information. IGPAC members applaud the recent actions undertaken by the Department of Commerce 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*. The challenges of assembling national, not to mention subcentral, information on procurement contracts and merchandise and services trade render reporting on specific trade agreement results quite problematic for the US and other countries. These data gaps make it difficult to conduct an informed analysis of the specific costs or benefits of trade liberalization for a given industry or US location.

A number of barriers confront state and local government officials and staff – whether procurement directors, trade directors, legislators or other officials – who may endeavor to analyze trade and investment agreements with a view to determining benefits and costs from the state or local perspective. Reliable, objective, unbiased information regarding the impact of trade liberalization is not readily available, nor are there sufficient state-level data for independent analysis. Many states may not be aware of the extent of existing international trade, procurement and investment agreement commitments that might have been made under prior administrations, and that situation is surely exacerbated by the growing number of bilateral and plurilateral agreements being reached in recent years, each of which involves similar but not identical provisions and coverage. Moreover, many states do not yet have a clearly defined set of policies or positions on such international matters. This situation may be a consequence of delicate partisan politics, and of the absence of trade policy staffing, at most state and local government levels. Finally, federal resources dedicated to assist state agencies' implementation of relevant agreements are largely nonexistent, leaving state procurement and other officials to grapple with confusing and inconsistent information. These barriers create a disincentive for state support of trade liberalization. States that participate in international trade and investment agreements, and wish to comply with commitments, face legal, political and resource challenges – while those states that refrain from participation manage to avoid such difficulties, and to still help their resident companies benefit as "free-riders" from the international market access and other opportunities gained through such agreements. The following elements are critical to resolving these challenges:

1. **Trade policy capacity with resources relevant to state level concerns** in order to accurately inform state and local officials, trade opponents, trade proponents, and the public about the impacts of trade, procurement and investment agreements. Such trade policy capacity would include legal analysis for the balanced evaluation of trade and investment agreements' impacts on state laws, regulations and practices during all phases of policy formulation, negotiation and dispute resolution. This trade policy function should be performed in a structured, responsive manner by nonpartisan, qualified staff with expertise in international trade/investment policy and law, and should offer general background and customized analysis, interpretation and guidance for state and local government officials. Tools for extending access to such resources and assistance could include a dedicated, interactive website and/or helpline.

2. **Information sharing between the USTR and states, and in the trade policy dialogue among states** including more timely and frequent consultations as trade policy is being formulated, as trade controversies emerge, and as trade negotiations are being initiated, allowing sufficient time for evaluation of trade and investment agreements and for effective response to challenges and concerns. Given the economic distress and employment dislocations created in certain industries and communities due to trade liberalization, and the lack of awareness of the benefits of trade and international investment in some communities, USTR informational efforts need to be more informed by state-level data analysis, with outreach that is more inclusive and public when feasible. The USTR should reconsider its reliance on states' Single Points of Contact and broaden its outreach to include multiple key state contacts. **IGPAC recommends that USTR communications and requests be sent to Governors, with copies to states' legislative leaders, Chief Justices, attorneys general, offices of federal affairs and IGPAC members.**

3. **Improvement of trade data and analysis** based on national, state, regional and zip-code level data on merchandise and services exports and imports, on international investment flows, and on international government procurement contracts awarded to US companies. Trade data applications should use mapping technologies and other tools to better inform analysis and planning. While IGPAC recognizes the challenges inherent in collecting such data, Canada manages to track product exports and imports by province, country and US state, and offers an instructive example (website link: http://strategis.gc.ca/sc_mrkti/tdst/tdo/tdo.php?lang=30&headFootDir=/sc_mrk). Trade data analysis should compare state/federal trade performance against major trading partners and regions with successful trade development agencies (e.g. Canada, European Union, Japan, China, India, Brazil) and evaluate performance measures, program outcomes, and customer satisfaction at the subnational level.

4. **Assessment of the comparative costs and benefits** to the federal budget and US economy, particularly in terms of employment creation/retention and trade value, of the **allocation of resources and trade protections** to agricultural commodities, technology research and development, industrial goods, manufactured products, and services sectors. Policy revisions based on such analysis could lead to more effective and reasonable resource allocation related to trade development, technology policies and workforce adjustment programs. In addition to suggesting appropriate redistribution of a small portion of the national gains from technology and trade to dislocated workers and communities, such research might foster more domestic understanding of, and support for, investments in education and technology, and for continuing trade liberalization in the future.

5. **Discussion of international procurement from the state perspective** including: the implications of participation in, or withdrawal from, the WTO Government Procurement Agreement and relevant FTA or FTA provisions; policy responses to such concerns as the lack of access to Canadian provincial procurement; the implications of the USTR's reciprocity policy; and development of international procurement assistance programs to assist US companies seeking overseas contracts.

6. **Improvement in the state/federal trade development partnership** with efforts that: prioritize support by overseas posts for state-led trade initiatives in global markets; increase cooperation in domestic trade development program delivery; increase linkage with USDA for expansion of agricultural export programs to agri-business and related non-agricultural exports; integrate Eximbank trade finance and delegated authority activities with those of states and the private sector, improve small and mid-sized firms' awareness of and access to trade financing; and learn from studies on the best practices of trade partners' export promotion programs.

7. **Prioritization of federal support for high technology manufactured goods and services exports**. This would build on a foundation of increased federal funding for research and development in emerging sectors such as biotechnology, nanotechnology, photonics, advanced materials, and other innovative technologies. Support for high technology infrastructure, commercialization and trade, along with an educational system preparing the technology workers of the future, is crucial to the nation's global competitiveness.

Many executive, legislative and judicial branch officials at the state and local level assert the critical need to **broaden and deepen an informed, non-partisan trade policy dialogue** in order to support on-going federal-state cooperation related to trade agreements' negotiation, implementation and dispute settlement. Existing consultative mechanisms are largely informational and reactive, and inadequate to this task:

- the expanded IGPAC is more energized and pro-active, but lacks staff, resources and independence;
- states' "Single Points of Contact" provide destinations for USTR communications, but typically remain unclear as to their function, and disengaged from interactive response.

Moreover, in light of the consequences of the current context of insufficient infrastructure, there is a need to **ensure that there is dedicated institutional capacity at all levels of government** in order to support on-going federal-state-local cooperation related to trade agreements' negotiation, implementation and dispute settlement. The creation in the US of a consultative federal-state trade policy infrastructure could be informed by the best practices of trading partners, such as the Canadian federal-provincial model for trade consultations (C-Trade), and would serve to bridge the gaps between federal agencies' understanding of the varied state processes and socio-economic contexts and states' understanding of the scope of federal requests -- and between federal agencies' needs and expectations, and states' capacity and willingness to engage in cooperative trade liberalization efforts. In order to ensure its effectiveness, such institutional capacity should be guided by the principles of US **constitutional federalism** and **nonpartisan independence**.

IGPAC Recommendation for Action:

Creation of a Federal-State International Trade/Investment Policy Commission to provide institutional structure for continuous bipartisan consultation about US federal-state trade policy. Priority **action plan items** for the Commission include: assessing content, process, impact and implementation issues in trade agreements including services, investment, procurement and other provisions relevant to subfederal governments; conducting benefit-cost analysis of federal resources and trade protections allocated to agriculture, goods, services and technology; improving trade and investment data collection and dissemination; increasing trade development collaborations, and transforming trade adjustment assistance programs.

Federal-State International Trade/Investment Policy Commission Purpose:

Establishing and fully funding a Commission would provide **institutional structure for continuous bipartisan consultation and contribution on US federal-state trade policy**. In light of the increasing state role in trade policy formulation, negotiation and dispute resolution, the Commission would facilitate federal-state-local and interstate dialogue on trade policy issues, including multilateral, regional and bilateral trade and investment negotiations and agreements. The Commission would provide the interactive framework needed by the USTR, IGPAC and key state and local decision-makers, facilitating more effective consideration of communications and requests. Such policy interaction by the Commission would build upon expanded USTR outreach to states – particularly if the states' Single Point of Contact process were improved, and if USTR requests sent to Governors were copied to states' legislative leaders, attorneys general, offices of federal affairs and IGPAC members. The Commission would address state and local trade policy interests in dispute settlement issues, government procurement, trade and investment agreements, negotiations and related economic, legislative and legal developments. The Commission would offer state and local officials guidance, assistance and information related to analysis and implementation of trade and investment agreements. The Commission would work to resolve state and local-level concerns and would also foster interstate dialogue on trade, procurement and investment issues with trade policy implications.

Given the economic distress and employment dislocations created in certain industries and communities due to trade liberalization, the Commission's public outreach should involve federal and state labor agencies and labor unions. Addressing the framework elements identified above, the Commission would convene meetings, conduct research and report on its findings derived from analysis of economic, social and governmental impacts of existing

and proposed trade and investment agreements, and would make duly informed recommendations to federal, state and local government officials and to the public. In summary, the roles of the Commission would be to:

- foster consultations among federal/state/local government officials on trade and investment concerns;
- be a resource for objective trade policy and trade law analysis, with expert staff and technology providing research and information;
- create reports and recommendations for consideration by federal, state and local governments.

Commission Structure:

The creation of this Commission should be informed by the best practices of major trading partners, such as the Canadian federal-provincial model for trade consultations (C-Trade) and trade policy consultation within the European Union, as well as by the federal-state structure and budgeting format of the Appalachian Regional Commission. The Commission would need:

- Bipartisan leadership, co-equal co-chairs from federal and state government, supported by qualified nonpartisan staff with trade policy and trade law expertise;

- Members drawn from federal and state officials responsible for trade policy in their respective jurisdictions, e.g. the USTR, IGPAC, TPCC federal agencies, Congress, academic and legal experts, foundations and other institutions;

- Sufficient resources and funding to develop essential institutional capacity, to ensure active consultations among members, to prepare and convey reports and to convene meetings at least quarterly;

- Liaison with national associations of legislative, executive and judicial branch officials and with national associations of state officials exercising regulatory functions, including active participation in relevant meetings and publications, with a focus on their international and economic development committees (including such organizations as: Council of State Governments; National Conference of State Legislatures; National League of Cities; National Governors Association; National Association of Attorneys General; National Center for State Courts; Conference of Chief Justices, National Association of Insurance Commissioners, National Association of State Procurement Officials, National Association of Regulatory Utility Commissioners; etc.);

- Involvement in the annual Trade Policy Leadership Seminar (begun as the National Trade Policy Forum in North Carolina in December 2003 and being supported as an annual event by IGPAC members, the National Conference of State Legislatures, the Forum on Democracy & Trade and the Harrison Institute of Public Law-Georgetown University), encouraging more active state trade policy capacity-building and interaction with the Commission, and building upon relevant Seminar findings.

Action Plan Suggestions for the Commission

- Advocating for **improved collection and dissemination of national, state, regional and zip-code level data on merchandise and services exports and imports, and on international investment flows**, deploying mapping technologies and other tools to better inform analysis and planning. Such data would make it possible for Commission researchers to conduct research relevant to assessing the state/local impact of trade and investment agreements and proposals. Commission research made possible by such data could be customized to the needs of federal, state and local government officials. Commission research

could also benchmark state/federal trade performance against other major trading partners and regions with successful trade development efforts (e.g. Canada, European Union, Japan) through regular evaluations of performance measurement, program outcomes, and customer satisfaction at the subnational level.

- Conducting research to assess the **comparative costs and benefits** to the federal budget and US economy, particularly in terms of employment creation/retention and trade value, of the **allocation of resources and trade protections** to agricultural commodities, technology research and development, industrial goods, manufactured products, and services sectors. Research would also assess the trade, investment and economic impact of increasing federal funding for R&D and technology commercialization in emerging sectors such as biotechnology, nanotechnology, photonics, advanced materials, and other innovative technologies. The Commission could recommend policy revisions based on such analysis, that in turn could lead to more effective and reasonable resource allocation.

- Taking action to substantially **transform, expand and fully fund the Trade Adjustment Assistance** program, perhaps renamed as the "Technology" or "Workforce Adjustment Assistance" program. The Commission could conduct research on the workforce implications of technological adaptations confronting many manufacturing and services industries in an increasingly integrated and competitive global context. Research findings could suggest improvements to a Technology or Workforce Adjustment Assistance effort, with respect to scope for new initiatives, funding requirements, implementation process, programmatic flexibility for adapting to varying states' needs, and effective outreach to impacted workers, employers and communities. Such Commission work, by exploring how best to redistribute a small portion of the national gains from technology 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.

- Assessing the impact on states of **services and investment provisions** in international agreements (e.g. NAFTA Chapter 11, WTO General Agreement on Trade in Services, FTAs, FTAs) on executive, legislative and judicial powers and regulatory functions (e.g. licensing, taxation, environmental policies, etc.) at all levels of US government. In reviewing past and current negotiation objectives and all investment tribunals' actions and rulings (interim and final) related to investor-state disputes, the Commission should ascertain:
  - the specific extent to which investment provisions in some international agreements extend greater investor rights to foreign investors than those available to US investors via US federal, state and local courts;
  - whether international agreements' investment provisions have redefined government regulation at the federal, state and local levels as "regulatory takings" of private property, subject to government compensation to owners, and how such redefinition may constrain the potential for and scope of government action, and
  - the scope of government authority exemptions under the GATS, and the extent to which domestic regulation disciplines impact state and local governments' jurisdiction.

  Based on such analyses, the Commission would make recommendations to IGPAC and the USTR, suggesting modifications to the process for consultation and negotiation of services and investment agreements, revisions to existing provisions on services and investment, procedural changes, and other guidance that would serve to bring agreements in line with established principles of US constitutional federalism and representative democracy.

- Consulting with the National Association of State Procurement Officials (NASPO) to collect information on the impact of **international procurement agreements** (GPA, FTAs) on the state level and of state actions on such agreements, including negotiation process, implementation experience and varied state policy legislative and programmatic responses. Following quantitative and qualitative analysis, the Commission could distribute a "white paper" report that would:
  - detail and clarify background information on agreements' provisions and implementation guidance for state procurement and trade policy officials, legislators and attorneys general;
  - develop plans for additional resources targeted to state procurement officials with front-line implementation responsibilities, such as a user-friendly website with links to: an email and telephone helpline for rapid response needs; key resource documents; explanatory charts outlining state commitments to various agreements; and details on states' varied terms, conditions and exceptions for participation;
  - suggest strategies for assisting small and mid-sized firms pursuit of new export markets through international procurement opportunities, and
  - recommend improvements to negotiation and coordination processes, best practices and suggested strategies relevant to federal and state procurement policymakers.

- Bolstering **collaborative federal-state trade development** efforts. Federal and state agencies need to be encouraged to deepen their trade development partnership, by, as examples: prioritizing overseas posts' support for state-led trade initiatives in global markets; ensuring that federal trade development products and services remain affordable for small and mid-sized US businesses; increasing cooperation in domestic trade development program delivery; and integrating Eximbank trade finance and delegated authority activities with those of states and the private sector, thus improving smaller firms' access to financing.

- Building on existing corporate, government, and academic **relationships of the US states abroad** as a bridge to foster cooperation and understanding in preparation for **future trade policy, trade capacity building, program development and trade agreement initiatives** and meetings, such as WTO Ministerials. The Commission could identify those state-global formal and informal international connections of greatest potential benefit to US trade policy objectives, advancing trading partners' participation in the world's trading system, and leadership in trade development and capacity building initiatives.

V. Advisory Committee Opinion on the US-Korea FTA

General Observations:

IGPAC comments on the Korea FTA are limited to the text of the agreement that currently appears on USTR's cleared advisor website. As such, we note that the document has not yet undergone legal review and that sections related to labor, environmental, intellectual property and possibly other provisions have not been finalized pending USTR negotiations with Congress. Given this, IGPAC reserves the right to provide additional comments on the agreement if and when these materials become known. Provided that serious reservations about investor-state dispute mechanisms, provisions on domestic regulation of services, and other elements contained in this agreement and previous TPAs and FTAs are addressed, IGPAC members, in principle, support the trade liberalization objectives of the US-Korea Free Trade Agreement (FTA). While this FTA advances a number of important trade development and market reform objectives in a manner generally beneficial to our national, regional and local economies, the agreement also includes problematic investor-state and other provisions that IGPAC members recommend be clarified and modified. Moreover, the FTA's objectives of economic growth, employment creation, sustainable development, and market opportunities should be pursued in a manner consistent with the nation's constitutional and public policy obligations to state and local governments and their constituents. Hence, IGPAC reserves the right to provide an addendum to this report. The IGPAC member representing North Carolina indicates that the state is opposed to this FTA on the grounds that it further accelerates the loss of textile jobs without additional protections for North Carolina's workers and communities.

This agreement with Korea, a critically important strategic ally of the US and a significant trading partner, should foster trade ties and deepen Asian regional economic integration. The US-Korea FTA should substantially improve mutually beneficial economic and industrial development objectives, while increasing trade and investment opportunities. US economic interests, entrepreneurs and employees would benefit from improved market access for goods, services, agricultural products, and from better access to central government procurement opportunities. IGPAC members note that the US and Korea are poised to benefit, both from expanded market access, and from greater strategic regional integration amongst smaller and larger nations in Asia.

Still, IGPAC members continue to believe that reviving momentum in the WTO Doha Development Round of multilateral market liberalization efforts is of far greater importance to state economic development objectives than any single regional or bilateral trade agreement. Given the limited trade policy time and resources at the state and local level, we are especially mindful of the considerable staff time involved in the analysis of trade agreements – whatever their scope and economic impact. Obviously, comprehensive multilateral agreements encompassing all WTO member countries would offer comparatively significant trade development benefits for the investment of federal and subfederal staff time and resources involved. With demonstrable trade gains on a large scale from multilateral trade accords, the case for constituent support can be persuasively made at the subfederal level. It may prove more difficult for state and local officials to communicate the relative importance and potential benefits of FTAs or Free Trade Agreements with smaller, individual countries or regions.

It is also the case that the broad scope of WTO negotiations creates new challenges for state and local governments. Many IGPAC members are particularly concerned about ongoing efforts within WTO General Agreement on Trade in Services (GATS) negotiations to impose trade disciplines on domestic regulation. Given the importance of these negotiations, IGPAC reiterates its request that the USTR consult closely and comprehensively with state and local governments, so that better outcomes are possible from GATS negotiations.

Further, IGPAC members support expanding trade and market access, but only as long as there is a simultaneous commitment to ensuring that our nation's trade initiatives, trade laws, enforcement efforts and the dispute settlement process respect the authority of states and local governments to regulate, legislate and interpret land-use, labor, health, safety, welfare, and environmental measures. Some of the core principles that could facilitate international trade and investment agreements, and dispute resolution processes, without sacrificing constitutional standards, include:

- Inclusion of language such as the phrase "no greater procedural or substantive rights" in trade agreements, notably with respect to international investment provisions. Such language would ensure that international businesses do not receive preferential treatment when compared to domestic businesses, and would reference the US Constitution as the benchmark with respect to competing language in international agreements. As evidenced by some cases arising from NAFTA Chapter 11, generalized expropriation language has allowed some foreign investors to file frivolous takings claims that challenge laws traditionally in the purview of state and local governments. The construction of any investor-state provisions should be approached with extreme caution and after extensive consultation with state and local governments, in order to avoid unintended consequences akin to NAFTA Chapter 11. Specific comments from IGPAC about the US-Korea FTA's investment provisions are outlined below.

- Legal standards that are "rationally related to a legitimate governmental interest," and that are consistent with the US Constitution and applicable case law, by ensuring state and local governments are not held to a higher standard in defending legitimate governmental interests with respect to international trade than domestic commerce. International agreements that include standards such as "least trade restrictive" or "least burdensome" for defining the permissible scope of governmental regulation are inconsistent with constitutional standards for evaluating legislation, and may affect a state or municipality's ability to implement effective economic development programs and zoning laws.

- Transparency in claim and dispute resolution processes. While it may be appropriate to include investor-state dispute resolution procedures in certain trade agreements, policymakers should take steps to ensure that these procedures are more accessible to both the public and all governmental entities that may be affected by particular investor claims. The United States and relevant international tribunals should promptly notify state and local governments when any regulation or law may be implicated by an investment dispute, seek their input and assistance at all stages of the process, and allow impacted state and local governments to participate fully in the hearing and deliberation process. Affected state and local governments should also be empowered to file *amicus* briefs in matters before dispute tribunals and be permitted to work with the federal government when necessary to defend their laws and regulations. Attention should also be given to making the investor-state proceedings open to the public. IGPAC members have been troubled by recent developments in trade disputes impacting federal and state jurisdictions, such as the WTO tribunal ruling on the Antigua-Barbuda GATS case involving US federal and state internet gambling restrictions, the NAFTA Chapter 11 arbitration claim filed by Glamis Gold Ltd. challenging California's environmental and extractive industry regulations, and the claim filed by Grand River Enterprises Six Nations Ltd. seeking compensation related to the tobacco Master Settlement Agreement. While aware that such challenges do not directly, automatically overturn state or federal laws, these disputes place significant demands on state legal and policy resources. Finally, further consideration should be given to the structural problems inherent in regulating important aspects of international trade through a process that uses *ad hoc* judges and ostensibly eschews precedent. In view of the need of businesses for stability and predictability and, in light of the substantial impact that decisions may have, there is an imperative need to ensure that the decisions and decision-makers are viewed as having substantial institutional credibility. Since NAFTA tribunal judgments are not formally precedential, many IGPAC

members recommend that the *Methanex* 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 existing FTAs and FTAs, and that corrected language be added to this FTA and all relevant future trade agreements.

- Improvement by USTR of the consultation process by implementing the recommendations for consultations outlined above, and by adopting the standard set out in Federalism Executive Order 13132, Section 6, (which requires federal agencies to consult with state and local officials and representatives of their respective national organizations *before* issuing proposed rules or submitting legislative proposals to the Congress) would help the USTR gauge the concerns of state and local governments in a timely fashion.

- No presumption of federal authority over state and local law, when dealing with matters of unclear constitutional authority. This would bolster due consideration for the principles of federalism, and the negotiating position of the US would be clarified if federal functions were clearly separated from those of state and local governments.

- Monitoring and enforcement by USTR and relevant federal agencies, to ensure Korea's compliance with commitments made under the FTA with respect to market access, labor standards, environmental protections and other provisions. Updated information on on-going US monitoring and enforcement efforts should be made readily and publicly available.

Government Procurement

This FTA's procurement chapter does not reference US states, the USTR reciprocity policy, or additional subfederal procurement coverage, since Korea and the US have already covered subcentral procurement through the pre-existing WTO Government Procurement Agreement (GPA). As a matter of general principle, IGPAC members support the goal of improving transparency and increasing fair market access in government procedures and regulatory decisions related to procurement, while preserving the independent authority of state and local governments to adopt legislation, standards and procedures consistent with their experience and interests. State officials on IGPAC have raised concerns about the USTR's state "reciprocity policy," adopted February 2005 and applied thus far only to the Panama FTA. Such IGPAC comments are detailed in prior reports.

Currently, public awareness of the implications of "outsourcing" or "offshoring" has been heightened as some US employment shifts overseas and across borders – while popular awareness of the benefits of opening international procurement markets, foreign direct investment and foreign affiliate employment to the US economy seems less evident. Varied proposals under review by federal, state and local elected officials could further increase limits on international procurement market access. Given this context, IGPAC members suggest that the USTR, the US Department of Commerce Export Assistance Centers, and other relevant federal agencies, provide information to the public to increase awareness of the benefits of procurement market liberalization, collect and share data on the market value of international procurement opportunities, and provide technical assistance to US firms to encourage success in their reaching procurement markets under other FTAs, FTAs and the WTO Government Procurement Agreement.

Investment

Some suggest that, where agreements are reached with countries with less fully developed legal systems, inclusion of a wholly separate litigation process, applicable only to foreign investors, may be viewed as necessary for creating conditions in such countries that are conducive to attracting and retaining international investment. Many IGPAC members' objections to the investor-state provisions in this and other FTAs stem from concerns that investors from nations with well-developed legal systems appear to have abused these provisions to improperly and frivolously challenge the authority of state and local governments. In particular, the *Methanex* and *Loewen* cases stemming from NAFTA Chapter 11 reinforced concerns that the provision would be abused by investors intending to circumvent established legislative and judicial procedures. Given the still evolving context of investor-state disputes as cited earlier, a number of IGPAC members maintain significant concerns about overly expansive definitions of investment, and investor-state provisions on dispute settlement claim submission and arbitration, and welcome clarifying language in NAFTA interpretive notes and in this FTA.

Some IGPAC members remain concerned about certain investor-state dispute settlement provisions in this agreement. Given that the Republic of Korea has a well-developed legal system, some IGPAC members question the need for including any special investor-state dispute resolution provisions in this agreement, and would prefer, like the US-Australia FTA, resolution of these types of disputes be left to the courts. IGPAC members are also concerned that, unlike other recent FTAs, Article 18 of the Korea-US FTA does not contain language that would provide additional sovereignty protection to US courts by precluding certain claims (e.g., those that have been previously been submitted to a national court or subjected to a national administrative review process) from being subsequently raised before an arbitral tribunal. IGPAC members recommend that such a provision be included in this and future trade agreements and that USTR also consider adding language that would preclude a notice of arbitration from being filed involving any dispute that is before a signatory nation's courts until a final appellate decision has been rendered in the matter. IGPAC members welcome those Section B investor-state dispute settlement provisions that seek to provide greater transparency, allow non-party and *amicus curiae* submissions, and to consider whether claims or objections may be frivolous.

Three additional concerns about investment provisions in this FTA (modeled on language in previous agreements) also warrant highlighting:
1) the problematic and overly broad Article 28 definition of investment, as it is far more expansive than NAFTA, includes concepts of “investment authorization”, licenses and permits, and is less linked to business enterprises;
2) the Article 5 “minimum standard of treatment” language, seeming to codify the *Loewen* case holding that state court actions are subject to review by international investment tribunals; and
3) the Article 5 due process standards, based on unclear international norms that may grant foreign investors greater rights, rather than reflecting US constitutional norms of substantive due process, as required by the Trade Act of 2002. While appreciating the importance of flexibility in provisions related to national treatment, the provisions in Article 3(3) could be clarified to entirely preclude misunderstandings and unintended consequences related to investment and subcentral jurisdiction. Conceivably, a foreign investor could use this provision to argue for the treatment provided by one US state for its investment in another US state. Though clearly not intended to be used in this manner, such language may leave open that potential interpretation and misuse. Our constitutional system of federalism accepts the idea that regulatory requirements may differ between the States without raising concerns or giving rights to challenge those requirements. It should be made clear in these agreements that non-discriminatory application of those differing provisions to foreign investors does not violate the FTA.

The ruling in the *Methanex* dispute established an important precedent for safeguarding important principles of federalism and state sovereignty of concern to this Committee. However, since such tribunal judgments are not

formally precedential, IGPAC members have regularly recommended that the *Methanex* 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 other existing FTAs and FTAs, and that corrected language be added to this FTA and 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 trouble many IGPAC members.

IGPAC is aware that these types of challenges cannot directly or automatically overturn local, state, or federal laws, regulations, or court decisions. Still, IGPAC would prefer to clarify and limit the circumstances in which these types of challenges may be raised, not the least because such challenges impose significant demands on state agencies' time and resources, and cause confusion about the scope of state and state and local authority in the context of free trade agreements. Moreover, the possibility that state or local laws may be challenged (by way of an action against the United States) is itself a chilling factor for those governments considering legislative and regulatory action. While the federal government is responsible for defending investor challenges that are lodged against state and local measures, state resources are heavily taxed during the course of such disputes. IGPAC therefore strongly 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.

- In the event that state laws, regulations or practices are challenged, and defended by state officials in the dispute settlement process, (most frequently in California under NAFTA Chapter 11), IGPAC members recommend that the USTR and US Department of Justice consider that awards for costs (per Article 26 in this FTA) be duly requested for the efforts expended by such states in assisting the federal government.
- The recent ruling in the *Methanex* dispute established an important precedent for safeguarding important principles of federalism and state sovereignty of concern to this Committee. Since NAFTA tribunal judgments are not formally precedential, IGPAC members would like the *Methanex* 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....,"** codified as a formal Interpretive Note in order to clarify existing agreements such as the NAFTA and other FTAs and FTAs, while corrected language should be added to this FTA and all relevant future trade agreements.
- In Section C, the meaning of "investment agreement" and "investment authorization" needs clarification. Explanation of the coverage and scope of these terms in the US federal and state context is also needed.

IGPAC appreciates that the US has taken commitments to improve the transparency of proceedings and the disclosure of documents. IGPAC encourages the USTR to actively oppose any proposals that would revise arbitration rules in order to increase the confidentiality of proceedings, and instead to continue to assert US principles of transparency and openness in investor-state proceedings.

<u>Market Access</u>

To the extent that state and local laws, regulations and other measures are, or may become, implicated by market access negotiations or commitments, IGPAC requests that, in concert with the consultation provisions that the

agreement establishes between the FTA parties, regular channels of communication and consultation between federal and subcentral governments be established as needed (note report recommendations in section IV) with respect to the provisions of this Agreement, and particularly as they apply to sanitary and phytosanitary measures, technical barriers to trade, government procurement, investment, cross-border trade in services, financial services, telecommunications, e-commerce, intellectual property, labor, environment, transparency, trade capacity building, and dispute settlement.

Pharmaceutical Products and Medical Devices

This agreement contains a comprehensive chapter on expanding trade in pharmaceutical products and medical devices. IGPAC members commend the USTR for ensuring that state-level Medicaid programs are specifically excluded from coverage, as indicated under the Article 8 Definitions of "health care program operated by a Party's central level of government, by its footnote 3: *"For greater certainty, Medicaid is a regional level of government health care program in the United States, not a central level of government program."*

IGPAC members commend the USTR for clarifying Korea FTA language in an area of major concern for states since the conclusion of the Australia-US FTA. The Australia FTA represented the first time that the United States had included a specific chapter of pharmaceuticals in a bilateral free trade agreement; Annex 2-C of that agreement noted that the disciplines found in that chapter applied to 'federal health care programs.' Medicaid is a federal program, administered by the states, and language in Annex 2-C was unclear as to whether the scope of disciplines would include state administration of Medicaid. IGPAC is gratified to note that USTR has acted on the concerns raised by many state elected officials in recent years by including language in the definitions (Article 8) of the pharmaceuticals chapter of this agreement to explicitly clarify that Medicaid is a "regional level" program, and not a central government program to which disciplines in the agreement will apply.

Services

Given the growing importance of services industries to the US economy, state and local governments generally support objectives of Free Trade Agreements to liberalize trade in services industries as a means of increasing market access for US firms and for reaching trade development objectives. IGPAC members equally assert that the independent exercise of state and local legislative and regulatory power is critical to protecting citizens' interests and safeguarding the federal system. IGPAC members suggest that WTO General Agreement on Trade in Services (GATS) negotiations, this FTA and other trade agreements 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. Since ambiguities in the existing language have been brought to light, it should be possible in negotiations to either *eliminate the ambiguity*, or *eliminate the requirement*, in the event that no consensus can be reached on the given requirement. If these two touchstones are used, we believe any agreements reached are far less likely to continue to raise concerns for governmental entities.

IGPAC members suggest that GATS negotiations, this FTA and other trade agreements 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. Since ambiguities in the existing GATS language have been brought to light, it should be possible in negotiations to either *eliminate the ambiguity*, or *eliminate the requirement*, in the event that no consensus can be reached on the given requirement.

Many IGPAC members are particularly concerned about ongoing efforts within WTO General Agreement on Trade in Services (GATS) negotiations to impose trade disciplines on domestic regulation. IGPAC members are encouraged that this FTA's Services Chapter Article 7 on Domestic Regulation does not include specific necessity test language. However, this article would be further improved were it to refer to "domestic" rather than "national" policy objectives in 7:2, and were 7:2(a) to omit the word "objective." The Article on Domestic Regulation specifies that it would be amended to be made consistent with results under GATS negotiations of Article VI:4. In light of the importance of GATS negotiations to domestic regulation provisions in this FTA and other FTAs and 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 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 and FTAs. [Article 301 (2) "The provisions of paragraph 1 regarding national treatment shall mean, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded by such state or province to any like, directly competitive or substitutable goods, as the case may be, of the Party of which it forms a part."].

IGPAC members have had most informative consultations with USTR colleagues in recent years to deepen our understanding of the negotiating process undertaken by the Working Party on Domestic Regulations (WPDR) and to advance IGPAC priorities. GATS Article VI:4 applies to measures related to broad categories of domestic regulation, including qualification requirements, licensing requirements and procedures, and technical standards. As GATS general obligations apply to all levels of government, IGPAC members are mindful of potentially significant impacts on state and local governments; notably the proposals to limit regulations to those that serve "national" policy objectives, given that GATS language calls for regulatory measures to be "based on objective and transparent criteria…", and to be "not more burdensome than necessary to ensure the quality of the service." As the 5/31/05 correspondence to the USTR from 29 state attorneys general indicated, state and local officials have stated that the least-burdensome requirement would "unacceptably encroach upon our states' regulatory authority."

On June 16th, 2006, Representative George Eskridge of Idaho, Chair of the National Conference of State Legislatures' State & Local Working Group on Energy & Trade Policy, wrote a letter to Carol Balassa at the USTR, outlining concerns about GATS provisions on regulation that illuminate specific state concerns:

> "…We concur with IGPAC's general concerns that the proposed GATS disciplines on domestic regulation could adversely affect state regulatory authority, so we will not cover the same ground in this letter. Of the two case studies sent to you by the IGPAC Services Working Group, the study on *GATS & LNG Facility Siting in California* was initiated by our Working Group after we sent you our *Interim Report on GATS & Electricity* in April of 2005. The version of the case study enclosed reflects further modifications by our Working Group and we hope it is a useful product for you. We look forward to your comments on the LNG study in writing or in conversation. As we did on regulation of electric utility monopolies, we would be happy to convene a meeting of state regulatory experts to explain our observations and to provide further detail.
>
> On our second point, state public utility commissions (PUCs) make regulatory decisions that relate to licensing or technical standards based upon whether the request is in the public interest. As we explained in part IV.F of our *Interim Report on GATS & Electricity*, state law usually provides multiple criteria for defining the public interest, some of which must be balanced against each other on a case-by-case basis. The reason that state legislatures have created public utility commissions is to exercise discretion in weighing these multiple factors. In other words, PUCs exist to make subjective decisions that balance competing public and private interests.
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> For example, the Idaho Code gives the Public Utilities Commission the authority to determine the "public convenience and necessity" for a license, and the service supplier has the burden of establishing the "necessity of

> additional service" (I.C. § 51-528), which is the converse of GATS proposals that require regulators to establish that domestic regulations are necessary. California delegates equally broad power to its PUC and, like many states, articulates a complex and practical set of competing objectives to balance. For example, in the context of a merger or acquiring a subsidiary, these objectives include economic interests of ratepayers, financial condition of the utility, quality of service, quality of management, fairness to utility employees, fairness to utility shareholders, community economic benefits, and preservation of the regulatory capacity of the PUC. (Cal.Pub.Util.Code § 854.)
>
> Most of the proposals to create new GATS disciplines on domestic regulation include an obligation to base licensing and other decisions on "transparent and objective" criteria. Thus, the objectivity test requires more than transparency; it appears to be a substantive obligation that may conflict with our traditionally subjective standard for balancing competing interests.
>
> This should be a concern for federal regulators as well. Since Congress adopted the Interstate Commerce Act in 1887, the federal government has regulated transportation, energy and other sectors based upon criteria of serving "public convenience and necessity." Where the federal government has taken the lead, such as regulation of wholesale energy markets and transmission, it is important to state and local governments that Congress and federal agencies retain their traditional authority to regulate in the public interest, uninhibited by international obligations to limit regulations to those that are "objective."
>
> On the surface, objectivity is a desirable goal. To raise objectivity to the level of an international obligation, however, undermines the ability of domestic regulators to deal with the inherent complexity of service industries. An international objectivity test moves in the direction of standardized and technocratic regulation and away from regulation in the public interest by legislatures and utility commissions that are accountable for balancing diverse public interests."

Based on IGPAC member interest in services, in June 2005 the Committee established a Services Working Group (comprised of cleared IGPAC advisors and outside experts knowledgeable about state services regulations and international trade law) to study the extent to which the WTO's services negotiations could potentially affect the manner in which state and local governments have traditionally regulated the delivery of certain services. IGPAC has previously conveyed comments to USTR regarding WPDR negotiations on GATS Article VI:4. WPDR proposals on domestic regulation appear to have the potential to significantly curtail the manner in which state and local governments may regulate an array of services that, for public policy and federalism reasons, have historically been subjected to state jurisdiction and oversight. While this scope of coverage is potentially broad enough to cover regulation of all kinds of services, most WPDR proposals only purport to cover measures that affect service sectors in which a country has a commitment to follow GATS rules on market access and national treatment. The US has such commitments in more than ninety service sectors, so clarifying the scope of coverage will be important even if the WPDR adopts only the most modest disciplines on domestic regulation. Any coverage adopted during GATS negotiations could become the platform for future negotiations that could strengthen the disciplines on local, state and national governments' "right to regulate."

Some of the GATS sectors that merit further analysis include, but are not limited to:

- Gambling – the IGPAC has suggested that the US commitment be withdrawn;
- Energy, electricity, related distribution services (per NCSL Interim Report on GATS & Electricity);
- Licensing of professionals – legal services, professional services, etc.
- Distribution services – esp. tobacco, alcohol and drugs;
- Health services, notably prescription drug benefits -retail and wholesale; health facilities, hospitals, other (certificates of need for construction of facilities) and health insurance;
- Environmental services;
- Desalination facilities – waste water
- Financial law enforcement – insurance and consultancy

- Hazardous materials – wholesale distribution, solid/hazardous waste management
- Higher education
- Library services – libraries
- Municipal telecom franchises – information and other communications
- Construction services; zoning-commercial development – retail distribution, land acquisition, etc.

Additional services issues in the Korea FTA warranting special mention:

- Given outstanding issues to be clarified with respect to the WTO tribunal ruling on the Antigua & Barbuda internet gambling case, IGPAC members would suggest a side letter specifying that Investment Chapter obligations do not extend to the recreational services, gaming, gambling sector, with exclusions at the US federal and state levels, both with respect to investment and cross border trade in services.
- While the USTR has diligently endeavored to identify various state statutes and local measures that may not conform to certain provisions in this agreement, excluding them from coverage by listing them in annexes of non-conforming measures, IGPAC members still strongly recommend shifting to a positive list approach. Given the current negative list context, it should not be presumed that these annexes are comprehensive, nor that future legislative and regulatory decisions must be consistent with commitments made in this agreement.

IGPAC would again suggest that involving the National Association of Regulatory Utility Commissioners (NARUC) as a member of IGPAC and as part of the trade policy consultation process could significantly enhance substantive comment on services provisions from the state and local regulatory perspective, as NARUC members include governmental agencies that regulate telecommunications, energy, and water utilities and carriers in the US, Puerto Rico and the Virgin Islands.

IGPAC members commend the USTR for consulting with states about negotiations on services. 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 Doha Development Round. It is hoped that the USTR can continue to work with the global community on forging a common view on domestic regulation and government authority issues, so that state and local governments can make more informed assessments of their positions on future agreements.

Comment on the Advisory Committee Process:

IGPAC members sincerely appreciate the dedication of USTR staff in providing information and assistance as we prepared this report. As always, IGPAC members would observe that the mandated 30 day review period is entirely insufficient, given the complexity of the agreements and the time needed for consultation amongst members of the Committee. However, in the case of the Korea FTA, there was not even a full 30 day period allotted for review, as many KORUS chapters were made available after the 4/1/07 notification date. In view of the compressed schedule and the need to consult with a large number of constituent members, the representatives of the National Association of Attorneys General (NAAG) do not take a formal position on this Agreement at this time. The National Association of State Procurement Officials (NASPO) appreciates its participation in the IGPAC and the inclusion of its input regarding the procurement-related issues in this report. Because NASPO represents purchasing directors from all states, some of which may take differing positions on the Agreement itself, NASPO also does not take a formal position on this FTA at this time.

In light of the commitment of the USTR and Congress to receiving input from IGPAC and other advisory committees, lengthening this time frame and deepening the resources devoted to the entire process, by creating a

Federal-State Trade and Investment Policy Commission (as detailed in section IV of this report), would be most laudable. IGPAC members emphasize that the creation of an institutional infrastructure, to foster on-going federal-state-local trade policy consultations before, during and after final trade agreement language is made available, would provide for a far more comprehensive, inclusive and valuable IGPAC review process.

IGPAC members recognize that an enhanced intergovernmental dialogue on trade policy issues is necessary to strengthen future agreements and our cooperative spirit. With that objective in mind, IGPAC has offered a number of recommendations to the USTR since 2004. In order to achieve progress, members respectfully and formally request that the USTR provide a list of what steps, if any, the federal government would be willing to take to strengthen the intergovernmental consultation process so that we are better able to reach our mutual goals.

VI. Membership of Intergovernmental Policy Advisory Committee (IGPAC)

Roster as of April 2007

Rep. Sheryl Allen	Utah House of Representatives
Jill Arthur	City of Santa Ana
Ron Bell	Commonwealth of Virginia/Dept. of Gen. Scvs.
Representative Daniel E. Bosley	Commonwealth of Massachusetts
George Brady	National Association of Insurance Commissioners
James A. Brooks	National League of Cities
Liz Cleveland	Mississippi Development Authority
Carol Colombo	State of Arizona
Karen Cordry	National Association of Attorneys General
Peter S. Cunningham	North Carolina Dept. of Commerce
Robert Hamilton	Office of Governor of State of Washington
Edward T. Hayes	Representing the City of New Orleans
Kathy M. Hill	Iowa Dept. of Economic Development
Brian Krolicki	Lt. Governor, State of Nevada
Peter Owens Lehman, Esq.	South Carolina State Ports Authority
Rep. Peter Lewiss	Rhode Island House of Representatives
Tony Lorusso	Minnesota Trade Office
Teresa Marks	Arkansas Attorney Generals Office
Cassandra Matthews	National Association of Counties
Robert R. Matthias	City of Virginia Beach
Jeremy Meadows	National Conference of State Legislatures
Dave Naftzger	Council of Great Lakes Governors
Mayor Meyera E. Oberndorf	City of Virginia Beach, VA
Paul D.A. Piquado	Commonwealth of Pennsylvania
Mayor Miguel A. Pulido	City of Santa Ana, CA
Ricardo A. Rivera-Cardona	Puerto Rico Trade Company
Lynne Ross	National Association of Attorneys General
Hannah Shostack	Office of Legislative Services, NJ Legislature
Richard Van Duizend	National Center for State Courts
Christopher Whatley	Council of State Governments
Kay Alison Wilkie	NY State Department of Economic Development
Frank Williams	Supreme Court of Rhode Island