

## **The Dominican Republic – Central America – United States Free Trade Agreement – Impact on State and Local Governments**

### **I. Introduction**

The Dominican Republic – Central America – United States Free Trade Agreement (CAFTA-DR or Agreement) will eliminate tariffs and trade barriers and expand regional opportunities for workers, manufacturers, consumers, farmers, ranchers and service providers in the United States and Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua (collectively “Central America”) and the Dominican Republic. Central America and the Dominican Republic make up the 2<sup>nd</sup> largest U.S. export market in Latin America, behind only Mexico and larger than Brazil. The United States exports more than \$15 billion annually to the region, making it America’s 10<sup>th</sup> largest export market worldwide. Central America and the Dominican Republic constitute a larger U.S. export market than Russia, India, Indonesia, and Saudi Arabia combined.

Today, nearly 80 percent of Central American and Dominican Republic products enter the United States duty-free under unilateral trade preference programs – the Caribbean Basin Initiative (CBI) and the Generalized System of Preferences (GSP) – as well as under existing duty-free treatment provided on a most-favored-nation (MFN) basis. The CAFTA-DR opens the region’s markets to manufactured goods, services, and farm products from the United States. More than 80 percent of U.S. exports of consumer and industrial goods will become duty-free immediately upon the entry into force of the Agreement, with remaining tariffs phased out over 10 years. Key U.S. export sectors in the states, such as information technology products, agricultural and construction equipment, paper products, chemicals, and medical and scientific equipment, will benefit from the elimination of duties.

In addition, more than half of current U.S. farm exports to Central America will receive duty-free treatment immediately, including high quality cuts of beef, cotton, wheat, soybeans, certain fruits and vegetables, processed food products, and wine. More than half of current U.S. farm exports to the Dominican Republic will become duty-free immediately, including corn, cotton, wheat, soybeans, many fruits and vegetables, and processed food products. Tariffs on most remaining U.S. farm products will be phased out within 15 years.

The Central American countries and the Dominican Republic will accord substantial market access across their services and investment regimes, providing access in sectors such as telecommunications, express delivery, computer and related services, tourism, energy, transport, construction and engineering, financial services, insurance, audiovisual and entertainment, professional, environmental and other sectors.

At the same time, the Agreement will further strengthen nascent democracies and economic reform, by supporting the rule of law, open and transparent governance, and the protection of private property rights and investments. The Agreement will contribute to regional integration and provide an impetus toward establishing the *Free Trade Area of the Americas*.

One of USTR's statutory advisory committees, the Intergovernmental Policy Advisory Committee on Trade (IGPAC), is comprised of representatives and associations representing executive, legislative, and judicial branches of sub-federal government, as well as states, counties, and cities. The National Governors Association (NGA), Council of State Governments (CSG), the National Conference of State Legislatures (NCSL), the National League of Cities (NLC), the National Association of Counties (NACo), and the National Association of Attorneys General (NAAG) are among the organizations represented on the IGPAC. In 2003 and 2004, USTR revitalized and significantly expanded membership and geographic representation on the IGPAC to include State Points of Contact designated by the Governors' offices as well as state legislators and attorneys general nominated by NCSL and NAAG respectively. In February 2004, USTR appointed Kay Wilkie, a public official from the State of New York, as IGPAC Chair.

Pursuant to the Trade Act of 1974, each of the statutory advisory committees including the IGPAC was required to produce a report on the Agreement. The IGPAC report assesses the impact of the Agreement from the perspective of U.S. state and local governments. In its report (available in full at [www.ustr.gov](http://www.ustr.gov)), the IGPAC recognizes that:

“This agreement with the Dominican Republic builds on the CAFTA obligations and commitments recently negotiated with the nations of Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. The CAFTA and FTA with the Dominican Republic deepen long-standing trade arrangements and regional economic integration, launched in 1984 through the Caribbean Basin Initiative. This FTA should substantially improve the business environment, and advance civil society development objectives, while increasing trade capacity and investment opportunities between the U.S. and this region of the Americas. The elimination of over 80 percent of tariffs on consumer and industrial product exports to [Central America and] the Dominican Republic at inception is most welcome, as are other market opening provisions for a wide range of technology, services and agriculture products. U.S. economic interests, entrepreneurs and employees would benefit from improved market access for goods, services, agricultural products, and from better access to government procurement opportunities. Provisions to promote workers rights, labor standards and environmental protections, and to advance regional development through trade capacity building, technical assistance and the integration of civil society, are appreciated and essential.”

The IGPAC further states that:

“[I]n principle, most IGPAC members support adding the Dominican Republic to the Central American FTA (CAFTA), support the Free Trade Agreements' broad goals of trade liberalization and reducing regional barriers to trade and investment, and take this opportunity to also suggest some clarifications to certain provisions. FTA objectives of economic growth, employment creation, sustainable development, and improvements to living standards and market opportunities should be pursued in a manner consistent with constitutional and public policy obligations to state and local constituents.”

Based on the IGPAC's report and other comments received regarding the potential impact of the Agreement on sub-federal governments, this Report addresses three main areas of interest to states and localities in the Agreement: (i) government procurement; (ii) investment; and (iii) services. Additionally, USTR has also taken into account states' and localities' overall interest in preserving sub-federal regulatory abilities and prerogatives.

## **II. Government Procurement**

During the Uruguay Round negotiations, 37 states agreed to cover some of their procurement under the World Trade Organization (WTO) Government Procurement Agreement (GPA). These commitments are limited to the procurement of the entities that each state specified in Annex 2 to the GPA and are subject to thresholds, reservations and conditions for such procurement set out in the GPA. These states volunteered to cover some of their procurement because they understood that having states agree to nondiscriminatory procurement significantly improves the United States' ability to persuade our trading partners to open their state or other sub-central procurement markets to U.S. suppliers, thus creating new opportunities for U.S.-based companies and workers.

In September 2003, USTR asked if those 37 states would be willing to extend to new free trade agreement (FTA) partners the same opportunities that they currently extend to WTO members covered by the GPA. USTR also asked the 13 states that are not covered by the GPA whether they would be willing to have their procurement covered under the GPA, as well as under the free trade agreements then under negotiation. States that are already covered by the GPA would not need to change their existing government procurement procedures or practices to implement the government procurement provisions in an FTA. Even a state that has not yet covered any procurement under an FTA would generally not need to change its procedures or practices to comply with GPA or FTA requirements for covered procurements. Twenty-two states and Puerto Rico have agreed to cover some of their procurement under the Agreement. (However, only 17 of those states and Puerto Rico are obligated to provide access to suppliers from Honduras.) A list is included as Attachment 1.

In response to state inquiries, USTR also prepared for states a Trade Fact Sheet with the following points of clarification, to ensure that the states are fully informed:

- state commitments to cover government procurement in trade agreements are voluntary;
- a state decides the extent to which it will cover its procurement under the new agreements;
- states may exclude sensitive goods, services, and local development programs;
- the agreements also exclude preference programs for small business, distressed areas, minorities, and women;
- states are explicitly permitted to maintain their own environmental policies for "green" procurement;
- county and city procurement is not covered by any of the agreements; and
- the thresholds for the application of the FTAs are high: \$477,000 for purchases of goods and services and \$6.7 million for construction contracts.

Regarding government procurement, the IGPAC report states:

“IGPAC members generally support the goal of improving transparency and increasing fair market access in government procedures and regulatory decisions that are 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. IGPAC members understand that sub-central, i.e. state, government procurement is covered by this Agreement as specified in Annex 9.1, Section C and other Annex notes to Chapter 9, and that local government procurement is neither covered in the CAFTA nor in the World Trade Organization (WTO) Government Procurement Agreement (GPA).”

The IGPAC report notes that coverage of state procurement in the Agreement only pertains to those sub-central entities that have affirmatively consented to include their procurement in the Agreement, subject to any terms and conditions that states may place on this coverage.

Under the Agreement, the Central American countries and the Dominican Republic must allow U.S. suppliers to participate in procurements of all of their central government ministries, as well as numerous sub-central entities and other government enterprises. In 2003, central government expenditures of the Central American countries and the Dominican Republic totaled \$11.46 billion, and procurement is estimated to be 10 to 15 percent of the budget, or approximately \$1.5 billion to \$1.7 billion.

### **III. Investment**

Chapter Ten of the Agreement draws on and clarifies investment protections that have been included in U.S. treaties and FTAs for decades. In accordance with the objectives set out by Congress in the Trade Act of 2002, the provisions of the Agreement on investment are designed to reduce barriers to foreign investment and secure important protections for U.S. investors in Central America and the Dominican Republic, while ensuring that foreign investors do not receive greater substantive rights than U.S. investors in the United States.

As with other FTAs, this Agreement protects states' regulatory authority. First, while state and local measures are covered, all existing inconsistent measures are excluded from the obligations in the Chapter pertaining to most-favored nation treatment, national treatment, performance requirements, and senior management and boards of directors. Future state measures should provide for treatment consistent with these provisions.

Second, the Chapter reflects U.S. legal principles and practices. For example, consistent with U.S. takings and due process protections, the Agreement clarifies that only property rights or property interests in an investment are entitled to protection against unlawful expropriation. The Chapter also incorporates standards that reflect U.S. Supreme Court jurisprudence on determining when a regulatory measure rises to the level of an expropriation.

Third, we have taken steps to improve the investor-State dispute settlement process and

ensure that arbitration panels interpret the Agreement in accordance with the intent of the Parties to the Agreement. For example, the Parties have the authority to issue interpretations of the investment provisions that are binding on arbitration tribunals. Furthermore, the Parties will be engaged throughout the arbitration. For example, Agreement countries that are not one of the disputing parties in an arbitration may make submissions to the panel regarding the interpretation of the Agreement. In addition, the Chapter goes beyond previous FTAs by committing the Parties, within fifteen months of the Agreement's entry into force, to develop an appellate or similar mechanism to review awards rendered by tribunals under the Chapter. The Administration is working to develop a draft of such a mechanism in close consultation with Congress, interested advisory committees, and other stakeholders.

Fourth, we have refined the investor-State dispute settlement process to help expedite the process and weed out frivolous claims. For example, we have developed procedures to expedite the selection of arbitrators. Furthermore, the Agreement includes an expedited procedure to dismiss frivolous claims (based on Rule 12(b)(6) of the Federal Rules of Civil Procedure) and handle jurisdictional objections. To further deter frivolous claims, the Agreement expressly authorizes awards for attorneys' fees and costs after deciding whether a claimant has raised a frivolous claim.

Finally, we have taken steps to enhance transparency and public involvement in the investor-State dispute settlement process. The Agreement provides that hearings will generally be open to the public and that key documents submitted to or issued by an arbitral tribunal will be publicly available, subject to the protection of confidential business information. It also expressly authorizes tribunals to accept and consider *amicus curiae* submissions, whereby the public could present views on issues in dispute.

The IGPAC report states that:

“Where agreements are reached with countries in Central America, with less fully developed legal systems, inclusion of a wholly separate litigation process, applicable only to foreign commerce and investment, may be viewed as necessary at the moment for creating conditions in such countries that are conducive to attracting and retaining international investment...IGPAC members do welcome those Chapter 10-Section B provisions in the CAFTA that bring about greater transparency, inclusion of non-disputing party and *amicus curiae* submissions, and consideration of whether claims or objections may be frivolous. IGPAC also notes that on-going US-sponsored efforts to strengthen the administration of justice in Central America and the Caribbean may ameliorate legitimate concerns in the future about these legal systems.”

#### **IV. Cross-Border Trade in Services**

Chapter Eleven of the Agreement covers the supply of services on a cross-border basis. This includes services supplied from the United States into CAFTA-DR countries or vice versa, including by electronic means; services supplied by a national of a Party in the territory of another Party; and services supplied in the United States to a consumer in another Party. Services supplied through investment are covered by the Investment Chapter, but also enjoy the

protection of certain provisions in the Cross-Border Trade in Services Chapter. Although state and local governments are subject to the obligations of this Chapter, they will not be required to make any changes to existing laws or regulations which may be inconsistent with core obligations in the Chapter such as local presence, market access, national treatment, and most-favored-nation treatment. In the Agreement, the United States made an exception for existing state level non-conforming measures (a “grandfather” clause). Existing local level non-conforming measures are given the same protection through the text itself.

Nothing in Chapter Eleven or any other provision of the Agreement requires the privatization or deregulation of any government services, including water supply or distribution services, education services, or health services. The Chapter expressly excludes services supplied in the exercise of governmental authority.

The implementation of this Chapter should not require an additional commitment of resources by state and local governments.

The IGPAC report comments that:

“State and local governments generally support objectives to liberalize trade in services industries as a means of increasing market access for U.S. 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.”

The IGPAC further notes that a general exemption for existing state and local measures could leave open the possibility of disputes about future changes, highlighting the need for USTR to educate and consult with state and local entities so that they are aware of such constraints on future actions.

## **V. Financial Services**

Chapter Twelve of the Agreement covers measures relating to investment in regulated financial institutions in the United States, Central America, and the Dominican Republic, and certain cross-border trade in financial services from the territory of a Party into the territory of another Party (including via electronic means), financial services supplied in a Party to a person of another Party, and financial services supplied by a national of a Party in the territory of another Party. The Chapter does not apply to measures relating to public retirement plans or social security systems. Although state and local governments are subject to the obligations of this Chapter, they will not be required to make any changes to existing laws or regulations that may be inconsistent with core obligations in the Chapter such as national treatment and most-favored-nation treatment. In the Agreement, the United States made an exception for existing state level non-conforming measures (a “grandfather” clause). Existing local level non-conforming measures are given the same protection through the text itself.

## **VI. Regulatory Interests**

The Agreement does not prevent the United States or state and local governments from enacting, modifying, or fully enforcing domestic laws protecting consumers, health, safety, or the environment.

## **VII. Conclusion**

States and localities are poised to benefit greatly under the Agreement. The United States is the main supplier of goods and services to Central America: Forty percent of total goods imported by Central America come from the United States. Over three-quarters of U.S. exporters to the region are small and medium-sized businesses, and such firms generate nearly half of the total value of U.S. exports to Central America. The Dominican Republic is the largest economy in the Caribbean, and an important export market for U.S. manufactured goods and farm products. Moreover, nearly 80 percent of products imported from Central America and the Dominican Republic already enter the United States duty-free under the CBI and GSP preference programs and existing MFN duty-free treatment. A free trade agreement would provide reciprocal access for U.S. goods in Central America and the Dominican Republic, thereby leveling the playing field for U.S. products. It also would provide increased access for U.S. firms to services sectors in Central America and the Dominican Republic, including opportunities in the financial services, distribution, energy, construction and engineering, health services, education and training, tourism and travel, audiovisual, and environmental services sectors.

Additionally, the Agreement will foster transparency, openness, and the rule of law in the Central American countries and the Dominican Republic, as well as supporting their efforts on environmental protection and labor. The Agreement will also provide an impetus toward the completion of the *Free Trade Area of the Americas*.

We do not believe that state and local governments will need additional resources to deal with the effects of increased trade under the Agreement.

## Attachment 1

State Coverage of Procurement under the Agreement:

### **Covered (22 states + Puerto Rico)**

Arkansas  
Colorado  
Connecticut  
Delaware\*  
Florida  
Hawaii\*  
Idaho\*  
Kentucky  
Louisiana  
Maryland  
Mississippi  
Nebraska  
New Hampshire  
New York  
Oregon\*  
Rhode Island\*  
South Dakota  
Texas  
Utah\*  
Vermont  
Washington  
Wyoming

Puerto Rico

(\*Indicates states not covered with respect to Honduras.)