INVESTMENT PROTECTIONS IN U.S. TRADE AND INVESTMENT AGREEMENTS

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES

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C O N T E N T S

INVESTMENT PROTECTIONS IN U.S. TRADE AND INVESTMENT AGREEMENTS

THURSDAY, MAY 14, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:03 a.m., in room 1100, Longworth House Office Building, the Honorable Sander M. Levin [Chairman of the Subcommittee] presiding.

[The advisory of the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TRADE

FOR IMMEDIATE RELEASE
May 07, 2009
TR–2

CONTACT: (202) 225–6649

Trade Subcommittee Chairman Levin Announces a Hearing on Investment Protections in U.S. Trade and Investment Agreements

Ways and Means Trade Subcommittee Chairman Sander M. Levin today announced the Trade Subcommittee will hold a hearing on investment obligations in U.S. bilateral investment treaties (BITs) and free trade agreements (FTAs). **The hearing will take place on Thursday, May 14, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from the invited witness only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

FOCUS OF THE HEARING:

The Obama Administration recently announced in the President's Trade Policy Agenda that it would "review the implementation of our FTAs and BITs to ensure that they advance the public interest." This hearing will focus on the investment protections that are included in U.S. FTAs and BITs. Those provisions have helped to safeguard investments held by U.S. citizens in dozens of foreign countries and protect U.S. investors from expropriation without compensation, as well as discriminatory and inequitable treatment by foreign governments.

At the same time, concerns have been expressed regarding these investment provisions. These concerns include: whether our FTAs and BITs give foreign investors in the United States greater rights than U.S. investors have under U.S. law; whether the FTAs and BITs give governments the "regulatory and policy space" needed to protect the environment and the public welfare; and whether an investor should have the right to submit to arbitration a claim that a host government has breached its investment obligations under an FTA or a BIT.

BACKGROUND:

The United States is the largest foreign direct investor in the world, and also is the largest recipient of foreign direct investment. New U.S. direct investment in other countries was $333 billion in 2007 and $318 billion in 2008. New foreign direct investment in the United States was $238 billion in 2007 and $325 billion in 2008.

The United States established its BIT program in 1981, largely modeled on European BITs with developing countries that had been in place since the late 1950s. Since then, the United States has established BITs with 47 countries, and has included investment chapters (similar to the provisions in BITs) in its free trade agreements. Among other things, FTA investment chapters and BITs provide for: "national treatment" of investors from the countries that are party to the FTA or BIT; limits on the expropriation of investments and provisions for the payment of compensation when expropriation takes place; a "minimum standard of treatment" for investors; and the right for an investor to submit an alleged breach of the investment provisions of the agreement to international arbitration.

Those investment obligations, particularly in the investment chapter of the North American Free Trade Agreement (NAFTA), have raised concerns in recent years, in particular following a series of controversial disputes in investor-State arbitrations at the end of the 1990s and the beginning of the current decade. (Many of those cases did not involve the United States as a party, and, to date, the United States has not lost an investor-State arbitration under NAFTA or any other FTA or BIT.) Responding to concerns that investment protections may have been written too broadly, and that foreign investors in the United States may receive more favorable treatment for their NAFTA investor-State claims than U.S. investors would under U.S. law, Congress in the Trade Act of 2002 mandated several negotiating objectives to narrow the scope of investment protection. For example, the Act stated that the principal U.S. negotiating objective on foreign investment is to reduce or eliminate barriers to investment, "while 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[.]" The parties to NAFTA also adopted a formal interpretation of the "minimum standard of treatment" provision at this time, to avoid a more expansive reading of that provision by arbitrators.

Incorporating congressional objectives, the 2004 model BIT contains several changes to past BITs, including narrowing the definition of investment covered under the agreement, clarifying the meaning of the obligation to provide investors with a "minimum standard of treatment," elaborating on the procedures for investor-State dispute settlement, and adding articles relating to the relationship between the investment obligations and labor and environmental standards.

More recently, in 2007, U.S. FTAs with Colombia, Panama, Peru, and South Korea were amended to clarify that "foreign investors are not hereby accorded greater substantive rights with respect to investment protections than domestic investors under domestic law where, as in the United States, protections of investor rights under domestic law equal or exceed those set forth in this Agreement."

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

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The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at http://waysandmeans.house.gov.

Chairman LEVIN. All right, let us start. The rumor is we may have unusually early votes, or at least one early vote, so let me make a very brief opening statement—and the Ranking Member, my colleague, Mr. Brady, will do the same—and see if we can at least begin the testimony before the vote. It is not certain, but it is likely.

So, today we are going to take up an important issue regarding the investment provisions. My feeling is this, that, by definition, trade issues are complex, they are controversial. And that is especially true if we believe that we both have to expand trade and to shape the content and the course of it. I do not think trade is automatically win-win. There are ups and downs to most trade issues. And I think that is the spirit within which we have to examine all of the key issues relating to the expansion of our international trade.

So, today we are going to focus in, I think, a very constructive way, and take a further look on the investment provisions that are in U.S. trade agreements and in our bilateral investment treaties. As we know, these provisions were originally designed to make sure that the investments by U.S. citizens overseas were safeguarded, were protected from expropriation without compensation and without due consideration, and to make sure that there wasn't discriminatory or inequitable treatment by foreign governments.

The question today is whether we have an appropriate balance. And issues have been raised—and I think often in a constructive way, perhaps sometimes not—about the provisions in our FTAs, and whether the provisions today adequately articulate what would be called a balanced approach, issues like the minimum standards of treatment.

There were some original provisions in NAFTA, as we know. And there then were some changes made a few years ago. The new Administration is taking a new look at trade policy, as they are at other key issues. And what the Administration has now done is to undertake a review of these investment provisions, both in our FTAs and in our bilateral investment treaties. And it has set up an advisory Committee within the State Department. The Advisory Committee on International Economic Policy has formed a Subcommittee to review these investment issues.

And we are fortunate today to have the cochairs of this Subcommittee, Ambassador Alan Larson and Thea Lee. So, we welcome the two of you. I assume you will probably say that you are not speaking as cochairs, but individually. But we are glad you are both, individuals and cochairs.

Also testifying today is Georgetown University professor, Robert Stumberg—welcome—Linda Menghetti, who is from ECAT, and Ted Posner.

So, we look forward to hearing from all of you. And we will hear your testimony after Mr. Brady gives his opening statement.

I think the clock is not working. With 1 minute left, we will give you some kind of a signal.

Also, if I might say, Mr. Brady, that I would like it very much if we could be as informal as possible, and each of us have Q&A, but see if we can have also some discussion among the five of you, because I think we will benefit from that.

So, welcome. And now, Mr. Brady, your opening remarks.

Mr. BRADY. Great. Thank you, Chairman Levin, for calling the hearing on investment. A hearing is exactly what we need on this topic. There is so much misinformation out there about the investment protections and our bilateral investment treaties and our trade agreements, because the investor mechanism is just so easy to demagogue. And, unfortunately, there will always be people who reflexively oppose trade. This hearing, however, is an opportunity to shine light on the facts and to set the record straight.

First of all, and perhaps most importantly, we don't need to fear foreign investment. As we know, it is not simply enough to buy American any more, we have to sell American products and goods throughout the world. Some of our companies can do that from here. Others, to compete, have to compete throughout the world.

According to our Commerce Department, U.S. companies that have these foreign operations employ twice as many U.S. workers than they do foreign workers. Furthermore, 95 percent of the goods and services produced by these companies abroad are sold not back here, but rather, in the host or the third country jurisdictions. Much has been made of Buy America recently, but U.S. investment abroad allows us to Sell America, which is what it will take for the United States to lead the world out of the global economic crisis.

The following point is perhaps already evident, but it needs to be highlighted. The United States is the party insisting on legal and procedural protection for outbound U.S. involvement. U.S. bilateral investment treaties and investment chapters in our bilateral and regional free trade agreements benefit our guys. We demand these provisions because they safeguard U.S. investments in foreign countries by shielding the investments from expropriation without compensation, as well as from discriminatory and equitable treatment by foreign governments.

Put another way, the core purpose of these legal instruments is to raise the level of investment and property rights protections in foreign jurisdictions to the level of protection that already exists here, in the United States.

The investor-state mechanism is designed to accomplish the same fundamental goal. It is meant to raise, for U.S. investors abroad, the level of protection—in this case, dispute settlement and due process rights—that exist for the equal benefit of domestic and foreign investors here, in the United States. In fact, investor-state mechanism is often credited with helping to instill the rule of law in developing countries.

In a sense, the investor-state mechanism allows the United States to export our Constitutional procedural due process standard to our trading partners. I have no problem with that. But I am sure we will hear today the investor-state mechanism exposes the United States to an endless stream of costly, frivolous, and invasive arbitration brought by foreigners.

Well, I have looked into the allegations, and here is what my research shows. The investor-state mechanism has existed in U.S. bilateral investment treaties since the very first ones we entered in, in the early 1980s. It has been around for a quarter century, and it has never been used against the United States. We have never been forced to defend a single law, regulation, or administrative action in a bilateral investment treaty investor-state dispute. In the handful of cases that foreign investors have brought under NAFTA, we have not, to date, lost or settled, on unfavorable terms, one single case.

You don't need to take my word for it. Consider this excerpt from the summer 2008 issue of the Harvard Journal on Legislation, "The United States has never lost a single dollar in investor-state dispute under NAFTA or under any other trade agreement or bilateral investment treaty." The author, our Chairman of the Ways and Means Committee, Charles Rangel.

The last point I will make is that the provision the U.S.—investment chapters of our free trade agreements have evolved over the years. I am eager to hear the testimony on this point, because the evolution of the provision, it seems to me, has been in direct response to the criticism raised.

Changes and clarifications that were made to our investment language include provisions to require the panels consider the same U.S. Supreme Court factors that U.S. courts consider when determining whether there has been an expropriation of property; provisions to allow panels to dismiss frivolous claims at an early stage of the proceeding; and provisions that clarify that environmental and other public welfare regulations are presumed not to constitute indirect expropriations.

Furthermore, the landmark May 10th deal added language in our pending free trade agreements with Colombia, Panama, and South Korea, that foreign investors are not accorded greater substantive rights with respect to investment protections than domestic investors under domestic laws, here in the U.S.

These changes, taken together, strike me as a compromise that aims for the right balance between the interest of U.S. regulators, on the one hand, and U.S. investment abroad on the other.

I welcome all the witnesses this morning, and look forward to your testimony. Mr. Chairman, I yield back.

Chairman LEVIN. Thank you. Right in 5 minutes. So, why don't we go down the line? I am not sure of the protocol, so we will use how you are seated. So, Thea Lee, if you would begin, and we look forward to your testimony.

All of your testimonies will be in the record. So deal with your five minutes or so as you would like. And, again, welcome to all of you. Thank you for coming. This is really an important hearing on an important issue that needs to be discussed.

Ms. Lee.

STATEMENT OF THEA MEI LEE, POLICY DIRECTOR AND CHIEF INTERNATIONAL ECONOMIST, AFL–CIO

Ms. LEE. Thank you so much, Mr. Chairman. Thank you, Mr. Brady. Members of the Subcommittee, good morning. I appreciate the opportunity to come speak to you today on behalf of AFL–CIO's 11 million working men and women on this important issue.

As you all know, trade and investment issues are enormously important to America's working families. They impact our jobs, our wages, our unions, and the government regulations that we count on to keep our communities healthy, and to safeguard our rights. Of course, these rules also affect workers and the environment in other countries. Our ultimate goal is to reform these rules in a way that strengthens democratic procedures, improves transparency, and protects workers and the environment, both here and abroad.

Of course, we understand that we are in a global economy, and we will continue to be in a global economy. The question really is whether the investment rules that we put in place can be made fairer and more balanced, so that they serve the interests of my members, among others.

We have had a longstanding concern over the investment provisions included in U.S. bilateral investment treaties and in trade agreements. We understand and support the importance of protecting the rights of investors, but we also believe that the existing investment provisions in U.S. investment and trade agreements are imbalanced in two crucial aspects.

It's worth remembering that the origin of these rules was, as Mr. Brady said, to protect outward foreign direct investment—generally in small, developing countries—in the bilateral investment treaties. It is not clear that they were designed to be a two-way street, where they could be used with major industrialized countries, like Canada, with big corporations that had presence in both countries being able to use them in the United States, as well as for U.S. investors, as they have an outward interest, as well.

That is one of the key issues: whether these provisions continue to be appropriate, given how they have evolved and how their use has spread now into bilateral free trade agreements, as well as possibly investment treaties with large countries like China, where there may be particular concerns.

The first problem that we see is that these agreements significantly enhance the rights of investors vis a vis governments, but they fail to establish commensurate responsibilities for investors, particularly with respect to worker rights and the environment.

The second problem is that they give substantive rights and procedural advantages to foreign investors that are not available to domestic investors. This raises the possibility that investment tribunals can be used to circumvent the democratic process, and to achieve de-regulatory outcomes in a secretive and inaccessible forum.

Certainly the experience that we have had with the investment chapter of the North American Free Trade Agreement and current bilateral investment treaties reinforces these concerns, both in the inward and the outward direction. We have two kinds of concerns with the investment provisions—the democracy and good governance concerns as well as job concerns. I just wanted to take a minute to talk about why, from the labor movement's point of view, these issues are important to us.

The investment protections are designed to enhance the security of foreign direct investment, and address investors' concerns with respect to unstable or corrupt governments where production may be located. In this sense, these provisions are a critical element in the trade agreements that we have negotiated over the last decade-and-a-half.

The tariff reductions that we negotiate are paired with enhanced security of investment and upward harmonization of domestic laws to prevent overly intrusive regulation of foreign investment. But this combination both facilitates and accelerates the offshoring of American jobs, precisely because, for the most part, there has been no commensurate set of investment obligations.

My fellow witness, Alan Larson, and I have been asked to cochair a subcommittee of the State Department's Advisory Committee on International Economic Policy, as Chairman Levin said, so that we can review the draft model and present our conclusions to the Advisory Committee on International Economic Policy. We are looking forward to a constructive dialog with a diverse and representative group, and we hope that the Subcommittee will be able to take a fresh look at this issue and work toward consensus on how to move this discussion forward.

Our key areas of concern include the investor-state dispute resolution mechanism, the failure to distinguish between legitimate regulatory action on the part of government and indirect expropriation, the overly broad definition of investment, the potential impact of these investment provisions on needed future national and global financial regulation efforts, and the need to establish commensurate and enforceable responsibilities for investors with respect to workers' rights and the environment.

Let me thank and congratulate the Subcommittee for holding this hearing today. It is both timely and relevant. We hope this will be only the first step in a more comprehensive review of U.S. trade and investment policy aimed at supporting the creation of good jobs at home and abroad, and laying a foundation for sustainable democratic and equitable development.

Thank you very much, and I look forward to your questions.

[The statement of Ms. Lee follows:]

Testimony of Thea Mei Lee
Policy Director
American Federation of Labor and
Congress of Industrial Organizations
(AFL-CIO)

Before the
Subcommittee on Trade of the
House of Representatives Committee on Ways and Means

"Investment Protections in U.S. Trade and Investment Agreements"

May 14, 2009

Mr. Chairman, Members of the Subcommittee, thank you for the opportunity to speak to you today about this critical issue on behalf of the 11 million working men and women of the AFL-CIO.

As you know, trade and investment issues are enormously important to America's working families – impacting our jobs, our wages, our unions, and the government regulations we count on to keep our communities healthy and to safeguard our rights. Of course, these rules also affect workers and the environment in other countries, so our ultimate goal is to reform these rules in a way that strengthens democratic procedures, improves transparency, and protects workers and the environment both here and abroad.

We have long expressed concern over the investment provisions included in U.S. Bilateral Investment Treaties (BITs) and Trade Agreements. While we understand and support the importance of protecting the rights of investors, we believe that existing investment provisions in U.S. investment and trade agreements are imbalanced in two crucial aspects.

First, they significantly enhance the rights of investors vis-à-vis governments, but they fail to establish commensurate responsibilities for investors, particularly with respect to workers' rights and the environment.

Second, they give substantive rights and procedural advantages to foreign investors that are not available to domestic investors. This raises the possibility that investment tribunals can be used to circumvent the democratic process and to achieve deregulatory outcomes in a secretive and inaccessible forum. Certainly the experience with the investment chapter of the North American Free Trade Agreement (NAFTA) and current BITs reinforces these concerns.

We have democracy and good governance concerns about the investment provisions, as well as job concerns. Investment protections in international agreements are designed to enhance the security of foreign direct investment and address investors' concerns with respect to unstable or corrupt governments where production may be located. In this sense, these provisions are a critical element in the trade agreements negotiated by our government over the last two decades. Negotiated and reciprocal tariff reductions are paired with enhanced security of investment and upward harmonization of domestic laws to prevent overly "intrusive" regulation of foreign investment. This combination facilitates and accelerates the offshoring of American jobs – precisely because for the most part there has been no commensurate set of investor obligations.

As we stated in a 2004 letter sent to the State Department with regard to the draft model BIT: "We believe that expansion of investment can and must be made compatible with the protection of the public interest in the United States and overseas." The full text of the letter, sent jointly by the AFL-CIO, the Center for International Environmental Law, Earthjustice, Friends of the Earth-U.S., the National Wildlife Federation, Oxfam America, and Sierra Club is available at:
http://ciel.org/Publications/BIT_Comments_Jan1604.pdf

While there have been several notable attempts in recent years to address these concerns – first to revise the model BIT (in 2004) and, second, to alter the investment chapter in trade agreements (in 2007, when Democratic leaders in Congress pressed for the inclusion of new investment language in pending trade agreements), these revisions have not yet gone far enough to address the fundamental problems outlined here.

My fellow witness, Alan Larson, and I have been asked to co-chair a subcommittee of the State Department's Advisory Committee on International Economic Policy (ACIEP) to review the draft model BIT and present our conclusions to the ACIEP. We are looking forward to a constructive dialogue with a diverse and representative group and hope that the subcommittee will be able to take a fresh look at this issue and work toward consensus on how to move this discussion forward.

The key areas of concern for the AFL-CIO with regard to current investment provisions include: investor-state dispute resolution; failure to distinguish between legitimate regulatory action on the part of government and "indirect expropriation"; an overly broad definition of investment; potential impact on needed future national and global financial regulation efforts; and the need to establish commensurate and enforceable responsibilities for investors with respect to workers' rights and the environment.

Investor-State Dispute Resolution

The investor-state dispute settlement mechanism gives investors the right to bypass domestic complaint procedures and mount legal challenges that would not be permitted under domestic law. In the context of trade agreements, no other non-government actors are given similar rights to seek redress without the support of their own government.

President Obama has stated that he is opposed to "granting foreign investors any rights in the U.S. greater than those of Americans." [1] Yet by construction, international investor-state dispute resolution grants greater rights to foreign corporations than those enjoyed by Americans. This is evident, for example, in NAFTA investment cases, where corporations have taken advantage of foreign subsidiaries or citizenship to file cases in their own country – circumventing domestic democratic processes.

Indirect Expropriation

It is absolutely essential that international investment provisions distinguish in a clear and explicit way between legitimate government regulation and expropriation – or seizure – of an investor's property. In our view, governments should not be expected to compensate corporations – domestic or foreign – for the imposition of legitimate government regulation in the public interest – to protect public health, the environment, or workers' rights, among other things.

Capital Controls

We are concerned that current provisions on financial transfers would limit governments' ability to use legitimate measures designed to restrict the flow of capital in order to protect themselves from financial instability. Without adequate measures to prevent and respond to such financial instability, broad sustainable development will remain out of reach for many developing countries. The increased frequency and severity of financial crises also hurts U.S. economic interests, as crisis-stricken countries devalue their currencies and flood the U.S. market with under-priced exports in order to recover.

The United States should ensure – for the sake of developing economies, international financial stability, and its own economic interests – that countries have the policy flexibility needed to impose capital controls in appropriate circumstances. Also, as the international community begins an important discussion on global financial regulation, it is crucial that these international investment agreements not provide an obstacle to needed regulatory reform.

Environment and Labor

The 2004 model BIT includes articles on environmental and labor commitments that reflect the important recognition that investments may compromise environmental quality and workers' rights and that a country may weaken environmental protection and labor standards in order to attract investments. These provisions need to be significantly strengthened, however.

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[1] Barack Obama for President, *A Blueprint for Change*, Strengthening the economy: Trade, 13, available at http://www.barackobama.com/issues/ (viewed August 24, 2008).

First, the content of the obligations is extremely limited, as evidenced by the use of "each Party shall strive to ensure," instead of a mandatory "shall ensure." Second, each provision has a footnote that limits its scope solely to federal laws and regulations, leaving aside all other sub-national laws. This limitation is particularly noteworthy given that the scope of the draft model BIT otherwise covers measures adopted or maintained by a Party, which includes all governmental organs and other entities exercising public functions. Third, the procedural mechanisms to ensure compliance with these provisions are also exceptionally weak, as further proceedings beyond consultations are excluded.

Finally, the second paragraph of Article 12 attempts to safeguard a Party's ability to adopt, maintain, or enforce measures necessary for the protection of the environment. Given the broad range of government measures an investor could challenge under the draft model BIT, it is essential that this safeguard be binding and effective, and that it apply to environmental protection measures as well as other governmental measures vital to the public interest, such as laws protecting consumers, health and safety, and workers' rights and human rights. Yet there is no provision analogous to Article 12(2) under the labor article or any other place in the model BIT. Unfortunately, even the limited safeguard for environmental protections in Article 12(2) is rendered meaningless by the qualification that only those environmental measures "otherwise consistent with this Treaty" may be protected from challenge. Thus, the use of Article 12(2) as a defense or exception to the other substantive obligations of the BIT appears to have been severely constrained or even eliminated. Article 12(2) cannot operate as a defense or exception to the other substantive obligations of the BIT, which in effect means that a Party may be ordered to pay damages to an investor even for adopting a measure necessary to protect the environment.

Conclusion

I would like to thank and congratulate the Subcommittee for holding this hearing today. It is both timely and relevant to review the elements of investment obligations in U.S. trade and investment agreements. We hope this will be only the first step in a more comprehensive review of U.S. trade and investment policy aimed at supporting the creation of good jobs at home and abroad and laying a foundation for sustainable, democratic, and equitable development. I look forward to you r questions.

Chairman LEVIN. Gee, you did this in exactly 5 minutes. Ambassador.

STATEMENT OF ALAN P. LARSON, SENIOR INTERNATIONAL POLICY ADVISOR, COVINGTON & BURLING LLP

Mr. LARSON. I will try to do as well. Chairman Levin, Ranking Member Brady, and Members of the Subcommittee on trade, my name is Alan Larson. I am an economist, a senior international policy advisor at Covington & Burling, and a former under secretary of state for economics under the Administrations of George W. Bush and William Clinton.

International investment plays an essential role in sustaining the economic health of the United States. Inbound investment puts foreign capital to work in our countries, supporting output and jobs. It also bridges the gap between our low national savings rate and our large investment needs.

During the recent global, financial, and economic crisis, international investors have made investments in troubled U.S. companies, including in financial services firms and automobile companies, that have been very, very valuable to our economic strength.

Outbound investment also is valuable. It opens access to and increases supplies of critical raw materials. It also provides channels through which a substantial share of U.S. exports flow.

International agreements help provide a stable and predictable legal and regulatory environment for international investment. Bilateral investment treaties, for example, provide assurance of nondiscriminatory treatment, specifically most favored nation treatment and national treatment, subject to clearly specified exceptions. They also provide a minimum standard of treatment grounded in customary international law. This standard is expressed in the concept of fair and equitable treatment.

Investment treaties limit the circumstances under which a host government can expropriate an investor's property. And, if an expropriation does occur, they require prompt, adequate, and effective compensation. The expropriation clause of bilateral investment treaties is modeled closely on the takings clause of the United States Constitution.

The BITs also provide investor-state dispute settlement through international arbitration. The model BIT that is used as the template for launching negotiations with a new partner has periodically been reviewed and revised, with the last review taking place in 2004.

I am honored to be serving, along with Thea Lee, as cochair of a private sector advisory panel that will contribute input to the Administration's review of the model bilateral investment treaty. As you said, Mr. Chairman, our report will go to the Advisory Committee on International Economic Policy, which itself is a private sector advisory Committee established under FACA.

Thea and I intend to assemble a panel of private sector experts with a variety of points of view that can inform our deliberations and inform the report that we will provide for ACIP. This report, I understand, will be part of a broader outreach process on the part of the government that could include such things as public hearings and a notice and comment process.

For the purposes of our panel, I expect we will want to look at the experience of the United States with international investment agreements, we will want to consider the role that these agreements play in the new economic circumstances our country now finds itself in, and will want to consider whether we have recommendations on how these agreements—agreements I consider to be very, very good agreements—could be made even better. Thank you, Mr. Chairman.

[The statement of Mr. Larson follows:]

Statement of Alan P. Larson
Senior International Policy Advisor, Covington & Burling
Before the House Ways and Means Committee
Subcommittee on Trade

May 14, 2009

Chairman Levin, Ranking Member Brady, and members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the issue of international investment.

My name is Alan Larson and I am the Senior International Policy Advisor at the law firm of Covington and Burling LLP. I also am a retired Career Ambassador in the United States Foreign Service and served as Under Secretary of State for Economics in the administrations of George W. Bush and William Clinton.

My testimony will offer perspectives on international investment and international investment policy gained from experiences in both the public and private sectors. As a government official, I have witnessed the policy value of investment agreements to the economic health and foreign relations of the United States. In my private sector work at Covington, I have experienced the great importance of predictability and the rule of law, both for U.S.-based companies making investments abroad and for clients seeking to make investments in the United States.

I understand that the Obama Administration has decided to conduct a review of the model Bilateral Investment Treaty (BIT), the template that the United States uses as a starting point when contemplating negotiation of a new bilateral investment treaty. The last such review of the model BIT was concluded in 2004, not long before I left government service. I understand that the Obama Administration has decided to seek input from the private sector regarding its review, including by inviting a report from a private sector advisory subcommittee of the State Department's Advisory Committee on International Economic Policy (ACIEP). I am honored that the Obama Administration has asked me to serve as co-chair of this advisory subcommittee, along with Thea M. Lee, Policy Director of Government Affairs for the AFL-CIO. I further understand that the Administration also intends to provide interested parties with opportunities to comment on the review of the model BIT through a public hearing and a traditional notice and comment process.

My statement today sketches the valuable role that international investment, both inbound and outbound investment, plays in promoting the economic health of the United States. It then outlines how international investment agreements contribute to these benefits by providing international investment with a more stable and predictable environment. The statement summarizes briefly recent experience under the investor-state dispute settlement mechanisms of investment treaties. Finally, the statement touches upon a few policy issues about the model BIT that have been raised in the past and that may be examined again, both by the private sector panel and during the course of the Administration's own review.

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Inbound and outbound international investment plays a valuable role in sustaining the economic health of the United States. International investment in the United States contributes to our economy by putting foreign capital to work in our domestic economy. International investment is especially important now, because it bridges the difference between our relatively low national savings rate and the high levels of private and public sector investment that we need to attract in order to maintain a dynamic, growing and innovative economy. Inflows of international investment often bring with them technology and managerial techniques that contribute to our domestic productivity. In turn, these contributions support American employment and output levels. Inbound international investment creates domestic competition and spurs creativity and innovation. During the present financial and economic crisis, international investment has made very important contributions to troubled sectors through, for example, business investments in financial services firms and in automobile companies.

Outbound investment makes an equally important contribution to our economic health. Outbound investment helps open access to and increase the supplies of natural resources such as oil that are crucially necessary to support production and jobs. By facilitating the establishment of sales and service facilities abroad, outbound international investment also improves access to foreign markets and supports U.S. exports. In fact, a significant share of total U.S. exports flow through the affiliates that U.S. companies have established through their investments in other countries. Finally, in a competitive global economy, the success of our most important export-oriented companies, and the viability of the U.S. jobs that depend on those exports, often is linked to the opportunity of these firms to operate successful international investments, through which they may gain access to competitively priced, less skill-intensive inputs to their final products.

International investment agreements can be essential to providing investors with a stable and predictable environment for conducting business abroad. Any investment involves a certain number of risks; the political, legal and regulatory risks of an investment are magnified when it crosses national borders. International investment agreements can help mitigate the increased risk that accompanies investing abroad. By using the phrase "international investment agreements," I include the varied and various forms that these agreements have taken on since their earliest days. These include, but certainly are not limited to, treaties of friendship, commerce and navigation, bilateral investment treaties, regional investment treaties and the investment chapters of free trade agreements. Notwithstanding their differences, most of these international investment agreements have converged on several core provisions. In no particular order, I would like to highlight a few of these provisions and discuss specifically how they are handled in the current model BIT.

A provision providing "most favored nation treatment" assures that a host country will afford an investor from one country no less favorable treatment than that which is afforded to an investor from another country, subject to specified exceptions. The most favored nation principle clarifies the domestic regime and provides helpful transparency for investors. This provision is found in Articles 4(1) and 4(2) of the U.S. model BIT. In the model BIT, the provision limits the application of most favored nation treatment to treatment that is afforded "with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." I expect the advisory panel may wish to examine this provision.

A related provision involves "national treatment." National treatment guarantees that a host country will afford an international investor no less favorable treatment than that which it affords to its own domestic investors, again subject to specified exceptions. This provision assures nondiscrimination and precludes investment protectionism, two goals that are vital to an efficient free trade regime. As part of the G-20 process, the Obama Administration committed itself, correctly in my view, not to engage in investment protectionism. This provision is found in Article 3 of the model BIT.

Experience over many centuries has shown, however, that national treatment is not sufficient protection for international investors. Sometimes an international investor finds itself in a situation where the host State is subjecting it to harmful arbitrary and capricious measures and the investor cannot prove that domestic investors may not be subject to similar harmful treatment. For this reason there is a long tradition for international investment treaties to include a provision guaranteeing a "minimum standard" of treatment. This guarantees that, at the very minimum, a foreign investor will be treated in a "fair and equitable" fashion. International law jurisprudence has provided an important roadmap for interpreting what constitutes fair and equitable treatment. This guidance has centered around age-old notions of justice and due process. Article 5 of the model BIT contains this provision and Annex A is designed to ensure that the provision is interpreted in accordance with customary international law. The "fair and equitable treatment" provision of the current model BIT has provided important protection for U.S. investors on many occasions, but it does not, in my judgment, impose significant additional obligations on U.S. officials beyond those that the U.S. legal system is intended to provide all investors, international or domestic.

Another customary investment treaty provision provides clear limitations on the circumstances under which government may expropriate private property. As a corollary, this provision ensures that, when expropriation can be justified, the expropriating government must make prompt, adequate and effective compensation. This idea is hardly a new concept to our U.S. legal regime. We know it as the takings clause of the U.S. constitution. A legal regime that respects private property and grants restitution when those rights are disturbed is highly developed in the United States. Such protections do not exist, however, in every country where U.S. investors might seek to do business. The expropriation provisions in our international investment agreements – such as Article 6 of the current U.S. model BIT – strive to bind other countries to principles very similar to those in U.S. jurisprudence on the takings clause and, in so doing, to ensure a transparent and stable investment environment.

In the drafting of its international investment agreements, the U.S. government has sought, in my experience, to ensure that their expropriation provisions closely mirror the principles of U.S. takings law. A prime example is Annex B of the current U.S. model BIT. This Annex provides Tribunals with adjudicative guidance by stipulating several of the factors that should be considered when determining whether an expropriation has occurred. It is no coincidence that these are the same as several of the factors used by the U.S. Supreme Court to determine whether a taking has occurred. I expect that the private sector panel may want to have another look at this issue.

Past reviews of the model BIT have addressed the interest of the U.S. government in ensuring that the ability of our government representatives retain the flexibility to take measures appropriate to protect health, safety and the environment. The earlier model BIT was amended in 2004 to address this issue in several ways in Annex B. As an initial matter, the model BIT now recognizes that an expropriation determination is highly contextual. Thus, it instructs the adjudicator to engage in a "case-by-case, fact-based inquiry." Second, it makes clear that a *per se* approach is inapplicable to an indirect expropriation analysis. So, "an adverse effect on the economic value of an investment," in and of itself, is insufficient to establish a finding of indirect expropriation. Third, amongst the factors that are to be considered by the adjudicator is the character of the government action. Finally, the annex contains the caveat that only in rare situations will public welfare regulations which are applied in a non-discriminatory manner constitute an expropriation. In this clause, it specifically mentions "public welfare objectives, such as public health, safety, and the environment."

Finally, investment treaties usually provide for investor-state dispute settlement through international arbitration. The ability to resort to international arbitration bolsters investors' faith that the rule of law will apply to all situations and not only when their interests align with those of the home State or host State. Indeed, investor-state dispute settlement procedures provide investors with a neutral and depoliticized forum in which they can assert their rights and defend their interests. Investor-state dispute settlement offers a very important protection for U.S. investors in some foreign countries. Over the years some commentators, such as the Argentine diplomat Carlos Calvo, have argued that only the national laws of host governments could appropriately be relied upon to decide disputes involving international investors. The "Calvo doctrine," which was prevalent for many years in Latin America, has largely but not totally receded as a politcal force.

According to the United Nations Conference on Trade and Development, "international investment arbitration is a part of the 'normal' investment landscape."[1] The majority of these cases are brought by investors from developed countries. Bilateral investment treaties are the most common international investment agreement relied upon by investors who are filing claims. The substantive issues raised and addressed in investor state dispute settlement include the definition of investor, the definition of investment, and the scope of the various principles discussed above. On balance, it is fair to say that the outcome of such cases does not suggest a bias in favor of either the State nor the investor.

I already have mentioned some of the issues that have been raised in past BIT reviews and that I expect that our panel may review again. Let me also highlight a few new issues the panel may wish to assess.

It is possible that the panel will want to review new issues that have arisen as a result of economic changes during the past five years. For example, the recent global economic and financial crisis has underscored both the possible need for new financial regulations as well as the importance of the financial services sector having the ability to attract foreign investment. We may want to review whether we believe the provisions of our international investment agreements bear an appropriate relationship to this new situation. Another issue is the current importance of gaining access to foreign supplies of natural resources; the panel may want to review whether the model BIT is appropriately tailored to support this need. In addition, global climate change will certainly result in new domestic and international regulatory regimes and it may also inaugurate new flows of foreign investment related to clean energy technologies, emissions trading systems and "offsets" under "cap and trade" programs. The panel may wish to examine whether our international investment agreements need to evolve to fit these new and ever-changing challenges.

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[1] UN Conference on Trade and Development, "Latest developments in investor-state dispute settlement," IIA Monitor No. 1(2009) at p. 1.

I have mentioned the foregoing issues for illustrative purposes, knowing that this Subcommittee is keenly interested in the substance of our work. My testimony is not intended to provide a complete list. Indeed, the panel has not yet been formed and has not begun its work.

My colleague Thea Lee and I know that we have been given an extraordinarily challenging assignment in serving as co-chairs of a private sector panel review of the United States Model Bilateral Investment Treaty. We are seeking to draw individuals from various backgrounds in order to tap into their expert knowledge.

In conclusion, I believe we should undertake this review with a full understanding of the importance of both inbound and outbound international investment to the economic health of the nation. We should acknowledge that, in recognition of the importance of international investment, the United States has created an investment regime girded by international investment agreements such as bilateral investment treaties. These investment agreements have been used to good effect by successive administrations of both parties.

As we review the basic template of these agreements, our goal will be to understand why they have been structured as they have been. We will seek to determine how they have worked in practice, with respect both to U.S. investment abroad and to international investment in the United States. And we will deliberate collegially to determine whether, based on this experience and on current circumstances, we have any recommendations for ways in which a good model bilateral investment treaty might be made even better.

Again, I thank you for the opportunity to testify before you today. I look forward to answering your questions.

Chairman LEVIN. Thank you very much.

Mr. Posner, welcome. You have been in this room before. Welcome.

STATEMENT OF THEODORE R. POSNER, PARTNER, INTERNATIONAL TRADE GROUP, CROWELL & MORING

Mr. POSNER. Indeed, I have. And it is very good to be back. And I thank you, Mr. Chairman, and Ranking Member Brady and Members of the Subcommittee, for the opportunity to testify today. My name is Ted Posner, and I am a partner in the international trade and international arbitration groups at the law firm of Crowell & Moring.

Prior to my return to private practice at the beginning of this year, I had the good fortune to work on the law and policy of international investment, both in the congress and in the executive branch, including as your trade counsel, Chairman Levin, then as trade counsel to the Senate Finance Committee, where I was deeply engaged in drafting the investment-related provisions of the Bipartisan Trade Promotion Authority Act of 2002, and then, as an attorney in the Office of the U.S. Trade Representative, where I participated in most of the negotiations under the 2002 framework, as well as in the 2004 revision of the model Bilateral Investment Treaty, to which Ambassador Larson alluded a moment ago.

Today I want to make three points. First, investment protections in bilateral investment treaties and free trade agreements, together with the availability of a neutral forum in which to assert those protections, provide an essential set of rights to U.S. persons doing business in a globalized economy. They facilitate precisely the kind of economic activity we should be encouraging in our efforts to reverse the economic downturn.

Second, a sustainable international investment policy requires a balancing of interests. As Chairman Levin said in his opening remarks, the question of the day is, “Have we achieved that appropriate balance?” I contend that that balance was achieved in the Trade Act of 2002, and that no development since then warrants a disrupting of that balance.

And, finally, I want to note that discussions of this topic frequently have been muddied by misunderstandings of what BITs and FTAs require of host governments, and what they don’t require. And I would like to clarify a few of those misunderstandings.

To appreciate the value of investment treaties and agreements, it is useful to consider the situation that a U.S. investor faces in a foreign country in the absence of such instruments. As a practical matter, in the absence of treaty protections or domestic legislation providing for international remedies, that investor can rely only on the rights afforded by the domestic law of the host country. Often those rights will not be easily accessible to an outsider.

And to defend its rights, the investor’s only recourse usually will be the local court system, which will require the investor to be familiar not only with local substantive law, but also with all of the technical aspects of local procedural law and customs.

If that fails, the investor may seek the assistance of the U.S. Government, in which case its interests will be competing with diplomatic, national security, and other interests. And, if the investor is doing business in multiple countries, its familiarity with its legal rights in one will give it no comfort in others.

A treaty or agreement changes all of that. It puts the relationship between the United States investor and the host country on an international law footing. Now, the investor is protected not only by the domestic laws of the host, but also by a set of rights that is common across multiple countries. And that investor is able to assert those rights before a neutral tribunal under rules that will vary only slightly from agreement to agreement.

By facilitating investment in this way, investment protections serve as an engine of economic growth. Critics of this view say that it gives undue weight to the interest of companies doing business abroad, while giving insufficient weight to the interest of investors and consumers in the U.S. market.

The treaty obligations the United States negotiates are reciprocal. Critics argue that more attention should be paid to how those obligations constrain the United States, as host to foreign investment. In fact, there was a very vigorous debate on this very issue during the drafting of the Trade Act of 2002, when I was serving as counsel to the Senate Finance Committee. The outcome of that debate was a balancing of the interests of the United States as both exporter and importer of investment.

The 2002 Act calls on negotiators to pursue investment protections, similar to those contained in earlier treaties and agreements, but the Act also takes account of U.S. defensive interest in several notable respects, including the well-known "no greater substantive rights" objective, standards with respect to expropriation that Ambassador Larson alluded to earlier, a transparent dispute settlement process—and a dispute settlement process, I would add, that is to include mechanisms to deter the filing of frivolous claims.

The message of the 2002 Trade Act was heard loudly and clearly. The agreements we have negotiated since then have adhered closely to those objectives. And with respect to the question of the day, "Should that balance achieved in 2002 be adjusted or disrupted in some way?" I would respectfully submit that the answer is no. As I have said, no developments in the intervening 7 years suggest any reason to dispense with the balance reflected there.

I would also say, as a former negotiator, that changing those objectives, and trying to impose new obligations on our foreign counterparts will be a substantial challenge, perhaps an insurmountable one, leaving U.S. investors without the protections that their foreign competitors receive under other countries' BITs and FTAs.

I will leave it at that, Mr. Chairman. I see my time is up. I would refer to my written testimony with respect to some of the misunderstandings about obligations under BITs and FTAs I referred to earlier. Thank you.

[The statement of Mr. Posner follows:]

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Testimony of Theodore R. Posner, Esq.
Partner, Crowell & Moring LLP

Before the Subcommittee on Trade
of the Committee on Ways & Means
of the U.S. House of Representatives
Hearing on
Investment Protections in U.S. Trade and Investment Agreements

May 14, 2009

Mr. Chairman, Ranking Member Brady, thank you for the opportunity to testify today on a topic that has occupied a lot of my professional attention over the past decade. My name is Ted Posner, and I am a partner in the international trade and international arbitration groups at the law firm of Crowell & Moring.

Prior to my return to private practice at the beginning of this year, I had the good fortune to work on the law and policy of international investment both in the Congress and in the Executive Branch. It was as your trade counsel, Chairman Levin, that I started to examine these issues. Then, as trade counsel to the Senate Finance Committee, I was deeply engaged in drafting the investment-related provisions of the Bipartisan Trade Promotion Authority Act of 2002. Those provisions established the framework for all of the investment negotiations that have occurred since then. And, as an attorney in the Office of the U.S. Trade Representative from 2002 to 2008, I participated in most of those negotiations, as well as in the 2004 revision of the U.S. Model Bilateral Investment Treaty.

In carrying out these responsibilities, I became very familiar with the interests and concerns of U.S. and foreign companies, U.S. regulators at all levels of government, foreign governments, and non-governmental organizations. I have had frequent occasion to reflect on those diverse views. Today, I want to highlight three points I believe to be essential to a review of U.S. international investment policy:

- First, investment protections in bilateral investment treaties (BITs) and free trade agreements (FTAs), together with the availability of a neutral forum in which to assert those protections, provide an essential set of rights to U.S. persons doing business in a globalized economy. They facilitate precisely the kind of economic activity we should be encouraging in our efforts to reverse the economic downturn.

- Second, a sustainable international investment policy requires a balancing of interests. It must reflect the interests of the United States not only as a participant in the global economy, but also as a protector of the public welfare at home. That balance was achieved, after substantial deliberation and debate, in the articulation of investment-related negotiating objectives in the Trade Act of 2002. No developments since then warrant disrupting that balance.

- Finally, discussions of this topic frequently have been muddied by misunderstandings of what BITs and FTAs require of host governments. Critics of investment protections have asserted, for example, that they constrain the right to regulate in the public interest or otherwise jeopardize U.S. sovereignty. Such assertions are incorrect and get in the way of a productive discussion.

I will speak briefly to each of these points.

Investment Protections Facilitate Economic Growth

To appreciate the value of investment treaties and agreements, it is useful to consider the situation a U.S. investor faces in a foreign country in the absence of such instruments. As a practical matter, in the absence of treaty protections or domestic legislation providing for international remedies, that investor can rely only on the rights afforded by the domestic law of the host country. Often, those rights will not be easily accessible to an outsider. To defend its rights, the investor's only recourse usually will be the local court system, which will require the investor to be familiar not only with local substantive law, but also with all the technical aspects of local procedural law and customs. If that fails, the investor may seek the assistance of the U.S. government, in which case its interests will be competing with diplomatic, national security, and other interests. And, if the investor is doing business in multiple countries, its familiarity with its legal rights in one will give it no comfort in the others.

A treaty or agreement puts the relationship between the U.S. investor and a host country on an international law footing. Now, the investor is protected not only by the domestic laws of the host, but also by a set of rights that is common across multiple countries. And, the investor is able to assert those rights before a neutral tribunal under rules that will vary only slightly from agreement to agreement.

Thus, a U.S. company that has invested in Chile and understands its rights under the U.S.-Chile FTA will be able to invest in Peru or in Costa Rica, for example, confident of its entitlement to similar protections, regardless of differences in national law. Of course, the business and regulatory environment will vary from country to country, and these are significant factors in any investment decision. But, at a minimum, the investor knows it is entitled to certain basic protections that will remain relatively constant across jurisdictions that are parties to U.S. BITs or FTAs.

By facilitating investment in this way, investment protections serve as an engine of economic growth. While the existence of an investment treaty may not be decisive for a company contemplating an investment, there is empirical evidence to suggest that it does help.[1]

And, such encouragement to invest is absolutely vital in the current economic environment. The UN Conference on Trade and Development (UNCTAD) reported last week that foreign direct investment declined by 15% in 2008 and is likely to decline even more in 2009.[2] To reverse this trend, it will be essential to eliminate barriers to investment and provide investors a degree of legal security. BITs and FTAs are excellent tools for doing just that.

<u>The Trade Act of 2002 Reflects a Carefully Crafted Balance of Interests</u>

Critics of this view say that it gives undue weight to the interests of companies doing business abroad, while giving insufficient weight to the interests of investors and consumers in the U.S. market. The treaty obligations the United States negotiates are reciprocal. Critics argue that more attention should be paid to how those obligations constrain the United States as host to foreign investment.

In fact, there was a vigorous debate on this very issue during drafting of the Trade Act of 2002. Proponents of strong investment protections advocated for negotiating objectives similar to those contained in the previous grant of trade negotiating authority, in the Omnibus Trade and Competitiveness Act of 1988. Others pointed

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[1] *See, e.g.*, Eric Neumayer and Laura Spess, "Do Bilateral Investment Treaties Increase Foreign Direct Investment To Developing Countries?", 33(10) WORLD DEVELOPMENT 1567 (2005); The Economist and the Columbia Program on International Investment, "World Investment Prospects to 2011: Foreign Direct Investment and the Challenge of Political Risk" 96 (2007).

[2] "Deep declines in foreign investment expected in 2009 as crisis hits developing world, UNCTAD chief says," UNCTAD/PRESS/PR/2009/014/Rev.1 (May 4, 2009).

to claims then being brought under NAFTA – including claims against the United States – and to perceived flaws in the NAFTA procedures for investment arbitration and called for a major overhaul.

The outcome of that debate was a balancing of both sets of interests. The 2002 Act calls on negotiators to pursue investment protections similar to those contained in earlier treaties and agreements – protections such as national treatment, fair and equitable treatment, and compensation for expropriation under standards similar to those provided under U.S. law. But, the Act also takes account of U.S. "defensive" interests in several notable respects:

- It establishes the "no greater substantive rights" objective. According to this objective, negotiators are to seek to "ensur[e] 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;"

- It calls on negotiators to seek standards for expropriation and compensation for expropriation and for fair and equitable treatment "consistent with United States legal principles and practice;"

- It calls on negotiators to seek dispute settlement procedures that eliminate and deter the filing of frivolous claims; and

- It calls on negotiators to ensure transparency in all aspects of investment dispute settlement.[3]

[3] Pub. L. No. 107-210, § 2102(b)(3), 116 Stat. 933, 995 (Aug. 6, 2002).

The message of the 2002 Trade Act with respect to investment was clear, and negotiations conducted under the Act's framework adhered closely to the Act's objectives. For example, the resulting agreements consistently included annexes elaborating on expropriation and fair and equitable treatment in light of those objectives. Similarly, the dispute settlement procedures in these agreements are completely transparent and provide for expedited dismissal of frivolous claims, as well as authorizing tribunals to sanction parties that pursue frivolous claims.

The question now is whether the balance in the 2002 Trade Act should be revised. I respectfully suggest that the answer is No. No developments in the intervening seven years suggest any reason to dispense with the balance reflected there and start again.

When the 2002 Act was agreed to, the United States had not lost a single investor-State arbitration. Seven years later that is still the case. Meanwhile, U.S. investors have come to rely increasingly on investor-State arbitration as a means of defending their rights overseas.

As a negotiator of free trade agreement investment chapters during my time at USTR, I had the experience of explaining the objectives in the 2002 Act to foreign counterparts. It is not easy. Urging transparency in dispute settlement, for example, is a hard sell. But, in the ten FTAs with investment chapters[4] and two BITs[5] concluded since 2002, the United States has succeeded consistently in achieving these objectives. Modifying those objectives – particularly in ways that are perceived as replacing international treaty standards with U.S. domestic legal

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[4] FTAs with Colombia, Panama, Korea, Chile, Singapore, Australia, Morocco, Oman, Peru, and the Dominican Republic and Central American countries. (The U.S. FTA with Bahrain does not contain an investment chapter, due to a pre-existing, relatively recent BIT with Bahrain.)

[5] BITs with Uruguay and Rwanda.

standards – will increase the challenge substantially, perhaps insurmountably, leaving U.S. investors without the protections that their foreign competitors receive under other countries' BITs and FTAs.

Nevertheless, from time to time there have been calls to modify the current model in significant ways – for example, by limiting the right to compensation for expropriation or by severely curtailing or eliminating investor-State arbitration. Some of these calls are based on misunderstandings of what our investment treaties and agreements do and what they do not do. Accordingly, as my last point, I would like to address three of the more glaring misconceptions that have made their way into the public discourse.

<u>A Productive Discussion Must Avoid Misunderstanding of Investment Treaty Obligations</u>

First, some critics have argued that the standard for expropriation and compensation for expropriation under U.S. BITs and FTAs is more investor-friendly than the standard under the Takings Clause of the Fifth Amendment to the U.S. Constitution, exposing the United States to claims it would not face in a U.S. court. This is patently incorrect. Following enactment of the Trade Act of 2002, a consistent feature of BIT and FTA investment chapters has been a special annex elaborating on the expropriation provision. The annex sets forth principles drawn directly from U.S. takings jurisprudence. For example, the annex explains that an action is an expropriation only if it "interferes with a tangible or intangible property right or property interest in an investment," and it spells out factors to be considered in a fact-based inquiry as to whether a regulatory action is an indirect expropriation.

To the extent some find the annex on expropriation to be inadequate, their criticism may be based on a flawed understanding of the analogous U.S. law. For example, one widely circulated report asserts incorrectly that "U.S. regulatory takings jurisprudence applies only to real property. . . ."[6] In fact, for at least the past 25 years the U.S. Supreme Court has recognized the applicability of the Takings Clause to property other than real property.[7]

Another criticism charges that BITs and FTAs tie the hands of Federal, State and local governments, constraining their ability to regulate in the public interest. This, too, is false. It is based in part on a focus on claims that private parties have asserted – some of them of questionable merit, some never actually litigated – as opposed to findings that arbitrators actually have made. The criticism also is based on a misreading of certain NAFTA cases. For example, the often-cited S.D. Meyers case was not about Canada's right to adopt environmental regulations – in that case, regulations concerning the destruction of PCBs. Rather, it was about actions "to protect and promote the market share of enterprises that would carry out the destruction of PCBs in Canada and that were owned by Canadian nationals."[8]

The fear of unduly constraining regulators also is based on a mischaracterization of the powers of arbitration panels. Contrary to that mischaracterization, these panels cannot compel governments to change laws or take any other specific actions. At most, they can find breaches of BIT or FTA obligations and award damages based on any harm resulting from such breaches.

Finally, from time to time, the debate on international investment policy has raised questions about the ability of the United States to defend its national security

[6] Public Citizen, NAFTA's Threat to Sovereignty and Democracy: The Record of NAFTA Chapter 11 Investor-State Cases 1994-2005 at viii-ix (Feb. 2005).

[7] *See, e.g.*, *Ruckelshaus* v. *Monsanto*, 467 U.S. 986 (1984) (recognizing trade secrets as protectable under Takings Clause);

[8] *S.D. Myers* v. *Canada*, Partial Award, para. 162 (Nov. 13, 2000).

interests once it undertakes obligations to foreign investors in BITs or FTAs. Some have suggested that the obligation to provide non-discriminatory access to investment in certain sectors, such as port services, would deprive the United States of the power to exclude a given investor on national security grounds. This claim, too, is false.

The United States routinely includes an "essential security" provision in its BITs and FTAs. Actions by a country that might otherwise be inconsistent with a BIT or FTA obligation are excused if "it considers" those actions to be necessary for the protection of its "essential security interests." The key phrase here is "it considers." That language makes clear that a country may determine for itself whether actions are necessary to protect its essential security. And, to eliminate any doubt whatsoever, the most recent FTAs state explicitly that upon a party's invocation of the essential security exception, an arbitration panel shall find that the exception applies.[9]

Conclusion

In conclusion, Mr. Chairman, the task the Administration has set for itself of "review[ing] the implementation of our FTAs and BITs to ensure that they advance the public interest" is an important task. The Congress is an essential participant in that review. The main message I want to leave with the Subcommittee is that the review should be undertaken on the basis of accurate premises. While that would seem obvious, it bears emphasis in light of some of the misconceptions surrounding investment protections.

[9] *See* U.S.-Peru FTA, art. 22.2(b), fn 2; U.S.-Colombia FTA, art. 22.2(b), fn 2; U.S.-Panama FTA, art. 21.2(b), fn 2; U.S.-Korea FTA, art. 23.2(b), fn 2.

On the whole, these protections have provided a significant degree of legal certainty that has facilitated investment and economic growth. At the same time, they have been crafted in a way that takes due consideration of U.S. interests as a host to foreign investors. It is my hope that participants in the review will recognize these facts, and that the Administration and the Congress will continue to be strong supporters of BIT- and FTA-based investment protections.

Thank you.

Chairman LEVIN. Professor, if you take five, and, Ms. Menghetti, if you take five, then we will go and vote and we will come back.

Professor, your 5 minutes.

STATEMENT OF ROBERT K. STUMBERG, PROFESSOR OF LAW AND DIRECTOR OF THE HARRISON INSTITUTE FOR PUBLIC LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. STUMBERG. Good morning, Mr. Chairman. Congressman Brady, if I may begin with your introduction to the issue, I agree that U.S. negotiators have struck a balance between the twin mandates, on the one hand to protect the interests of American investors abroad, and on the other hand, to assure that no greater rights go to foreign investors.

I also agree that the language of the most recent agreements reflects that kind of compromise. Because it is a compromise, my view is that the United States has not achieved the goal of no greater rights, and I would like to make three points to explain why.

First, I would like to talk about the change in countries with which we are negotiating, and raise the question as to whether one size fits all. That is to say, does one model for an investment agreement work in every case?

The free trade agreement with Australia shows that one size need not fit all, because both countries agreed in that agreement that investor-state arbitration was not necessary. Why? Because both countries had functioning courts, and because both countries have cross-investments in each other which, if there were investor rights, might cause a risk of investor-state litigation.

Korea—an agreement that is on the table which may soon come to this congress—sounds a lot like Australia. It is a country in which there is lots of investment going both ways. And both American and Korean courts work. So why is investor-state arbitration part of a proposed free trade agreement with Korea?

Another agreement that is on the table—Panama—raises interesting questions because the government of Panama, through a variety of banking tax and regulatory policies, is recruiting companies to place, their corporate domicile in Panama to escape taxation or regulation in their home country. Panama has a creative and aggressive legal industry that has recruited, to date, over 350,000 foreign companies to establish a domicile in Panama.

So, essentially what you have is a country that has embarked on a strategy of attracting the kind of companies that would, if they could, use investor-state arbitration if their interests are affected by policy in the United States.

Last year, the United States also began negotiations on a bilateral investment treaty with China. Those negotiations are now suspended. China is interesting, just because of its size. Presently, there is only about a billion of Chinese foreign direct investment in the United States.

But, as you all know, China has accumulated a humongous surplus in trade with the United States, and at some point is going to start reinvesting that money in more profitable investments.

And there is a lot of pressure for China to follow the successful investment path of Japan, which was in a similar position.

If China does so, and starts moving billions into the American economy, it is likely to buy assets or shares in American companies that implement its distribution chain. So, for example, that might look like companies like Wal-Mart or Target or Sears, icons of American retail commerce.

If you are thinking long term, anticipating that within 30 or so years the Chinese economy is projected to be about the same size as the U.S. economy, you can anticipate that so-called American companies could have the benefits of investor-state arbitration. So, a big chunk of the economy could opt out of U.S. courts if they wanted to, and instead look to the investor benefits.

Let me conclude by referring to a case that is now active, and it is rumored to be very close to a decision, the Glamis Gold case against the United States. It allows me to illustrate the issue of investor rights with respect to two questions.

First, who is a foreign investor? The Glamis Gold company started as a Canadian company with mines in Canada. It then sold its Canadian assets and established subsidiaries in the United States. Now its holdings are in the United States, Mexico, Honduras, and Guatemala. So, it essentially is a binational company that is able to take advantage of the free trade agreement to bring its claim against the United States.

The big issue is the minimum standard of treatment. And the big question there is whether a change in the reclamation standards adopted by the State of California amounts to a violation of the agreement.

The United States Department of State argues that a change in the law does not violate the agreement, because the recent language, assuring that there are no greater rights, says that it is not a denial of justice for the law to change. Glamis, on the other hand, argues that there are plenty of NAFTA cases it can cite to show that the standard of minimum treatment can evolve, and should assure a stable regulatory environment, which means the government has a duty not to change the law, once a company like them has a mining claim in effect.

What this shows, in conclusion, is that these agreements allow for a narrow interpretation—one which is argued by the U.S. State Department, in its brief—or, they are interpretations that allow for a broad reading of the minimum standard of treatment.

This is the fundamental ambiguity that exists also with respect to protections from expropriation and protections with respect to national treatment.

[The statement of Mr. Stumberg follows:]

HARRISON INSTITUTE FOR PUBLIC LAW
GEORGETOWN LAW

Testimony of Robert Stumberg[1]
Reform of Investor Protections
House Committee on Ways & Means, Subcommittee on Trade
Rep. Sander M. Levin, Chair
May 14, 2009

Mr. Chairman, thank you for this oversight of investor protections in free trade agreements (FTAs) and bilateral investment treaties (BITs). These agreements have evolved in recent years in response to the bipartisan mandates of protecting American investors abroad while granting no greater substantive rights to foreign investors.[1]

U.S. negotiators have been responsive to the "no greater rights" mandate, but they are short of achieving it. The reasons are clear enough. The negotiators at USTR are working under two competing objectives, each with its proponents. On the "offensive" side, much of corporate America asks for investment agreements that use the most robust international standards of investor protection.[2] On the "defensive" side are state and local governments,[3] with which I work, and environmental and public interest advocates.[4] They fear that investors will succeed in challenges that would fail in U.S. courts. Examples include environmental policies that could have significant business consequences such as mining reclamation, emergency financial measures or evolving climate policies.[5] The defensive side seeks investor protections that align with U.S. constitutional protections for property rights, which are the strongest in the world.

This is an important time for oversight. During the campaign, candidate Obama pledged to meet the objective of "no greater rights" for foreign investors and to preserve the sovereignty of American courts.[6] Recently, the Administration announced that it will review FTAs and BITs to ensure that they advance the public interest. As you know, the House would have no vote on proposed BITs with countries such as China or India unless this committee defines a need for implementing legislation.

The Congress should care about investor rights because:

- One size does not fit all countries;
- The FTAs and BITs outsource constitutional law; and
- Congress can do more to preserve America's policy space.

Does one size fit all?

Your hearing notice asks the threshold question: Is it appropriate to give arbitration rights to investors from all the countries with which we are negotiating? For example, investor arbitration was not included in the U.S.-Australia FTA because (a) Australia has a well-developed legal system,[7] and (b) Australian investors own substantial assets in the United States. Consider the very different positions of these three countries:

- *South Korea* – South Korea has significant U.S. investments, which are concentrated in wholesale distribution services. In the five years prior to the current recession, Korean investments grew by 77 percent.[8] While U.S. firms raise concerns about regulatory

[1] Professor of Law, Georgetown University Law Center. This testimony presents the views of the author only and not those of Georgetown University.

transparency, economic reforms are underway (including finance and economic development zones), and South Korea has a developed legal system that is available to U.S. investors.[9] In short, Korea looks more like Australia than the developing countries with which the United States has investment agreements.

- *Panama* – Panama has a small economy, but it wants to become the legal domicile of companies (over 350,000 as of 2006) that seek a tax or regulatory haven.[10] For example, the "Panamalaw" web page advertises the virtues of doing business through a Panama corporation, with virtual anonymity, and without ever having to travel to Panama.[11] So long as any of these companies do "substantial" business in Panama – including U.S. companies – they would be able to use their Panama corporations or subsidiaries to challenge domestic regulations in the United States.[12]

- *China* – In about 35 years, the Chinese economy is projected to exceed the U.S. economy in size.[13] China's current ownership of U.S. investments grew by 62 percent over the five years prior to the recession.[14] China has invested its global trade surplus primarily in foreign exchange reserves such as U.S. Treasury Notes.[15] Some analysts expect China to follow Japan's development path, which would shift from cash reserves to acquiring foreign firms that are part of its distribution chain.[16] For example, China could be looking for a stake in companies like Wal-Mart, Target or Sears. So in the long run, is it wise to provide investor arbitration to Chinese-owned firms that are significant actors in the U.S. economy?

The China numbers underline the broader trend that the United States has begun to import more capital than it exports through foreign direct investment (FDI). In quantitative terms, the defensive interests of the United States clearly now matter.[17]

Outsourcing constitutional law

Investor protections in FTAs and BITs take questions about governing authority and move them from U.S. courts to international arbitrators. The literature on this sovereignty shift is voluminous. Much of it concerns indirect expropriation, or "regulatory takings." The United States successfully defended an indirect expropriation claim in *Methanex v. United States*, and the ruling provides a model for reforming the language of indirect expropriation in U.S. agreements.

In my limited time, I will focus on the most open-ended investor protection, the duty to provide minimum treatment under international law. Lets look at two current situations.

Mining and reclamation – the Glamis Gold case

In the early 1990s, Glamis Gold Ltd. acquired dozens of mining claims on public lands in the Imperial Valley, a desert environment east of San Diego. Glamis proposed digging a large open-pit mine next to the Indian Pass trails, an area where the Quechen Indians practice their religion and venerate their ancestors. The site also abuts a wilderness habitat for desert wildlife.[18] Glamis uses a "cyanide heap-leach" process, which extracts 422 tons of ore to produce an ounce of gold. As its name implies, heaps of contaminated ore would surround the pit. Glamis also proposed to extract 389 million gallons of water per year from the aquifer beneath the desert.

In January 2001, the U.S. Interior Department rejected the Glamis proposal.[19] Within a few months of taking office in 2001, the Bush Administration reversed the Interior Department's legal opinion. In 2002, the California State Mining and Geology Board, and then legislature in 2003, acted to protect Native American sacred sites and other sites of environmental or cultural value.[20] The measure required mining companies to backfill and re-contoured open-pit mines after operations are completed. When he signed the legislation, Governor Gray Davis said its intent was to stop the Glamis Gold operation in Imperial County.[21]

In July 2003, Glamis filed a NAFTA claim seeking $50 million from the United States government for expenses and expected profits.[22] Glamis alleged violations of U.S. obligations under NAFTA chapter 11 to provide compensation for expropriation and to provide minimum treatment under international law.[23]

When Glamis filed its NAFTA claim, its main office was in Reno, Nevada, and its assets were in Nevada, California, Mexico, Honduras and Guatemala.[24] Glamis applied for the mining permit as a U.S. company.[25] In 2006, Glamis merged with Goldcorp, Inc., a Canadian mining company with assets in Canada.[26] Throughout much of the NAFTA dispute, Glamis was arguably a dual-national. This illustrates the ease with which companies can establish a corporate domicile to take advantage of investor rights.

Of the two substantive claims, one being expropriation, I will focus on the minimum standard of treatment, which includes the right to "fair and equitable treatment."[27] In 2001, the NAFTA Free Trade Commission issued an Interpretive Statement that the minimum standard entitles foreign investors to only the standard of treatment for aliens that is provided under customary international law. The two sides of this dispute show how open-ended investor protections produce fundamental ambiguity:

- ***Glamis Gold*** argues that the minimum standard requires governments to maintain stable and predictable regulations in order to protect investments' expectations.[28] In other words, government should compensate investors if regulatory changes occur after their expectations are set. Glamis also argues that even after the 2001 Interpretive Statement, the customary international law standard continues to "evolve" and now includes a right to a "stable and predictable regulatory environment." Glamis cites several NAFTA and BIT cases that support this view.[29]
- ***The State Department*** argues that the minimum standard includes three elements: (1) compensation for expropriation (not relevant here), (2) "internal security," and (3) "denial of justice" where domestic courts or agencies (not legislatures) treat foreign investors in a way that is "notoriously unjust" or "egregious" such as a denial of procedural due process.[30] Further, the burden should be on the investor, and the expectation of unchanging regulations is not part of customary international law.[31] According to the State Department, the narrow language of the Interpretive Statement supersedes the cases on which Glamis relies.[32]

The Panama FTA and the 2004 Model BIT both contain language similar to the 2001 Interpretive Statement, which links the minimum standard of treatment (including fair and equitable treatment) to the customary international law standard of treatment of aliens.[33] In theory, customary international law is based on the general and consistent practice of States that they follow from a sense of legal obligation. In practice, arbitral tribunals have applied an expanding, "evolving" approach of the minimum standard of treatment that is based on the decisions of other tribunals rather than the actual practice of States. Accordingly, the language linking the minimum standard to customary international law does little to constrain arbitrators who want to interpret the standard broadly, as advocated by Glamis, to include greater rights than those provided to U.S. citizens under the Constitution.[34]

Financial services

The Emergency Economic Stabilization Act authorized $700 billion for the U.S. government to purchase troubled assets (*e.g.*, mortgage-backed securities) and make capital contributions if financial institutions have "significant operations" in the United States.[35] However, the 300 banks to receive such assistance are all U.S. institutions, even though foreign institutions also purchased the toxic assets.[36] Other aspects of the bailout are explicitly limited to U.S.-based firms, such as the participation by hedge funds in the $1 trillion public-private investment program, which matches private equity investments with government contributions.[37]

Could foreign investors challenge economic stabilization measures of the United States? During the 1990s, the Czech Republic confronted a financial crisis as it broke from the orbit of communist state control. Non-performing loans of the "Big Four" banks had risen in the range of 16 to 34 percent of their portfolios.[38] In 1998, a new government came to power and eventually made selective bailouts to the Big Four, in which the government held a large equity stake.[39] A smaller bank owned by a Dutch subsidiary (of a Japanese bank) also sustained major loses but did not receive a comparable bailout. In an investor-state dispute, *Saluka v. Czech Republic*, arbitrators ruled that the Czech Republic violated investor rights to "fair and equitable treatment" when it withheld a bad-debt bailout from the small bank while providing a bailout to the big banks with a comparable problem. "Too big to fail" was not a reasonable basis for differential treatment of banks with comparable problems.[40]

During his confirmation hearing, USTR Ron Kirk assured the Senate that the U.S. BITs and FTAs include an exception to safeguard prudential measures.[41] However, as phrased in the pending Panama TPA and the Model BIT, the exception is only available for prudential measures *that do not avoid* U.S. obligations under the agreement.[42] Looking at parallel language in other agreements, legal commentators make three possible interpretations of the exception:

- The most favorable meaning is that it requires a rational connection between the objective of stabilizing the banks and the way a measure is implemented.[43]
- A less favorable meaning is that it creates a burden of proof that favors investors.[44]
- The least favorable meaning is that it is circular, hortatory or self-cancelling.[45]

Should the United States want a prudential exception that works, we need look no farther than NAFTA, which provides an unambiguous exception with no self-cancelling language.[46]

Another important question for congressional oversight is, which agreements can foreign investors use to challenge U.S. financial measures? Starting with the FTAs and BITs, the Australia FTA is a notable exception because it omits investor arbitration. The Singapore FTA is of particular interest because its sovereign wealth fund, CIG, has lost billions of dollars in U.S. financial markets.[47] Another option could be the old Friendship, Commerce and Navigation (FCN) treaties that include most of the BIT investor protections.[48] In a 1924 dispute, the Supreme Court ruled that investors could enforce their treaty rights directly in U.S. courts.[49]

If investors can persuade their home country to press their claim through state-to-state dispute settlement, they could invoke the WTO's General Agreement on Trade in Services (GATS). Since its inception, the WTO's Secretariat has maintained that Most Favored Nation treatment under GATS requires countries that have BITs to make investor protections available to investors from all WTO countries.[50] GATS may well provide an option for sovereign wealth funds like the Abu Dhabi Investment Authority and the China Investment Corporation, which have lost billions in U.S. banks without the benefit of BIT or FTA investor protections.[51]

Preserving America's policy space

To date, the U.S. defense team has successfully defended against NAFTA investor-state claims.[52] Yet behind closed doors, there is significant concern that NAFTA panels will begin to rule against the United States.[53] For example, Abner Mikva, a former congressman and retired DC circuit court judge, was the U.S. government's appointed arbitrator in *Loewen v. United States*. Judge Mikva recounted a meeting with U.S. officials prior to the panel being constituted. "You know, judge," they said, "if we lose this case we could lose NAFTA." "Well, if you want to put pressure on me," Mikva replied, "then that does it."[54]

As BITS and FTAs multiply, more investors have arbitration rights. The risk grows that arbitrators will start to interpret the ambiguity of investor protections in ways that are unfavorable to the United States. "No greater rights" is still the right mandate for negotiators. But the language in BITs and FTAs needs to be revised to ensure that it confirms to the conservative interpretation that the United States has used to defend against the investor claims.

The briefs of the U.S. defense team provide a balanced interpretation of "no greater substantive rights." There are also procedural reforms that would align investor arbitration more closely with U.S. law. I conclude with an overview these reforms. My colleague, William Waren at the Forum on Democracy and Trade, will submit a more detailed explanation of the options. Thank you for this opportunity.

Options for Reform of Investor Protections

1. **Substantive investor protections**
   a. *Minimum standard of treatment* – Narrow the minimum standard to the elements of customary international law as explained in the US brief in *Glamis*.
   b. *Indirect expropriation* – Narrow indirect expropriation so that it does not apply to nondiscriminatory regulations as explained in the *Methanex* award.
   c. *Protected investments* – Narrow the definition of investment, which extends beyond the kinds of property that are protected by the takings clause of the U.S. Constitution.
   d. *Denial of benefits* – Limit "denial of benefits" language so as to preclude claims by subsidiaries of U.S. corporations.
   e. *Prudential measures* – Use the NAFTA prudential exception as a model to safeguard emergency stabilization measures.
   f. *Transfers* – Allow countries to impose capital controls in response to a financial crisis.

2. **Procedural reforms**
   a. *Exhaustion of remedies* – Follow international law and require investors to exhaust domestic remedies before using investor-state arbitration.
   b. *Diplomatic review* – Enable a country to block a claim in sensitive sectors or to clarify the self-judging nature of key exceptions for security and prudential measures.
   c. *Objective arbitration* – Establish stronger conflict of interest standards for arbitrators and eventually replace private arbitrators with an investment court that uses independent judges with tenure.

3. **Implementing legislation** –
   a. *BITs* – Ensure that BITs do not create a private right of action for investors to enforcing their treaty rights in U.S. courts.
   b. *Impact on states* – Establish protections against federal preemption and unfunded federal mandates that BITs and FTAs can impose on states as a result of investment disputes.

Endnotes

[1] In 2002, Congress directed U.S. negotiators to seek to establish standards and compensation for expropriation consistent with U.S. legal principles and practice, and ensure that foreign investors would not be entitled to compensation for government regulation. Congress also directed the Executive to eliminate frivolous claims; deter the filing of frivolous claims; enhance opportunities for public input into the formulation of government positions; encourage transparency, open hearings and *amicus curae* submissions, and work to develop an appellate body or similar mechanism to provide coherence to the investor state decisions. Senate Report 107-139, Bipartisan Trade Promotion Authority Act of 2002, 107th Congress 2nd session, Calendar No. 319 (February 28, 2002) at 13. In the Bipartisan Trade Deal of May 2007, Congress and the Bush Administration restated the negotiating objective, that investment agreements should grant no greater substantive rights to foreign investors, and agreed that the preamble should reflect this policy. USTR, Bipartisan Trade Deal, Investment, at 3-4 (May 2007), available at http://www.ustr.gov/Benefits_of_Trade/Section_Index.html?ht= (viewed May 10, 2009).

[2] Business groups that want to expand investor rights:
U.S. Council for International Business. USCIB is the American affiliate of the International Chamber of Commerce (ICC), the Business and Industry Advisory Committee (BIAC) to the OECD, and the International Organisation of Employers (IOE). USCIB now supports expansion of investor-state arbitration to Brazil, India and China, and in the Korea FTA negotiations, urged U.S. negotiators to "return to the provisions of the model BIT," rather than crafting exceptions to deal with sensitive sectors such as government services. USCIB, Recommendations on Objectives for the U.S.-Korea FTA (March 24, 2006) 9, available at http://www.uscib.org/index.asp?documentID=829 (viewed May 10, 2009).
National Association of Manufacturers. NAM supports a multilateral agreement on investment under the OECD and expansion of BITs to include Russia, China, Brazil, India, the EU and Japan. NAM, 2.01 International Investment , available at http://www.nam.org/policypositions/ (viewed May 10, 2009).
U.S. Chamber of Commerce. The Chamber also supports trans-Atlantic investment negotiations through the OECD. Its goals are to limit "increasingly burdensome" investment regulations and standards on technology, environment, health and safety. U.S. Chamber of Commerce, Unleashing Our Economic Potential: A Primer on the Transatlantic Economic Council (2008), Appendix II.E, available at http://www.uschamber.com/publications/reports/0804econ_potential.htm (viewed September 7, 2008); U.S. Chamber of Commerce, Global Regulatory Cooperation Project, available at http://www.uschamber.com/grc/default (viewed September 7, 2008).
Emergency Committee for American Trade. In principle, ECAT supports the negotiating objective of "no greater substantive rights" for foreign investors. However, it opposes interpretive notes or congressional action to clarify open-ended language on expropriation and the minimum standard of treatment, saying that these terms "should properly be an issue for the investor-state tribunal."About ECAT, available at http://www.ecattrade.com/about/ (viewed May 10, 2009); ECAT, Bulletin #15: Bipartisan TPA Act v. Kerry Amendment (2002).

[3] State government groups that call for "no greater rights":
Intergovernmental Policy Advisory Committee. IGPAC, the state and local advisory committee to USTR, filed its most recent comments on investment under the pending Colombia FTA. IGPAC urges U.S. negotiators to codify the holding of the Methanex panel to limit expropriation, limit the minimum standard of treatment to procedural due process and reject substantive due process, require investors to exhaust judicial remedies, and reimburse the states (CA, MA, MS, VA) that have been "heavily taxed" in defending investor-state disputes. IGPAC, *Advisory Committee Report to the President, the Congress and the United States Trade Representative on the US-Colombia Trade Promotion Agreement*, September 15, 2006, 3 and 20-22.
National Conference of State Legislatures. NCSL opposes investor-state arbitration: "Trade agreement implementing language must include provisions that deny any new private right of action in U.S. courts or before international dispute resolution panels based on international trade or investment agreements." NCSL also calls for U.S. negotiators to: (1) "carve out" state laws that might be subject to challenge, (2) use a "positive list" approach to defining the scope of covered investments, and (3) enable states to "make adjustments" to limit coverage of state policies. NCSL, Free Trade and Federalism, 2008 - 2009 Policies for the Jurisdiction of the Labor and Economic Development Committee, available at http://www.ncsl.org/standcomm/sclaborecon/sclaborecon_Policies.htm#FreeTrade (viewed May 10, 2009).
Conference of Chief Justices. CCJ is concerned that investor-state arbitration "can undermine the enforcement and finality of state court judgments." CCJ, Resolution 26, adopted as proposed by the International Agreements Committee at the 56th Annual Meeting on July 29, 2004.
Cities, mayors CSG. National League of Cities, U.S. Conference of Mayors, Council of State Governments and National Conference of State Legislatures, joint letter to Ambassador Robert Zoellick (September 23, 2003).
National Association of Attorneys General. NAAG asked Congress to "ensure that … foreign investors shall receive no greater rights to foreign compensation than those afforded to our citizens." NAAG, Resolution, Spring Meeting, March 20-22, 2002, Washington, DC.
Association of Towns and Townships. Tom Halicki, Executive Director, NATaT, letter to U.S. Senators (April 4, 2002).

[4] Environmental and public interest groups that oppose investor-state arbitration or call for "no greater rights":
Sierra Club. The club asserts that "The problem with NAFTA's Chapter 11 investor suit rules has not been fixed in CAFTA." Sierra Club, *NAFTA's corporate investor rights and their threat to the environment*, and *The Problem with NAFTA's Chapter 11 Investor Suit Rules Has Not Been Fixed in CAFTA*, 2004, both available at

http://www.sierraclub.org/trade/nafta/corporate_investor.asp (viewed May 10, 2009).
Earthjustice. Earthjustice lawyers have filed amicus briefs in NAFTA arbitrations that challenged California laws: "This is not what California was promised when NAFTA passed." Comments of Martin Wagner, Earthjustice, in release, "New Study Analyzes Seven Years of Corporate Investor Challenges to Democratic Governance and State Sovereignty Under NAFTA" (September 4, 2001), available at http://www.commondreams.org/news2001/0904-08.htm (viewed September 6, 2008); *see also* Human Rights and the Environment, Case Study: Gold Mining on Native American Tribal Lands (September 9, 2005) available at http://www.earthjustice.org/our_work/issues/international/human_rights/case-studies/gold_mining_on_native_american_tribal_lands.html (viewed September 6,2008).
Friends of the Earth – US. FOE, *Glamis Gold: A Case Study of Investing in Destruction* (2004), available at www.foe.org/camps/intl/greentrade/glamis.pdf (viewed September 6, 2008).
National Wildlife Federation. NWF, Testimony of Mark Van Patten, President and CEO, National Wildlife Federation, Before the Committee on Finance, United States Senate, On Trade Promotion Authority (June 20, 2001) at 2, available at www.senate.gov/~finance/062001mvtest.pd (viewed September 6, 2008).
Public Citizen. Public Citizen's Global Trade Watch, *NAFTA Chapter 11: Corporate Cases*, available at http://www.citizen.org/trade/nafta/CH__11/ (viewed September 6, 2008).

[5] *See* Kate Miles, *International Investment Law and Climate Change*, Society of International Economic Law, Working Paper No. 27/08 (2008), available at http://www.ssrn.com/link/SIEL-Inaugural-Conference.html (viewed August 24, 2008); Jacob Werksman, Kevin A. Baumert and Navroz K. Dubash, *Will International Investment Rules Obstruct Climate Protection Policies? An Examination of the Clean Development Mechanism*, 3 International Environmental Agreements: Politics, Law and Economics 59 (2003).

[6] In 2008, Senator Obama pledged: "I will ensure that foreign investor rights are strictly limited and will fully exempt any law or regulation written to protect public safety or promote the public interest. And I will never agree to granting foreign investors any rights in the U.S. greater than those of Americans." Pennsylvania Fair Trade Coalition, 2008 Presidential Candidate Questionnaire, answer of Sen. Barack Obama, question 10, available at http://www.citizenstrade.org/pdf/QuestionnairePennsylvaniaFairTradeCoalition040108FINAL_SenatorObamaResponse.pdf (viewed August 24, 2008); reiterated in letters to Fair Trade Coalition in Texas, Iowa, Wisconsin, and Pennsylvania; *see* http://www.citizenstrade.org/positions.php. Senator Obama agreed to renegotiate these provisions in NAFTA but he did not agree to "renegotiate" these provisions in other more recent trade agreements.

[7] *See* House Ways and Means Committee Report 108-597, United States-Australia Free Trade Agreement Implementation Act, 108th Congress 2nd session (July 12, 2004) 4 -5; Summary of the U.S.-Australia Free Trade Agreement, Important New Protections for U.S. Investors (February 8, 2004), available at http://www.ustr.gov/Document_Library/Fact_Sheets/2004/Summary_of_the_US-Australia_Free_Trade_Agreement.html?ht= (viewed May 10, 2009) ("In recognition of the unique circumstances of this Agreement – including, for example, the long-standing economic ties between the United States and Australia, their shared legal traditions, and the confidence of their investors in operating in each others' markets – the two countries agreed not to adopt procedures in this FTA that would allow investors to arbitrate disputes with governments.").

[8] Between 2002 and 2007, Korean investments grew from $3 to $13 billion, with $9 billion of that in wholesale distribution companies. U.S. Bureau of Economic Analysis, Foreign Direct Investment in the U.S., Foreign Direct Investment Position in the United States on a Historical-Cost Basis, by Country and Industry: Korea, available at http://www.bea.gov/international/ (viewed May 10, 2009).

[9] USTR, National Trade Estimate, Korea, Investment Barriers, 315-316.

[10] Government Accountability Office, *Large U.S. Corporations and Federal Contractors with subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*, GAO-09-157 (December 2008), available at http://www.gao.gov/products/GAO-09-157 (viewed May 10, 2009); CRS, *Panama: Political and Economic Conditions and U.S. Relations*, (updated November 16, 2006), available at http://fpc.state.gov/documents/organization/77706.pd (viewed May 10, 2009); U.S. Drug Enforcement Administration, "Panama: Country Brief," (May 2005) 12.

[11] Panama Legal, Frequently Asked Questions, available at http://www.panamalaw.org/faq.html (viewed May 10, 2009).

[12] Panama TPA, art. 10:12(2).

[13] Albert Keidel, China's Economic Rise – Fact and Fiction, Carnegie Policy Brief 61 (July 2008), Table 2 at 6.

[14] Between 2002 and 2007, Chinese investments grew from $400 million to $1.1 billion, with $850 million of that in wholesale distribution companies. U.S. Bureau of Economic Analysis, Foreign Direct Investment in the U.S., Foreign Direct Investment Position in the United States on a Historical-Cost Basis, by Country and Industry: China, available at http://www.bea.gov/international/ (viewed May 10, 2009).

[15] CRS, *China's Holdings of U.S. Securities: Implications for the U.S. Economy* (January 9, 2008) 3.

[16] *See* Curtis J.Milhaupt, *Is the U.S. Ready for FDI from China? Lessons from Japan's Experience in the 1980s*, Investing in the United States, A reference series for Chinese investors, Volume 1, Deloitte and the Vale Columbia Center on Sustainable International Investment (2008).

[17] U.S. Bureau of Economic Analysis, U.S. Net International Investment Position at Yearend 2007, available at http://www.bea.gov/newsreleases/international/intinv/intinvnewsrelease.htm (viewed May 10, 2009).

[18] Counter-Memorial of United States of America, 11-12 and 35-37 (September 19, 2006); Mary Bottari and Lori Wallach, NAFTA's Threat to Sovereignty and Democracy: the Record of NAFTA Chapter 11 Investor-State Cases 1994-2005, Public Citizen, 52-55 (Febuary 2005); Friends of the Earth, "Glamis Gold: A Case Study of Investing in Destruction," Briefing Paper, 2 (August 2003).

[19] Glamis Gold, Notice of Arbitration, December 9, 2003, http://www.state.gov/s/l/c10986.htm (viewed May 9, 2009).

[20] Counter-Memorial, at 19-22; FOE at 3.

[21] Office of the Governor, Press Release, "Governor Davis Signs Legislation to Stop Proposed Gold Mine Near "Trail of Dreams" Sacred Site," (April 7, 2003), available at http://www.governor.ca.gov/state/govsite/gov_htmlprint.jsp?BV_SessionID=@ (viewed May 10,2009).

[22] Transcripts, submissions, and tribunal orders in *Glamis Gold v. United States* may be found at http://www.state.gov/s/l/c10986.htm (viewed May 9, 2009).

[23] Counter-Memorial, at 19-22. FOE at 3.

[24] Glamis Gold, Ltd., Company history, available at http://www.fundinguniverse.com/company-histories/Glamis-Gold-Ltd-Company-History.html (viewed May 10, 2009).

[25] "In the late 1990s, however, the use of the land as a sacred site was even futher threatened. Glamis Gold Ltd., a Canadian gold mining company, established an American subsidiary, Glamis Imperial, in order to claim the right to petition the US Government for permission to develop the federal land. Under the General Mining Law of 1872, United States citizens (or corporations) are allowed to perform open mining operations on federally owned land with a permit from the BLM." The Pluralism Project, Research Report: Indian Pass, CA (Quechan), Harvard University (2004), available at http://pluralism.org/research/profiles/display.php?profile=73418 (viewed May 10, 2009).

[26] News release, "Glamis Shareholders Overwhelmingly Approve Combination with Goldcorp," (October 26, 2006), available at http://www.goldcorp.com/news/glamis/2006/ (viewed May 10, 2009).

[27] NAFTA art. 1105:1.

[28] Memorial of Claimant Glamis Gold Ltd., ¶ 534, p. 298-299, available at http://www.state.gov/s/l/c10986.htm (viewed May 9, 2009). Glamis also argues that "fair and equitable treatment includes a good faith obligation to protect legitimate expectations of an investor through establishment of a transparent and predictable framework," and that "the fair and equitable treatment standard has also been recognized as requiring the protection of legitimate investment-backed expectations." Memorial at ¶ 532, p. 297.

[29] *CMS Gas Transmission Co. v. Argentine Republic*, 44 International Legal Materials 91, ¶¶ 274, 269, 281; *Tecmed v. United Mexican States*, ICSID CASE No. ARB(AF)/00/02 (May 29, 2003) ¶153; *Metalclad v. Mexico*, ICSID Case No. ARB(AB)91/1, ¶7; *Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7(award)(Jan.25,2000) ¶ 83; *Waste Management v. United Mexican States*, ICSID Case No. ARB (AF)/00/03(Award) (August 30, 2000) ¶ 98; *Loewen Group v. United States*, NAFTA/ICSID(AF) Tribunal, Case No. ARB(AF)98/3, Final Award, 26 June 2003, ¶ 135.

[30] Counter-Memorial of Respondent United States of America, in Glamis Gold v. USA (September 19, 2006) 221.

[31] *Id.* at 226, 232.

[32] *Id.* at 231.

[33] See Panama FTA, art. 10.5; 2004 Model BIT,art. 5 and Annex A.

[34] *See generally* Matthew C. Porterfield, *An International Common Law of Investor Rights?* 27 U. Pa. J. Int'l Econ. L. 79 (2006).

[35] The operative phrase is: "… having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government." " Emergency Economic Stabilization Act of 2008, 12 U.S.C. § 5202(5).

[36] Todd Tucker, The Trade-Policy Blindspot in the U.S. Financial Crisis Response, Paper for IDEAS Conference on Re-Regulating Global Finance in the Light of the Global Crisis, Tsinghua University, Beijing (April 10, 2009), 15, Pew Charitable Trusts, Subsidy Scope, available at http://www.SubsidyScope.org/ (viewed May 10, 2009); U.S. Public-Private Investment Program, Memorandum from Cleary Gottlieb Steen & Hamilton LLP to clients and other friends of Cleary Gottlieb (March 26, 2009), available at http://www.cgsh.com/files/News/f1440266-4e85-40a6-836c-

5681541e/Dbe/Presentation/NewsAttachment/7954a2c7-d6b9-45c8-8703-5758c364368a/Alert%20Memo_%20Public-Private%20Investment%20Program.pdf (viewed May 10, 2009); *see also* U.S. Public-Private Investment Program, Memorandum from Cleary Gottlieb Steen & Hamilton LLP to clients and other friends of Cleary Gottlieb (March 26, 2009), available at http://www.cgsh.com/files/News/f1440266-4c85-40a6-836c-5681541e/Dbe/Presentation/NewsAttachment/7954a2c7-d6b9-45c8-8703-5758c364368a/Alert%20Memo_%20Public-Private%20Investment%20Program.pdf (viewed May 10, 2009).

[37] Tucker, *supra*, at 16; Cleary Gottlieb, *supra*, at 3.

[38] *Saluka Investments BV v. Czech Republic*, UNCITRAL, Permanent Court of Arbitration, Award (Mar. 17, 2006), ¶ 39, available at http://ita.law.uvic.ca/documents/Saluka-PartialawardFinal.pdf (viewed May 11, 2009).

[39] *Id.* at ¶ 83.

[40] *Id.* at ¶ 498.

[41] *Hearing on Confirmation of Mr. Ronald Kirk to be United States Trade Representative*, 111th Cong. 70 (2009) (Question 18 from Sen. Stabenow, answer from Mr. Kirk).

[42] The operative phrase is: ". . . a Party shall not be prevented from adopting or maintaining measures for prudential reasons . . . . Where such measures do not conform with the provisions of this Agreement …, they shall not be used as a means of avoiding the Party's commitments or obligations … ." Model BIT 2004, art. 20:1; U.S.-Peru TPA, art. 12:10(1); U.S.-Singapore TPA, art. 10:10(1). The same language is used for the prudential exception in GATS. GATS Annex on Financial Services 2(a).

[43] Several commentators analyzed the parallel prudential exception in the GATS Understanding on Financial Services: Bart De Meester, Testing European Prudential Conditions for Banking Mergers in the Light of Most Favoured Nation in the GATS, 11 J. INT'L. ECON. L. 609, 644 (2008); Joel P. Trachtman, Transatlantic Regulatory Cooperation from a Trade Perspective: A Case Study in Accounting Standards, in TRANSATLANTIC REGULATORY COOPERATION: LEGAL PROBLEMS AND POLITICAL PROSPECTS 223, 237 (George A. Bermann et al. eds., 2000).

[44] Several commentators analyzed the parallel prudential exception in the GATS Understanding on Financial Services: *See* De Meester, *supra*, at 644 (burden on claimant). *But see* Trachtman, *supra* note 31, at 237 (silent on who bears burden). Given that the main concern of the WTO is to eliminate perceived burdens to trade liberalization, and the fact that it is usually the respondent who bears the burden of proof under GATT, it seems unlikely that the burden should be shifted under GATS. *See* Steve Charnovitz, *Environmental Trade Sanctions and the GATT: An Analysis of the Pelly Amendment on Foreign Environmental Practices*, AM. U. J. INT'L L. & POL'Y 751, 778 n.169 (1994).

[45] Several commentator analyze NAFTA art. 1114, which says that countries may adopt "any measure otherwise consistent": with the agreement: David A. Gantz, Some Comments on NAFTA's Chapter 11, 42 S. TEX. L. REV. 1285, 1296-97 (2001); Robert K. Paterson, A New Pandora's Box? Private Remedies for Foreign Investors Under the North American Free Trade Agreement, 8 WILLIAMETTE J. INT'L. L. & DISP. RESOL. 77, 105 (2000); Todd Weiler, A First Look at the Interim Merits Award in S.D. Myers, Inc. v. Canada: It Is Possible to Balance Legitimate Environmental Concerns with Investment Protection, 24 HASTINGS INT'L. & COMP. L. REV. 173, 181-82 (2001); see Chris Tollefson, Games Without Frontiers: Investor Claims and Citizen Submissions Under the NAFTA Regime, 27 YALE J. INT'L. L. 141, 152 (2002).

[46] NAFTA art. 1410(1).

[47] Costas Paris, "Singapore GIC Said to Favor Keeping Citi Preferred Shares," Wall Street Journal (February 27, 2009); Costas Paris, "GIC Weighing Its Options on Citigroup Investment," Wall Street Journal (March 6, 2009).

[48] *See, e.g.,* Equitable Treatment: "Each Party shall at all times accord equitable treatment to the persons, property, enterprises and other interests of nationals and companies of the other Party." Treaty of Friendship, Commerce and Navigation, Dec. 12, 1956, U.S.-Den., Art. 1, 12 U.S.T. 908. The United States has FCNs with the following OECD countries: Denmark, Greece, Germany, Ireland, Italy, Japan, Korea, Netherlands, available at http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/index.asp (viewed May 10,2009). *See also* Barnali Choudhury, *Recapturing Public Power: Is Investment Arbitration's Engagement of the Public Interest Contributing to the Democratic Deficit?*, 41 VAND. J. TRANSNAT'L L. 775, 780 (2008); Won-Mog Choi, *The Present and Future of the Investor-State Dispute Settlement Paradigm*, 10 J. INT'L ECON. L. 725, 731 (2007); Kenneth J. Vandevelde, The Bilateral Investment Treaty Program of the United States, 21 CORNELL INT'L L. J. 201, 207 (1988).

[49] The Court stated that a FCN treaty "stands on the same footing of supremacy as do the provisions of the Constitution and laws of the United States. It operates of itself without the aid of any legislation, state or national; and it will be applied and given authoritative effect by the courts." Asakura v. City of Seattle, 265 US 332, 341 (1924).

[50] GATS art. II; *See* Rudolf Adlung and Martin Molinuevo, *Bilateralism in Services Trade: Is there Fire Behind the (BIT)-Smoke?* WTO Staff Working Paper ERSD-2008-01, 18-19 (January 2008).

[31] Richard Wray, "Revealed: how sovereign wealth funds were left nursing multibillion losses," The Guardian, (March 22, 2008) 44, available at http://www.guardian.co.uk/business/2008/mar/22/banking.investmentfunds (viewed May 10, 2009).

[32] USTR stated in a fact sheet, "Nothing in NAFTA's investment provisions prevents a country from adopting or maintaining non-discriminatory laws or regulations that protect the environment, worker rights, health and safety, or other public interest. The United States has never lost a challenge in the cases decided to date under NAFTA, nor paid a penny in damages to resolve any investment dispute. Even if the United States were to lose a case, it could be directed to pay compensation but it could not be required to change the laws or regulations at issue."

[33] There is considerable speculation about why the United States has not lost any NAFTA cases, including open discussion by arbitrators about the pressures of deciding claims against the United States. *See, e.g.*, David Schneiderman, "Judicial Politics and International Investment Arbitration: Seeking an Explanation for Conflicting Outcomes" ExpressO, (2009), available at: http://works.bepress.com/david_schneiderman/1 (viewed May 10, 2009) ("Not so easily explained are conflicting tribunal awards drawing on virtually identical facts, invoking the same treaty text, where arbitrators seemingly change their mind from one case to the next without any explanation.")

[34] Remarks of Judge Abner Mikva, Symposium: The Judiciary and Environmental Law, Panel on Trade, the Environment and Provincial/State Courts, Pace University School of Law, White Plains, New York, (December 7, 2004) (transcript on file with author).

Chairman LEVIN. Thank you very much. Ms. Menghetti? I think the bell will ring when we have 5 minutes left. So even though the clock is not working, the bells are.

STATEMENT OF LINDA MENGHETTI, VICE PRESIDENT, EMERGENCY COMMITTEE FOR AMERICAN TRADE

Ms. MENGHETTI. Thank you, Mr. Chairman. Congressman Brady, Members of the Subcommittee, thank you for the opportunity to appear before you today on behalf of the Emergency Committee for American Trade, ECAT, an association of the chief executives of leading U.S.-based business organizations with global operations.

Let us make no mistake. U.S. investment overseas is squarely in the U.S. economic and our broader national interest. With 95 percent of the world's consumers and 80 percent of world purchasing power outside the United States, U.S. industries need to be fully engaged internationally to remain competitive. U.S. investment overseas largely complements U.S. activities here at home. It is not a substitute for them.

U.S. companies that invest abroad export more. They expend more on research and development here, in the United States, and they pay their U.S. workers 24 percent more than purely domestic companies. In order to secure these benefits, the United States has long undertaken a program to protect investors who oftentimes find themselves in jurisdictions with weak rules and/or weak court systems.

The modern version of this program is the BIT and trade agreement system. The investment protections in these international instruments are based on core principles of U.S. law, from the Takings, Equal Protection, and Due Process Clauses of our Constitution, to the protection against arbitrary and capricious government action in the Administrative Procedure Act.

U.S. investors have relied upon these provisions to successfully address foreign government action that is discriminatory, expropriatary, or otherwise violative of core principles. They have won cases under a number of U.S. BITs, including with Argentina, Ecuador, Poland, and Turkey, and under NAFTA in cases with Canada and Mexico.

Such provisions are now more important than ever, particularly as some countries, including those in our own hemisphere, are turning their backs on basic international obligations and rules of fairness. And they are equally vital as we look to the negotiations with India and China. For U.S. companies to be able to penetrate those markets successfully, we need these types of instruments to address the unfair and discriminatory barriers that we find in those markets.

In many more instances, cases are never filed, as these clear rules promote the amicable resolution of disputes.

The United States has been a defendant in only a small number of cases. Where decisions have been issued, the United States has prevailed on the merits in decisions that reflect the high standards for which these arbitration panels are well known. And there has been no onslaught of cases, as some claimed might happen. About 50 cases have been filed in the past 14 years of NAFTA, overall.

This is less than a third of the cases filed every year in U.S. court on federal Takings claims alone.

Between 2001 and 2004, the U.S. Government engaged in an extensive review of the previous 1994 model BIT, and considered the same issues that we are discussing today. The outcome, the 2004 model BIT, represented a substantial change from the earlier model. And, unfortunately, it narrowed and weakened some of the protections for U.S. investors overseas. Notably, these provisions have not been tested, as no case has been decided on the substantially changed new model.

The proposals that are being discussed here today raise some very serious concerns for U.S. industries investing overseas. Further incorporating the no greater rights language, for example, would reverse decades of U.S. support for strong and binding international rules that largely benefit the United States and its investors. Such an approach would have little effect on challenges to the United States, since these investment protections are already largely consistent with U.S. laws and jurisprudence. And, at the direction of Congress, the 2004 model BIT moved the United States to even greater conformity.

While the benefit for the United States as a potential defendant is, at best, minimal, the risk for U.S. companies is great. Other countries will insist on relegating U.S. investors to local standards, negating the purpose of the BITs, and subjecting investors to weak and sometimes corrupt legal systems.

On regulatory issues, let us be clear. Investment rules simply do not prohibit the bona fide nondiscriminatory application of legitimate regulation. And none of the NAFTA cases demonstrate otherwise.

I urge you to reject proposals to embrace blanket exceptions for government actions to protect the environment and public welfare. The United States itself does not impose such exceptions in the Administrative Procedure Act, in the Takings clause, in the Equal Protection, or in our other legal principles. To establish such a safe harbor would allow foreign governments to expropriate U.S. property to the detriment of U.S. companies and their workers.

U.S. leadership is essential to promote a stronger international investment climate to benefit the U.S. economy, U.S. companies, and U.S. workers. ECAT looks forward to working with this Committee and the Administration to achieve that objective. Thank you.

[The statement of Ms. Menghetti follows:]

EMERGENCY COMMITTEE FOR AMERICAN TRADE

TESTIMONY OF LINDA MENGHETTI
VICE PRESIDENT OF THE
EMERGENCY COMMITTEE FOR AMERICAN TRADE
BEFORE THE
SUBCOMMITTEE ON TRADE
OF THE
COMMITTEE ON WAYS AND MEANS
OF THE
U.S. HOUSE OF REPRESENTATIVES
ON
INVESTMENT PROTECTIONS IN U.S. TRADE AND INVESTMENT AGREEMENTS

MAY 14, 2009

Mr. Chairman, Congressman Brady, Members of the Subcommittee. Thank you for the opportunity to appear before you this morning.

I am testifying today on behalf of the Emergency Committee for American Trade – ECAT – an association of the chief executives of leading U.S. business enterprises with global operations. ECAT was founded over four decades ago to promote economic growth through expansionary trade and investment policies. Today, ECAT's members represent all the principal sectors of the U.S. economy – agriculture, finance, high technology, manufacturing, merchandising, processing, publishing and services. The combined exports of ECAT companies run into the tens of billions of dollars. The jobs they provide for American men and women – including the jobs accounted for by suppliers, dealers, and subcontractors – are located in every state and cover skills of all levels. Today, the annual sales of ECAT companies exceed $2.7 trillion, and the companies employ more than 6.4 million people.

ECAT and ECAT companies are strong supporters of trade and investment liberalization to support economic growth. With 95 percent of the world's consumers and 80 percent of world purchasing power outside the United States, U.S. industries need to be fully engaged as exporters, importers and investors to remain competitive, expand our operations and support better jobs here in the United States. At the same time, we recognize that trade and investment are not panaceas. Domestic policies to address social and economic issues must also be in place to advance America's growth and prosperity at home and in the international economy.

Today's hearing could not be more timely, with the United States having commenced Bilateral Investment Treaty (BIT) negotiations with China, India and Vietnam and investment negotiations with the P-4 countries of Brunei, New Zealand, Chile and Singapore last year, while also considering formally launching broader negotiations to create a Trans-Pacific Partnership (TPP) with the P-4 and other countries in the Asia-Pacific corridor. The investment issues on

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which this hearing is focused this morning are also vital to promoting much-needed economic recovery in the U.S. and world economies.

Today, I will focus on three main points:

- First, the critical need for both U.S. outbound and inbound investment to support America's economic growth and recovery.
- Second, the genesis of and major issues considered in developing the current model BIT and why strong investment protections are vital and squarely in America's economic and national interest.
- Third, the key issues involving BITs identified in the notice for this hearing.

U.S. Investment – Outbound and Inbound – Promotes Economic Growth, American Values and American Jobs

Foreign investment, both inward and outward, is of substantial importance to the U.S. economy, U.S. industry and U.S. workers. It has been demonstrated to spur U.S. productivity, economic growth, research and development, investment in physical capital, and new technology. The payoff is in higher-paying jobs and a higher standard of living in the United States.

U.S. Outbound Investment[1]

Contrary to some speculation, U.S. investment abroad is not a substitute for activity in the United States. In fact, numerous studies over the past 20 years have demonstrated that U.S. investment overseas largely *complements and enhances economic opportunities in the United States*. Over the past 20 years, U.S. companies that invest abroad have:

- exported more (accounting for one-half to three-quarters of all U.S. exports),
- expended more on U.S. research and development and physical capital investments in the United States, and
- paid their U.S. workers more

than companies not engaged globally. Furthermore, U.S. investment abroad:

- ***Expands market access abroad for U.S. goods and services.*** Nearly 20 percent (or $203 billion) of all U.S. exports goes to the foreign subsidiaries of U.S. companies abroad. Moreover, U.S. parent companies and their foreign-affiliates account for 51 percent of total U.S. exports. Even more significant is the fact that these foreign affiliates in turn sell more than $4 trillion in goods and services. The vast majority of these sales – about 93 percent – are sales overseas, with less than seven percent of these foreign-affiliate sales returning to the United States.

[1] Data on U.S. investment overseas and its benefits come from the following sources: *Global Investments, American Returns (GIAR)* (1998 and 1999 Update), Matthew Slaughter, Published by Emergency Committee for American Trade; *U.S. Multinational Companies: Operations in* 2006, Raymond J. Mataloni, Jr., BEA (Nov. 2008); How *U.S. Multinational Companies Strengthen the U.S. Economy* (2009), Matthew Slaughter, Published by Business Roundtable and United States Council Foundation.

- ***Spurs the productivity and competitiveness of U.S. firms and their workers,*** with globally engaged U.S. firms accounting for nearly 25 percent of total U.S. output, 31 percent of all private-sector investment in the United States and nearly 76 percent of total research and development. Notably, U.S. companies' receipts from overseas operations now account for nearly half of worldwide net income.

- ***Expands opportunities for U.S. workers, with globally engaged companies paying higher compensation to their U.S. workers*** than companies that are not invested abroad. Increased exports and sales abroad strengthen U.S. companies, enabling them to better support employment domestically. On average, U.S. workers at globally engaged companies earn 24 percent more than U.S. workers at non-globally engaged companies. It is also important to note that foreign affiliates in high-income countries accounted for 79 percent of total affiliate output.

- ***Supports other important U.S. national objectives, including:***
  - Economic development and improved stability in developing countries;
  - Stable access to energy and other natural-resource supplies;
  - Continued U.S. leadership in creating new and advanced technologies;
  - Improved protections for intellectual property; and
  - Transparency and the rule of law.

It is also important to note that U.S. and other countries' foreign investments are also critical to help alleviate poverty and spur economic growth around the world. Global foreign direct investment flows remain the largest external source of financing for developing countries, equal to about one-third of their GDP and generating some 53 million jobs in their countries, according to UNCTAD. In its 2001 report on *FDI in Least Developed Countries at a Glance*, UNCTAD emphasized that increased foreign direct investment is of "particular importance" to achieving sustainable, poverty-reducing growth and development in the poorest countries.

Inbound Investment[2]

In 2008, the United States was the largest single-country recipient of foreign investment, with $325.2 billion in inflows, according to the Organization for International Investment. This foreign investment in the United States, supported by the United States' open investment policy, has many important benefits for America:

- Foreign-invested firms employed over 5.3 million U.S. workers, accounting for 4.6 percent of the U.S. workforce. Thirty percent of the U.S. jobs created by foreign-invested companies was in manufacturing.
- Foreign-invested firms generated 19 percent of all U.S. exports, totaling $195.3 billion.
- Foreign-invested firms bought $1.5 trillion in intermediate inputs from U.S. suppliers, amounting to 76.8 cents for every dollar spent of their total input purchases of $1.96 trillion.
- Foreign firms invested over $34 billion on U.S. research and development activities and $160.2 billion on plant construction and new equipment in the last year. Over 90 percent

[2]Data on inbound investment come from: *FDI and the U.S. Economy: Fact Sheet*, Invest in America, U.S. Department of Commerce; *Insourcing Statistics*, Organization for International Investment.

of U.S. assets owned by foreign-invested companies is owned by companies from OECD member countries.

<u>The Genesis of and Major Issues Considered in the Development of the 2004 Model BIT and the Importance of Key Protections in U.S. Trade and Investment Agreements</u>

Bilateral Investment Treaties (so-called BITs) and the investment chapters of U.S. trade agreements are vital to promoting and protecting U.S. investment overseas. A BIT is essentially an international agreement between two governments that sets forth binding rules on each government's treatment of investment from the other country. The rules are based in substantial part on core U.S. legal principles, such as non-discrimination, the Takings Clause requiring compensation for expropriations, the Equal Protection and Due Process Clauses and other protections against arbitrary and capricious government behavior.

<u>A Brief History of Bilateral Investment Treaties</u>

The United States and other major capital-exporting nations have long sought to promote inward and outbound investment to promote growth and new opportunities. Given concerns over the lack of rule of law in other countries, the United States has long promoted the use of international law to protect foreign investors and their property.

BITs were developed in the last half-century by the United States and other capital-exporting nations in order to clarify that international law protects foreign investment and investors against discriminatory, unfair, arbitrary and expropriatory government action. This was and remains vital since many foreign jurisdictions do not provide basic fairness protections for foreigners, let alone their own citizens. At the time, many developing countries and the Soviet Bloc took the opposite view – adopting the so-called Calvo Doctrine (associated with Carlos Calvo, a 19th Century Argentine diplomat and jurist) which essentially holds that "the responsibility of governments toward foreigners cannot be greater than that which these governments have toward their own citizens."[3] This doctrine was espoused in Latin America and the Soviet Bloc to exclude international legal protections being accorded to foreign investors and their property. The United States was the principal opponent, urging that governments must accord foreigners, including foreign investors, with certain basic rights under international law, whatever the level of domestic rights within a particular country. First, through Treaties of Friendship, Commerce and Navigation and ultimately with BITS starting in 1982, the United States was successful along with many other nations in ensuring that foreigners and foreign investors would have basic international protections in their activities abroad.

Now, there are over 2,300 BITs in the world, and the United States is party to approximately 40 of them. The United States has also concluded trade agreements with substantially similar investment provisions with 15 countries.[4] But for U.S. companies, the

[3] D. Shea, THE CALVO CLAUSE Vol. III quoting Calvo (1955), at p.19; see also O. Garibaldi, Carlos Calvo Redivivus: The Rediscovery of the Calvo Doctrine in the Era of Investment Treaties, TRANSNATIONAL DISPUTE SETTLEMENT, Vol. 3, Issue 5 (Dec. 2006).

[4] U.S. trade agreements in force with the following countries include comparable investment chapters: Canada, Chile, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Oman, Peru and Singapore. The pending trade agreements with Colombia, Panama and Korea also include comparable investment

network of protection is much smaller geographically than that of many of our competitors. Most major European countries have much broader networks of BITs. For example, Germany has 147 BITs, the Netherlands has 105 BITs, France has 103 BITs and the United Kingdom has 102 BITs. Germany and the Netherlands have each concluded a BIT with China in the past several years with fairly strong protections and dispute settlement provisions. The United Kingdom and several other major European countries also have longstanding BITs with India and other major developing countries. The relatively small footprint of U.S. BITs and trade-agreement partners puts U.S. companies at a significant competitive disadvantage in numerous markets overseas.

At the same time, in Latin America, Venezuela, Ecuador and Bolivia are renouncing their treaty commitments to resolve disputes under international rules, seeking instead to ignore commitments and subject investors to local courts using local laws. To ensure the protection of U.S. investors and the benefits that accrue to the United States from high standards of protection, U.S. leadership is essential to promote a stronger international-investment climate for U.S. companies. It is crucially needed now. Weakening our BIT standards, turning away from a strong investment-protection agenda or embracing a Calvo-like approach, as some now suggest in the United States, will further embolden those who would seek to abandon and renege on their agreements to the detriment of the United States.

Basic Provisions of BITs and the Investment Chapters of U.S. Trade Agreements

U.S. BITs and the comparable investment chapters of U.S. trade agreements contain three basic parts: (1) market-access provisions to allow investment in each other's territory; (2) core investment protections; and (3) two forms of binding dispute settlement before independent arbitration panels – investor-to-state and state-to-state arbitration.

BITs require each government to:

- *Not discriminate* against U.S. investors in favor of domestic investors or other foreign investors (so-called national treatment or most-favored-nation treatment), with limited, explicit exceptions taken.
- *Treat U.S. investors in accordance with international law*, including providing U.S. investors with fair and equitable treatment and full protection and security.
- *Provide prompt, adequate and effective compensation in the event of a direct or indirect expropriation.*
- *Allow investors to move their own capital into and out of the country.*
- *Not impose performance requirements*, such as requirements that investors source inputs locally or export finished products.
- *Allow for neutral and fair arbitration* with the investor or the investor's government to resolve disputes about breaches of the BIT or an investment agreement between the investor and the host government.

BITs and U.S. trade agreements also explicitly provide an exception in the case of action by a government necessary for "the protection of its own essential security."

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chapters. The investment chapter of the U.S.-Australia Free Trade Agreement lacks investor-state dispute settlement and therefore does not afford the same level of protection as U.S. BITs or other U.S. trade agreements.

Benefits of BITs and Investment Chapters of U.S. Trade Agreements

BITs are vital to improve U.S. competitiveness in the international economy for its farmers, manufacturers, service providers and their workers through more secure foreign investments. Among the benefits that BITs provide the United States are the following:

- BITs enable manufacturers and agricultural producers to establish a local presence to market, service, adapt and distribute their products. Notably, nearly 20 percent of all U.S. exports go to U.S. foreign subsidiaries worldwide, and U.S. parent companies and their foreign-affiliates account for 51 percent of total U.S. exports.
- BITs enable U.S. service providers to establish a physical presence in markets where they operate. Our highly productive service sector – from information and telecommunications services to audio-visual, distribution and financial services – needs investments in foreign countries to compete effectively with rivals from other parts of the world and to provide services directly to foreign consumers through branch and affiliate offices.
- BITs enable U.S. retailers to open new stores in different markets, which provides enormous opportunities for many U.S. manufacturers not only to export products to sell in these overseas stores, but also provide many of the materials used to build and operate the store, from shelving and air-conditioning units to shopping carts.
- BITs enable U.S. firms to set up networks to research and develop products that meet local tastes and increase sales.
- BITs ensure that U.S. firms are protected against discrimination and arbitrary and capricious government actions. With the protections included in the U.S.-Rwanda BIT for financial services, ECAT is pleased to see that these protections are afforded to all U.S. industries.
- BITs ensure that U.S. firms are provided with an objective and fair forum to address unfair government actions.
- BITs can better ensure the security and long-term viability of U.S. foreign investments, particularly those that are critical not only for U.S. companies, but also for broader national U.S. interests, such as developing stable sources of energy supplies, accessing scarce resources and continuing the United States' leadership in creating new and advanced technologies.
- BITs foster the rule of law and greater stability. Indeed, the existence of strong and clear BIT obligations, coupled with dispute settlement, promotes resolution of conflicts between investors and host governments.

BITs and trade and investment agreements also provide substantial benefits to the country receiving foreign investment. BITs help establish a stronger and more transparent investment climate, promote the rule of law and serve to attract the long-term investment that is essential for economic growth and poverty reduction.

2004 Model BIT

Following enactment of the Trade Act of 2002, which included fulsome investment negotiating objectives,[5] the Administration engaged in an extensive inter-agency review of the

[5] The investment negotiating objectives contained in the Trade Act of 2002 stated:

(3) FOREIGN INVESTMENT- Recognizing that United States law on the whole provides a high level of protection for investment, consistent with or greater than the level required by international law, the

U.S. negotiating position on investment, seeking advice from business and other non-governmental organizations. Many of the issues on which this hearing is focused were also raised and considered during that period. In November 2004, the Administration finalized the 2004 Model BIT. In December 2004, the United States signed a BIT with Uruguay based on that model, the first U.S. BIT negotiated since the early 1990s.

The resulting 2004 Model BIT represented a substantial modification to the earlier Model BIT of 1996. Not only did its length grow from 14 to 40 pages, the 2004 Model BIT narrowed the scope of key protections for U.S. investors overseas in an attempt to address some of the theoretical defensive concerns raised following a few cases brought against the United States or its NAFTA partners, discussed below. Procedurally, the 2004 Model BIT also increased the transparency of dispute settlement proceedings and modified procedures for investor-state dispute settlement. Major changes in the 2004 Model BIT included:

- Incorporating the test from the landmark Supreme Court case *Penn Central Transp. v. New York City*[6] on what constitutes an indirect expropriation.
- Defining expropriation in terms of "property rights or property interests" based on the U.S. Constitution's Takings Clause.
- Defining "fair and equitable treatment" in terms of due process rights.

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principal negotiating objectives of the United States regarding foreign investment are to reduce or eliminate artificial or trade-distorting barriers to foreign investment, while 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, and to secure for investors important rights comparable to those that would be available under United States legal principles and practice, by--
(A) reducing or eliminating exceptions to the principle of national treatment;
(B) freeing the transfer of funds relating to investments;
(C) reducing or eliminating performance requirements, forced technology transfers, and other unreasonable barriers to the establishment and operation of investments;
(D) seeking to establish standards for expropriation and compensation for expropriation, consistent with United States legal principles and practice;
(E) seeking to establish standards for fair and equitable treatment consistent with United States legal principles and practice, including the principle of due process;
(F) providing meaningful procedures for resolving investment disputes;
(G) seeking to improve mechanisms used to resolve disputes between an investor and a government through--
(i) mechanisms to eliminate frivolous claims and to deter the filing of frivolous claims;
(ii) procedures to ensure the efficient selection of arbitrators and the expeditious disposition of claims;
(iii) procedures to enhance opportunities for public input into the formulation of government positions; and
(iv) providing for an appellate body or similar mechanism to provide coherence to the interpretations of investment provisions in trade agreements; and
(H) ensuring the fullest measure of transparency in the dispute settlement mechanism, to the extent consistent with the need to protect information that is classified or business confidential, by--
(i) ensuring that all requests for dispute settlement are promptly made public;
(ii) ensuring that--
(I) all proceedings, submissions, findings, and decisions are promptly made public; and
(II) all hearings are open to the public; and
(iii) establishing a mechanism for acceptance of amicus curiae submissions from businesses, unions, and nongovernmental organizations.

Trade Act of 2002, Title XXI, Section 2102(c), Pub. L. 107-210 (2002).

[6] 438 U.S. 104 (1978).

- Clarifying that non-discriminatory, regulatory government actions designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, only rarely result in indirect expropriations.
- Defining expropriation and fair and equitable protections as reflecting customary international law, defined as the "general and consistent practice of States," which includes the United States.
- Creating a motion-to-dismiss process based on Federal Rules of Civil Procedure 12(b)(6) on frivolous claims.
- Including provisions to increase transparency and to permit the filing of amicus briefs.

In 2007, the U.S. agreements with Peru, Colombia, Panama and Korea, which included the 2004 Model BIT language, were further modified as a result of the May 10, 2007, Congressional-Administration trade deal to clarify that when, as in the United States, protections of investor rights under domestic law equal or exceed the investment protections in the agreement, foreign investors are not accorded greater substantive rights with respect to investment protections than domestic investors under domestic law.

ECAT was very disappointed by several of the changes made in the 2004 Model BIT that served to narrow the protections afforded to U.S. companies overseas. Notably, those changes were driven by theoretical defensive concerns – concerns that never came to pass in any litigation involving the United States or its NAFTA partners.

For example, several very significant changes were made to the expropriation standard. Most significantly, the 2004 Model BIT defines expropriation in terms of "a tangible or intangible property right or property interest in an investment," rather than in terms of investment (as did former U.S. BITs and the investment chapter of the NAFTA). Given that other countries have much more restrictive definitions of property than the United States, inclusion of this language may deny full protection for U.S. investors overseas as a result of this limit, while foreign investors in the United States will continue to have very broad protection afforded by the United States' own broader jurisprudence as to what constitutes property. ECAT is also concerned by other restrictions on expropriation in the 2004 Model BIT, as well as the language on fair and equitable treatment that focuses on procedural due process rights, rather than both the procedural and substantive due process rights that are a cornerstone of U.S. legal jurisprudence. In addition, while ECAT recognizes the value of increased transparency, it is important to ensure that cases are not tried in the proverbial "court of public opinion" rather than before a neutral and objective arbitration tribunal. ECAT is also watching closely the changes to the essential-security provision incorporated into the 2004 Model BIT, given that other countries increasingly are improperly invoking essential-security rationales for economic, not security, reasons in ways that harm U.S. investors and their operations here at home. The May 10th Congressional-Administration trade deal also moved the United States towards a Calvo-like negotiating position, rather than emphasizing the long tradition of U.S. support for strong international legal protections for its investors overseas.

<u>Current Model BIT Review</u>

The Administration has indicated that it will be reviewing the Model BIT text. While we understand the desire of any new Administration to review current negotiating texts, two facts are particularly noteworthy regarding the 2004 Model BIT:

- First, as Finance Committee Chairman Max Baucus recently stated in his questions during the nomination hearing of Mayor Kirk, now United States Trade Representative, the "current model BIT represents a carefully calibrated compromise between many competing viewpoints."[7]

- Second, it is noteworthy that no case has been filed or completed under these revised provisions, such that the changes made to the 2004 Model BIT as a result of the variety of essentially theoretical concerns raised over the past decade have not been tested.

As the Administration undertakes this review, therefore, ECAT strongly urges that changes to the 2004 Model BIT be considered carefully and promote stronger, not weaker, protections for U.S. investors overseas.

Addressing Concerns about BITs and Investment Provisions Going Forward

I would now like to review some of the chief concerns laid out in the hearing notice about the operation of our BITs and trade agreements.

No Greater Rights

As noted in the hearing notice, some remain concerned that "our FTAs and BITs give foreign investors in the United States greater rights than U.S. investors have under U.S. law." While the rhetoric may sound appealing, an approach to incorporate further the "no greater rights" language would reverse several decades of U.S. support for strong and binding international rules that largely benefit the United States and its investors. This return to Calvo is not necessary and would be very harmful.

The United States already provides strong protections both to its own citizens and foreign investors, who have full rights to use our courts and seek the protection of our Constitution and other governing laws. The Takings, Due Process and Equal Protection clauses of the Fifth and Fourteenth Amendments of the Constitution, the Administrative Procedures Act (APA) and other U.S. laws have established strong protections for U.S. property rights in the United States that protect U.S. citizens and foreign investors alike. This fact was recognized by the Report of the Senate Committee on Finance on the investment-negotiating objectives contained in the Trade Act of 2002, which noted that "protections of investor rights under U.S. law generally equal or exceed international law standards (including the non-discrimination and investment protection obligations described above)."[8] The Committee continued by indicating that:

> [W]hen the United States agrees to afford foreign investors the protections required by international law, it is not making a commitment that will result in foreign investors having substantially different rights in the United States than those accorded U.S. investors under U.S. law.[9]

[7] Finance Questions for the Record, Confirmation of Major Ron Kirk to be United States Trade Representative, March 9, 2009 at 8.

[8] Report 107-139 of the Senate Committee on Finance, Bipartisan Trade Promotion Authority Act of 2002 (H.R. 3005) at 13.

[9] Id. at 13.

I would also note that the Constitutional standards of expropriation and due process and the APA's arbitrary and capricious standard require highly complex, oftentimes fact-driven analyses. For example, there are few bright lines in the area of indirect or so-called regulatory Takings jurisprudence, but for the test laid out in the leading Supreme Court case of *Penn Central Transp. v. New York City* which was, as noted above, incorporated directly into the 2004 Model BIT. Indeed, as Justice O'Conner stated in her concurring opinion in the case of *Palazzolo v. Rhode Island*:

> [W]e have eschewed "any 'set formula' for determining when 'justice and fairness' require that economic injuries caused by public action be compensated by the government rather than remain disproportionately concentrated on a few persons." . . . The outcome instead "depends largely 'upon the particular circumstances [in that] case.'"[10] (citations omitted).

Given the case-by-case nature of these areas, and the fact that different U.S. courts emphasize different issues depending on the decision, the Finance Committee noted in its report that "there is unlikely ever to be a perfect overlap [between U.S. and international law], and U.S. courts differ on these issues."[11]

Seeking further one-to-one correspondence between U.S. and treaty standards beyond that already accomplished in the 2004 Model BIT would be extremely difficult and provide few, if any, benefits for the United States. But the risks that we would create for our U.S. investors overseas by pursuing a "no greater rights" approach would be extensive. In particular, pursuing a Calvo-like approach of no greater rights will only result in other countries applying the same rule, meaning U.S. investors will be relegated to local law and local courts of questionable integrity and standard contrary to the purpose of the BITs in the first place.

<u>BITs and the Regulation of the Environment and the Public Interest</u>

The hearing notice also noted concerns about "whether the FTAs and BITs give governments the 'regulatory and policy space' needed to protect the environment and the public welfare." In my view, BITs and trade agreements strongly provide the same essential flexibility that is built into U.S. law.

At the outset, I note that it should not be the United States' objective to seek "policy space." Indeed, that is the term used most often by those in the developing world when they seek to avoid opening their markets to U.S. goods and services or when they want to renege on a previously made commitment.

Legitimate environmental, health, safety, consumer and employment opportunity laws are not undermined by the investment protections in U.S. BITs and trade agreements. Investment rules simply do <u>not</u> prohibit bona fide, nondiscriminatory application of legitimate regulation. At the same time, it is important that our BITs and trade agreements <u>not</u> provide an overarching exception for such types of regulation, be it for the environment or the public interest. In a like manner, the United States does not maintain exceptions for its own Environmental Protection Agency or Food and Drug Administration regulations from the basic protections of the

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[10] 533 U.S. 606 (2001).

[11] Senate Finance Committee Report 107-139, at 15.

Administrative Procedure Act against arbitrary and capricious actions. Nor are there explicit exceptions in the Takings or Equal Protection Clauses or the Fifth and Fourteenth Amendments of the U.S. Constitution, or other core legal protections. Establishing special exceptions for certain laws or actions from basic investment protections is unnecessary and will likely lead to mischief, as some foreign governments will take advantage of this "safe harbor" to shield unfair, arbitrary and discriminatory actions.

While I support progress on environmental and broader public-welfare goals, creating blanket exceptions is simply not the right approach. Indeed, it will more likely undermine some of our country's important policy goals, including promoting new and innovative technology and supporting high-paying jobs here in the United States. If, as some have proposed, an exception from the expropriation and/or fair and equitable protection is included for governmental action to protect the environment or public welfare, then foreign governments could expropriate U.S. environmental technologies and associated intellectual property to the detriment of U.S. companies and their U.S. workers. The green jobs that we have and hope to create more of here in the United States – from wind turbines manufactured in Florida and more efficient gas turbines produced in Ohio to solar panels manufactured from Florida to California – will be at risk if such exceptions are included.

Investor-State Arbitration

The hearing notice also noted concerns about the ability of investors to take host governments to arbitration under the investor-state provisions. These provisions are at the core of BITs and the investment chapters of our trade agreements. Unfortunately, there seems to be much misinformation about these provisions.

Contrary to some critiques, these provisions do not provide an unprecedented right to challenge governments. To the contrary, foreign investors in the United States already have the right to challenge U.S. laws that potentially affect their investments in U.S. courts under U.S. law everyday. Indeed, hundreds of cases are filed each year against alleged U.S. government expropriations under the Takings Clause alone in U.S. federal court. Many do not go far, but they do serve the vital purpose of ensuring that government action does not unfairly or improperly harm individuals in the United States.

The investor-state arbitration model, which has existed for over 25 years, is equally necessary to ensure that U.S. investors abroad, who oftentimes do not have access to developed and independent court systems, can seek protection for their investments.

Nor have these provisions resulted in massive litigation. Indeed, actual litigation under BITs and trade agreements is fairly limited. Consider the NAFTA. Despite the over $1.7 trillion-a-day investment relationship between our three countries, there have been less than 50 cases filed against all three NAFTA countries in over 10 years. (Under no other agreement has the United States been challenged in investor-state arbitration.) That is far fewer than the approximately 200 expropriation-only cases filed each year in federal court alone. And that is only regarding expropriation, not the other core parts of the investment protections, such as those found under the Administrative Procedures Act or the Due Process Clause. Indeed, for many companies, the existence of the BIT itself – with clear protections, market-access provisions and dispute settlement options – is vital to spurring the resolution of conflicts without litigation.

And where there are countries whose own legal systems are underdeveloped, corrupt or crumbling, BITs and our trade agreements oftentimes become the only option for U.S. companies to ensure fair and non-discriminatory treatment, which is vital in order to continue to realize the strong benefits for U.S. economic growth, U.S. workers and U.S. companies from the overseas activities of U.S. companies. Indeed, it is oftentimes officials in such countries who seek to renege on the obligations made through BITs and other instruments, and where the binding nature of these obligations is absolutely essential.

Nor can arbitration panels overturn U.S. law. To the contrary, arbitration panels have far less power than U.S. courts since they cannot overturn any country's laws. Rather, they can only order compensation for wrongful acts or expropriation.

It is also important to note that arbitrators in investor-state panels are highly experienced individuals from academia, the judiciary and other parts of government and the legal community. Arbitrators have included former Congressman and Federal Circuit Judge Abner Mikva, former Secretary of State Warren Christopher and former International Court Chief Justice Stephen Schwebel. Each Party to the dispute selects one arbitrator and the third arbitrator is chosen by agreement of the Parties.

The NAFTA Record

At the heart of many critiques are concerns about a few cases filed pursuant to the provisions of NAFTA Chapter 11. But these critiques remain theoretical, as none of the NAFTA cases has produced the type of substantive outcome that NAFTA's critics have feared. Four cases in which investors have challenged U.S. actions have been decided, with the panels rejecting the investors' claims as summarized below:

- **Methanex v. United States.** Canadian-based Methanex challenged California's ban of the gasoline additive methyl-butyl ether (MTBE) as expropriatory, discriminatory and violating the minimum standard of treatment under Chapter 11. Contrary to claims that this case represents how the NAFTA rules provide foreign investors with greater rights than U.S. investors, these claims could largely have been brought in U.S. court. On August 9, 2005, a NAFTA panel dismissed all of the claims finding that there was no evidence that the ban was designed for protectionist – rather than public health – purposes. The panel awarded the United States legal fees of approximately $4 million.

- **ADF Group Inc. v. United States.** A Canadian corporation challenged U.S. law that requires the purchase of domestically produced steel for certain highway projects. In January 2003, the arbitration panel rejected ADF's claim in its entirety as not violating NAFTA's provisions.

- **Mondev International v. United States**. A Canadian corporation challenged the judgments by a court that provided immunity to a U.S. regulatory entity. In October 2002, the arbitration panel rejected Mondev's claim in its entirety.

- **Loewen v. United States.** The formerly Canadian-based funeral-home company Loewen was challenged in Mississippi court by a U.S. funeral home over transactions involving less than $5 million. A jury awarded the U.S. funeral home $500 million in punitive damages. This award was the largest in Mississippi's history and equaled 78 percent of Loewen's net worth. (According to Loewen's pleadings, the $500 million punitive award was 50 times greater than the largest punitive award ever considered by the Mississippi Supreme Court and 200 times greater than the largest award ever upheld by that Court.) The Governor of Mississippi called the trial "shocking," "tainted by zenophobic rhetoric" and "a denial of justice." Under Mississippi law, Loewen could only appeal this decision if it posted bond equal to 125 percent of the verdict (or $625 million). While Mississippi law permits a court to reduce or eliminate the bond requirement for "good cause," Loewen's petition for reduction/elimination was rejected. As a result of the onerous and bankrupting bond requirements, which the Mississippi courts failed to reduce, Loewen was effectively prevented from appealing its case in the Mississippi court system. Without an effective ability to appeal, Loewen settled the case for $175 million and brought a claim under NAFTA Chapter 11. In 2003, this claim was rejected by the investor-state panel reviewing it.

Other cases against Canada and Mexico have been wrongly criticized as overturning environmental and other safety laws. In fact, arbitration panels can only award damages and cannot change law. Furthermore, the cases that have been most heavily criticized are ones where the foreign courts found that the foreign governments had acted unfairly or for protectionist purposes:

- **Ethyl v. Canada.** The U.S.-based Ethyl Corporation challenged Canada's legislation banning the importation of a fuel additive, MMT (methylcyclopentadienyl manganese tricarbonyl). The NAFTA panel never issued a decision in this case. Rather, the Government of Canada settled it after it lost a similar case in its own court system brought by Canadian provinces. The court found that Canada's importation ban (while still allowing domestic production) was not justified as an environmental provision, but was discriminatory.

- **S.D. Myers v. Canada.** A U.S. company challenged Canada's ban of PCB waste exports to its U.S. EPA-approved waste-treatment company since exports were already permitted under a U.S.-Canadian transboundary agreement. The NAFTA panel found that Canada's ban was discriminatory and violated the national treatment obligation. Notably, according to statements by Canada's environmental minister, the purpose of the ban was to ensure that "the handling of PCBs should be done in Canada by Canadians."

- **Metalclad v. Mexico.** After U.S.-based Metalclad had obtained all necessary federal permits for the construction of a waste-disposal facility and several environmental studies demonstrated that the facility would reduce waste in the region and not harm the environment, the local jurisdiction denied Metalclad a municipal-construction permit. The governor then issued an Ecological Decree for the protection of cacti in the region that barred operation of the facility. A NAFTA panel and then a Canadian court in British Colombia held that the local-government action constituted an expropriation of Metalclad's investment and ordered the payment of compensation.

Conclusion

ECAT strongly supports efforts to liberalize investment overseas and ensure strong protections for U.S. industries and their workers through high-standard Bilateral Investment Treaties (BITs) that promote economic growth and core American values. Indeed, I believe that our new United States Trade Representative, Ambassador Ron Kirk, said it very well in his response to questions during his Senate confirmation hearing:

> Protection against denials of due process, discriminatory treatment of foreign investors, and expropriatory government action is essential to allow U.S. investors to compete on a level playing field in foreign markets and to ensure that they are treated according to the rule of law. U.S. investors have invested billions of dollars overseas. This is good for U.S. firms, for U.S. workers, and the U.S. economy, but the system only works if investors have these protections. That is why we will work hard to achieve strong protections for our investors overseas.[12]

U.S. leadership is essential to promote a stronger international investment climate that will benefit the U.S. economy, U.S. industry and U.S. workers.

As the Administration undertakes its review of the 2004 Model BIT, ECAT urges that any changes to the Model BIT improve disciplines to protect U.S. investment abroad for the benefit of the U.S. economy, U.S. companies and U.S. workers. ECAT also urges the rejection of proposals that would create unnecessary and harmful exceptions to the strong investor protections found in U.S. BITs or otherwise weaken investment protections.

Thank you again Mr. Chairman, Congressman Brady, Members of the Subcommittee. I appreciate this opportunity to express the views of ECAT on how the United States can best move forward on international investment in a manner that continues to expand the benefits for our economy, our industries, our workers and our broader national interest. I welcome your questions.

[12] Finance Questions for the Record, Confirmation of Major Ron Kirk to be United States Trade Representative, March 9, 2009 at 94.

Chairman LEVIN. All right, thank you very, very much. Unfortunately, as you know, everything is unplanned around here, at most. We have five votes. And one of them is going to be a longer vote.

So, be patient with us. I think we may take the materials that we have and read them while we have votes, so we will come back with even sharper questions.

So, thank you. Your testimony has been really excellent. We will be back. It will be a half-an-hour, I think, anyway. Maybe longer.

[Recess.]

Chairman LEVIN. Let us reassemble. I will not apologize, because I do not want to apologize for congressional procedures. But as soon as Mr. Brady arrives—several of my colleagues told me that they were rearranging their schedules. This was not expected, these five votes.

So, we will just wait for Mr. Brady. And others will filter in again. We very much appreciate your patience.

[Recess.]

Chairman LEVIN. Okay. So, we will start and others will join us. As we ask questions, let me urge that, to the extent we can, that we focus less on direct foreign investment, the need for it, because it is here to stay, in some degree—in major degree—and more on the structure of investment and how we handle the issues that arise from it.

And the number of issues—and, by the way, as we know, the rules have changed in the last years. It isn't as if we are dealing today with the precise language of a number of years ago. And so, I think if we can focus in on the structural issues, the important ones, it will be helpful. And a number of those issues have been raised. And let me just kind of quickly touch on them. And then maybe some of you pick them out and comment.

Issues have been raised about the transparency of these tribunals. Issues have been raised about one-size-fits-all. And I think, more and more, we have understood that one size doesn't fit all. And issues have been raised, you know, why Australia and not Korea, in terms of exclusion of that provision.

Also, an issue has been raised about subsidiaries. As we have more and more a globalized economy, there are going to be more and more subsidiaries of American-based companies. And what should be done about that?

And also, as we discuss this, let me just remind us that, as I said, there have been changes. And in recent agreements, there has been—this is a total surprise. All right, let us go on for—what is happening is we now have a controversial issue on the floor. Enough said.

You know, in recent documents, there has been included the provision, "Except in rare circumstances, non-discriminatory regulatory actions by a party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect appropriations." That is relatively new language.

Plus, the language that some of you have referred to, "Foreign investors are not hereby accorded greater substantive rights," and I won't read the rest of it, because I think you know.

So, pick out any of those issues. You have varying points of view. Take your pick, and help inform us. Shall we go down the row? Ms. Lee, do you want to pick out any one of the five that have varying positions to them? Yes?

Ms. LEE. Sure. And let me say that I think there has been movement in the right direction: in the 2002 Trade Act; and in the 2007 agreement that was reached around the trade agreements, we are moving in the right direction.

Let me just say one thing briefly, then let my colleagues come in, on the preambular language in the May 2007 deal that is in the Peru and other pending trade agreements that asserts that there shall be no greater substantive rights for foreign investors.

My question is whether that is sufficient, to state in the preamble that there are no greater substantive rights when you have the language, which is very different. Both the procedures and the substance of the investment rights remain different from what is available to domestic investors.

Just on the face of it, having the ability to use investor-state dispute resolution is a greater right than what a domestic investor would have. And so, on the face of it, unless we pull that back pretty substantially, that is a greater right, and it's in conflict with the preambular language.

I am not a legal scholar, but I have been trying to read up on all these issues, in terms of the definition of minimum standard of treatment and indirect expropriation. It seems to me that the investment language in international agreements still does not comport exactly with the takings language in U.S. law, and that you have a decision that is made by a different group. The final decision is not looked at by U.S. courts, it is looked at by these international arbitral groups that do not have the same familiarity with U.S. law, or the same history, and so on.

And so, on the face of it, I still think we are at a place where we continue to have both substantive and procedural issues that afford greater rights, whether we state that they shouldn't or not. And that is what I hope we can look at, going forward.

Chairman LEVIN. Ambassador, why don't you take a pick, any of those issues or any other issue?

Mr. LARSON. Could I say one sentence about two or three of them?

Chairman LEVIN. Sure.

Mr. LARSON. Okay. On transparency, as the chairman of the U.S. chapter of Transparency International, I think it is very important, and I appreciate the fact that there are two extensive clauses in here about transparency. I hope we can see whether those are adequate.

On annex B, I know from the research that Thea Lee and I will hear from people who think it doesn't go far enough and people who think that it has gone too far. And so that is going to be an interesting part of the work of the panel that she and I will be working on together.

The last comment I would offer is, Mr. Chairman, on your last point about no greater substantive rights. I mean, I think the challenge for U.S. negotiators is that in many—for U.S. foreign investors in other jurisdictions, we want to obtain greater substantive rights for our investors than domestic investors may have in those countries. That is sort of the value of the BIT.

We understand, as negotiators, that we would generally want to offer as little as possible, in terms of, you know, the substantive benefits that foreign investors might get under a BIT here. But there is clearly a tradeoff between what we want for our investors in some of the jurisdictions, and what we want to give up, in terms of rights for foreign investors in our country.

Chairman LEVIN. Let me just have a quick conference. So, we have one vote. Why don't we do this? Mr. Brady, why don't you take over, and I will go—if you don't mind—and I will have the staff take down your question and the answers. And you kind of take over for 5 minutes. I will come back, and why don't you now go and vote, and then you will be next when you come back. Okay? So, if you—is that okay with you?

Mr. BRADY. No, that is great.

Chairman LEVIN. Okay. And our staff will take down your question, and also the answer.

Mr. BRADY. Can I pass some legislation while you are away?

[Laughter.]

Chairman LEVIN. I think someone would call for a quorum, I think.

Mr. BRADY. Thanks Chairman, very much. Thank you. And, again, I think this panel—I will be quick. Thanks, Chairman.

I wanted to visit a little about, one, I think the panel's points have been really well made. I want to focus a little on the benefits and the improvements that have been made in these provisions over the years.

And if we could, look at the slide panel up there, sort of focusing first on what Ms. Menghetti had to say about the importance of us selling American products and services throughout the world. Ninety-five percent of the consumers live outside the United States. Selling—those sales are a huge part of our economy.

This investment provision, in various forms, has been put in place now for more than a quarter of a century. The purpose is to protect our investments overseas. Some of our companies can export from here. But if we want a Hewlett Packard to compete with computers around the world—Procter and Gamble with home products, Coca Cola with their beverages—they often times have to compete in that region to either produce or service or maintain their market share.

And the investment option has been a protection we have insisted upon to make sure that in countries that we are in, where their judicial system perhaps isn't as mature as ours, their investment property protections aren't as strong as the United States'. We've wanted to make sure our investors have the option to pull out and go to that dispute resolution process, that arbitration process. Again, a panel that both parties agree upon, a panel that creates consistent—a legal framework to resolve these issues.

What we find is that the U.S. has used this successfully throughout the years to resolve disputes. California-based Metalclad successfully used NAFTA to challenge issues in Mexico. S.D. Meyers, from Ohio, the same with Canada. We have had U.S. companies challenge bilateral investment trade issues in Poland to our benefit, Motorola in Turkey, Occidental in Ecuador, CMS and Sempra in Argentina, all again using this provision to protect U.S. investors.

But if you look at the number of foreign investors who have used this process to successfully challenge the U.S., you will see a blank piece of paper, because it hasn't been done. They have brought no lawsuits under bilateral investment treaties, none under our bilateral FTAs, and 15 to 17 under the NAFTA provision.

One of the reasons is because, for a foreign investor, the use of going to the arbitration is somewhat redundant, in that they have very strong protections already in the U.S. law and Constitution. And when they do challenge it, what they find is, again, the U.S. provisions from takings to due process and transparency issues all incorporated in that dispute resolution process, all of which has helped us.

So, Ms. Menghetti, do you—the belief that this works against U.S. interests, do you find that to be a credible argument?

Ms. MENGHETTI. Congressman Brady, I do not find that to be a credible argument.

In the NAFTA cases that have gone forward—and there haven't been that many of them, as I said, compared to what happens every year in a very small area of U.S. jurisprudence—but in all the NAFTA cases, you know, folks might be able to say, "I don't like this one statement that the panel said here," or, "This one statement that they said there." But in all the cases that were decided for investors, if a U.S. court were considering that case, the investor too would have won, and that is because the principles in these treaties are very close to—and, frankly, based on—the principles we have in our own jurisprudence.

In 2004, the model BIT was revised substantially, and in some ways made things worse, I would argue, for U.S. investors overseas. And we incorporated—and I can't think of any other international agreement that does this—we incorporated directly language from the leading Supreme Court case on indirect expropriation into the text of our expropriation annex.

Mr. BRADY. Yes.

Ms. MENGHETTI. The problem, I think, for U.S. investors is really we don't have enough of these instruments. There are over 2,000 bilateral investment treaties worldwide. The United States is party to about 40 of them, and about 15 more with countries through our FTAs.

There are treaties with China between Germany and the Netherlands that have investor-state and strong protections against expropriation. Our companies don't have that. Many OECD countries have investment treaties with Korea that have investor-state. If, as was proposed, we took out investor-state from our FTA with Korea, our investors, our businesses, our economy, and our workers would be the worse off.

Mr. BRADY. So it is a competitiveness issue, as well?

Ms. MENGHETTI. Absolutely, it is a competitiveness issue.

Mr. BRADY. And that, you know, there has been a concern raised over the years that this provision could be used to challenge, you know, state and local environmental regulations. But you know, improvements in this—one, that hasn't happened.

Ms. MENGHETTI. That has not happened.

Mr. BRADY. Successfully. But, two, I get the impression that improvements made in 2002 in the Trade Act, and then again in the May 10th provisions are now parts of our Peru, Panama, Colombia, and South Korea free trade agreements.

Mr. Posner, you talked about how those improvements have taken what is, at its basics, a way to export our Constitutional protections, and improve even greater upon it over the years. Can you expound?

You are always looking for ways to improve provisions in trade agreements. Have we seen improvements, and have they been good for us?

Mr. POSNER. Well, I think we have seen improvement, to the extent that you had a debate on the appropriate balance between protecting the interests of U.S. investors seeking to do business overseas, and the so-called defensive interests, taking account of the risk that the United States might be sued with respect to a regulatory action.

So, I see where we are today as an improvement over, say, where we were in 1982, in the sense that we have now had that debate and achieved that balance.

In terms of how would any of the improvements that we have made be interpreted by a panel, what would happen if you had a case that raised, say, an indirect expropriation and the panel had to interpret the annex that a number of people have referred to, how would it do it? What would the conclusion be? It is hard to say, because we haven't had that case yet.

So, all we can do at this point is make best guesses, based on what I think was our good lawyering, frankly, and our best efforts to accurately reflect the balance that was articulated in the 2002 Act. And I think we have done that. So, in that sense, in coming from where we were in 1982, when this program really got going, to where we are today, yes, I think we have improved because we are more balanced.

Mr. BRADY. Thank you, Mr. Posner. Ambassador, there is a concern that foreign investors could use this provision to challenge our state and local environmental laws. Yet we have seen states like California—very aggressive on environmental issues, whether it is clean air, toxic pits clean-up, Water Quality Control Act, health and safety code laws, just in the last—well, just in the last number of years, again, aggressive in environmental actions—unchallenged by foreign investors, probably more heavily challenged by U.S. domestic companies that have a different view of it.

Do you see the improvements that have been made over the years as eliminating or restricting greatly the possibility that that could occur successfully?

Mr. LARSON. Mr. Brady, I was in government at the time that the 2002 Trade Act was enacted. And the 2004 changes in the model BIT were made, and so obviously I was a part of that. And I agreed that they represented a good balance.

I have been out of government since then. And I know, from the preparation that I have done, along with my colleague, Thea Lee, that there have—continue to be concerns expressed about this issue. There have been concerns expressed on both sides of it, frankly.

And so, I am certain that this will be a part of the deliberative process that we will be co-chairing. I am going to be very interested in hearing the respective views that get expressed. I am going to not express a view of my own, since I will be co-chairing the process——

Mr. BRADY. Yes.

Mr. LARSON [continuing]. Except to say that, you know, it is public record that I was a part of the process that brought us to where we ended up in 2004.

Mr. BRADY. Thank you, Ambassador. And, Chairman, I will run and vote.

Chairman LEVIN. Okay.

Mr. BRADY. Thank you.

Chairman LEVIN. Thank you very much. Mr. Doggett is recognized.

Mr. DOGGETT. Thank you, Mr. Chairman. I have been raising concerns about investment provisions in our foreign trade agreements. I believe, first, in this Committee in 2001. Modest improvements have been made, but I think your decision to conduct this hearing is constructive, and each of the witnesses has offered constructive testimony looking at this.

I can say, first, what I agree with. I agree with Mr. Brady fully in his opening statement that our goal is to help bring other countries up to American standards. Our goal, however, should not be to give foreigners more rights than Americans have. And simply putting it in the preamble, as Ms. Lee noted, is constructive, and a big change, but it may not be sufficient, by itself.

I think that there are several issues the witnesses have touched on that I will, as time permits, explore. One is the decision of when it is that we decide we need to use these investor panels to protect investment interest. As you noted in your comments, Mr. Chairman, the question of whether we will have foreign investment here or American investment abroad, that is not at issue. I support that concept fully. It is a question of how that investment impacts the ability of states and localities and the Federal Government to provide meaningful protection to the environment, to health and safety.

So, the first question that has to be asked, I think—and I don't believe that USTR has had any real set of guidelines about how to do this—is whether you need any investment agreement or not, or whether, as we determined with Australia, that their courts are adequate to handle this.

There is, for an example, the decision to include investor panels for Korea. There is a body of case law in this country on forum non conveniens that Korea provides, through its judicial system, an adequate forum. And, therefore, cases have been dismissed that would be brought here, because it's maintained that Korea, through its court system, provides an adequate system.

Now, if I were a trade lawyer, and I had the choice of going to a Korean court or going to a panel of other trade lawyers who that day, instead of being advocates, were arbitrators, I think I would clearly prefer the arbitrator panel. But that doesn't mean that's what is in the best interest of the American public.

And so, looking at the way USTR determines whether to have an investment agreement, and whether we have adequate and clear standards as to whether they make that decision, is one very important decision.

I think that the changes that have been made in some of the agreements that are now being relied on as a reason not to do any more are there because a few of us raised these complaints about the lack of transparency. There is some progress that has been made there. But we need to put those rights to make them meaningful.

And the fact that the United States has yet to have a ruling against it, I think has to be considered against the backdrop of the fact that the trade lawyers who are the arbitrators in these panels are well aware of what the impact would be if the United States did lose a major decision.

Having raised some of those points, let me begin, Professor Stumberg, by asking you about the issue of Panama. I am pleased that, from this witness stand, Secretary Geithner endorsed the legislation that Carl Levin and I have to stop tax havens. And my concern is that not only are taxpayers being fleeced by corporations who buy a mailbox in Panama or some other sandy beach country, but I am also concerned about how the subsidiaries of American corporations can be used to launch an assault on decisions that are made by a state legislature.

You and others have suggested that these investment provisions could easily be manipulated to use foreign subsidiaries to gain rights that the American corporation wouldn't have if it simply brought a case directly in Federal court here. Why should we be concerned about this type of forum shopping by multi-nationals who don't want to file a claim in an American Federal court? And is this already happening? And is there any particular concern when it comes to Panama?

Mr. STUMBERG. Perhaps it would be helpful to not talk so much theory, but to take an example. Panama is controversial because of its banking law, the degree of anonymity or secrecy that financial institutions or investment banks or hedge funds can maintain in Panama, versus the United States.

So, your concern about subsidiaries is best understood when you think about the corporate structures of companies that the U.S. Government cares about. Most of the big banks and financial institutions that are involved in the current financial crisis, and who are sometimes benefiting, sometimes not benefiting from the bailout measures, are U.S. companies with domiciles in the United States, and they also have subsidiaries in Panama, which they manage for accounting, tax, and other investment purposes.

There is an interesting and disturbing arbitration decision related to financial services that came out of the Czech Republic just 2 years ago, the Saluka case. In the late 1990s, the Czech Republic was coping with a crisis of toxic assets. Ironically, the toxic assets were the result of banks shifting out of the control of a Communist state economy.

The government was forced with either letting some institutions fail, or bailing them out sufficient to maintain stability in the system. The Czech government bailed out the so-called Big Four, under the theory that they were too big to fail. Those happened to be the four banks in which the Czech government held the biggest equity stake. Sound familiar?

A bank that was operating in Czechoslovakia, domiciled in The Netherlands, and owned by a Japanese holding company, took advantage of the BIT between the Czech Republic and The Netherlands. It brought a claim focusing on the minimum standard of treatment, which includes fair and equitable treatment.

When all was said and done, the ruling was that the Czech Republic had violated the minimum standard. Its argument that the bail-outs were a prudential measure, because the banks that it bailed out were too big to fail, was not a sufficient objective. It was not a sufficient rationale for explaining why it was helping those banks and not the bank owned by the Dutch institution and the Japanese holding company.

The arbitrators ruled against the Czech government, and the amount actually is still in question. The latest I heard was that they were seeking in the range of 3.6 billion crowns. I haven't converted what a Czech crown is, compared to a euro or a dollar.

That's a real case, and it shows you that subsidiary structures matter. The companies can legally strategize to take advantage of BITs and free trade agreements, and the financial service sector is a huge and looming issue, because many investors and many institutions were virtually wiped out. Why do some get the bail-out and some don't?

Chairman LEVIN. Okay. Your time is up. Let me suggest this, that we move on. And, Mr. McDermott, you are next, I think.

Dr. MCDERMOTT. Thank you.

Chairman LEVIN. But before—if you don't mind, if—when I went down the row, I skipped three, Mr. Posner, Professor Stumberg, and Ms. Menghetti.

Ms. Menghetti—if you don't mind, Mr. McDermott—you want to take 30 seconds, just on this issue, and then we will come back to you?

Ms. MENGHETTI. I——

Chairman LEVIN. Just so we have some back and forth.

Ms. MENGHETTI. Absolutely, Mr. Chairman. I don't know the precise terms of that treaty—which was not a U.S. BIT, right? I do know that our BIT has very strong requirements, and denial of benefits under Article 17 requiring substantial business activity for the plaintiff in one of these cases. I would have to look into this other bit a lot further. I don't believe that that type of scenario can happen here.

Two other quick points, though——

Chairman LEVIN. Okay, let me suggest this. I don't want to take too much of Mr. McDermott's time right now.

We will come back to that, okay? So you have more—I just wanted you to have a little time to have some back and forth. So my colleague and friend, Mr. McDermott——

Dr. MCDERMOTT. And I assume, Mr. Chairman, too, you are welcome—and I would like to hear her other two points. Since we don't have time for them right now, they can supplement in writing so that we will have that.

Chairman LEVIN. Absolutely, absolutely.

Dr. MCDERMOTT. Thank you.

Chairman LEVIN. We are going to see how long you can go and how long we can go. And there may be another vote interrupting us, because this is a controversial issue before us. It's the supplemental.

So, Mr. McDermott, you are next.

Dr. MCDERMOTT. Thank you, Mr. Chairman, I guess, for having a chance to ask questions.

I would like to ask the panel. Is it right to assume that only investors have a private right of action? Mr. Posner.

Mr. POSNER. Yes, there are certain threshold questions in investor-state dispute settlement. To be a claimant, to actually be able to bring a claim to arbitration, you have to be an investor of a Party. You have to have an investment in the territory of the other Party. Or, in some cases, we have what's known as pre-establishment rights.

So, if you sought to make an investment, you made every effort, but you were kept out of the market because of discriminatory treatment on the part of the other government, you might be able to bring a claim with respect to that pre-establishment phase.

But the short answer to your question is, yes, you have to be an investor or somebody who is seeking to make an investment, and is being blocked in order to go to arbitration.

Dr. MCDERMOTT. Ms. Lee.

Ms. LEE. I think that is a very important question, and I would disagree that it is obvious on the face of it that only investors should have private right of action.

If you look at the trade agreements, investors have a privilege that no other group—not a union, not a non-governmental organization—has, to challenge whether the other party to the agreement is living up to its obligations or not.

We have talked a lot about whether unions, for example, should have the right to sue another government if it is not in compliance with a labor chapter, and whether we would have the opportunity to bypass our own government, so that we wouldn't have to convince our government to bring that case. Everything but the investment language in the trade agreement is adjudicated on a government-to-government basis.

I think it creates a huge imbalance in the trade agreements, certainly, if you give one group, private investors, the right to sue. Even in the context of the bilateral investment treaties, it creates an imbalance between private companies and governments. Governments have an obligation to protect the interests of their citizens. They have a democratic process for determining the level of regulation, whether it's public health or the environment.

To give an individual company the right to sue and to create a tax liability when it is successful is an enormous step, and one that I think should be rethought.

Ms. MENGHETTI. Congressman McDermott.

Dr. MCDERMOTT. Yes?

Ms. MENGHETTI. If I could just make one—two points about that, one is an investor should not be thought of as a business. So, an organization that goes overseas and opens an office for other purposes and invests capital in that country could be an investor.

And the other point I would make is it is very interesting that investor-state dispute settlement—we see it under our BITs, now our FTAs—we also see it in agreements that—say the World Wildlife Fund, an environmental, non-government organization has with foreign governments in tropical timber conservation, where there is a debt swap, and the governments make certain commitments. Those international—those environmental organizations have sought precisely these rights in those areas, as well.

And so, it's not something, I think, just confined to businesses. But investors, the reason you have investor-state as opposed to any other parts of a broader FTA is the investor is overseas. They are subjecting themselves to a foreign government's activities and actions. No other actor, if you're not an investor, is put in the same place.

Dr. MCDERMOTT. The reason I asked the question is that I remember—we have been going around and around on this issue for some period of time. And the most classic case was—or that I remember—was the gasoline additive produced by a Canadian company that—and which they sued the State of California for their law that said they couldn't have it any more. And they won.

And are we in that same place? Did they not win?

Ms. MENGHETTI. The U.S. Government won that case, the Methanex case.

Dr. MCDERMOTT. And the Canadian firm——

Ms. MENGHETTI. The Canadian firm lost. And in fact, the Canadian firm had to pay damages to the U.S. Government.

Dr. MCDERMOTT. And who was it that gave the evidence? Did they just defend the right of California to protect the common good?

Ms. MENGHETTI. I believe it was the Department of State's, the Legal Advisor's Office, which did the defense.

Mr. POSNER. That's right. In any of these cases, whether it involves a measure of the U.S. Federal Government, or a state government, or a local government, it is the United States, and in particular the Legal Advisor's office within the Department of State, that defends the measures.

I could elaborate on that more, but it goes to a point that I think Mr. Brady alluded to earlier, which is that when you go to arbitration, the only remedy you can seek is damages, money damages. So it is not as if, in the Methanex case, to use that as an example, the Canadian investor in that case could have sought to compel California to do something that it didn't want to otherwise do, in the interest of regulating on behalf of the consumers of California. The most that Methanex could have gotten, if it had won, which it did not, was money damages from the U.S. Government.

Dr. MCDERMOTT. And that same thing, then, could be happening with our bail-out money to banks. If there is some creative lawyers in some countries, we may wind up, our $700 billion bail-out of our banks—Mr. Stumberg.

Ms. MENGHETTI. I think that's not the case. I mean, in 2004, one of the very big innovations put into our model BIT was this prudential carve-out—that governments have the right to take measures, precisely financial measures, if they need to, for prudential reasons.

The bail-out that we have seen, the TARP, has not been discriminatory. I don't see any allegation that it has come close to violating anything our government has committed to.

Mr. STUMBERG. The question about the prudential carve-out was raised in Ambassador Kirk's confirmation hearing. It's a two-sentence exception. The first sentence says nothing in the agreement should stop a government from taking prudential measures. The second sentence says that governments may not take advantage of the exception, if to do so would avoid their obligations under the agreement. It appears to be self-canceling. Or, perhaps it creates a burden of proof in favor of the investor and against the government.

That is the kind of question I am trying to raise to your attention, where I am not arguing that there shouldn't be investor protections. I am saying that these are very complex agreements. We learn as we go. And every time we anticipate a new factual scenario, we should take advantage of it. We should be prudent and manage future risk, and do things like tighten the screws on that prudential exception.

If you want a good model for one, go back to NAFTA. NAFTA has a one-sentence prudential exception, and it says, "Governments may take prudential measures, and that will not be a violation of this agreement."

There are hundreds of billions of losses, as you know, in the U.S. financial markets, and there is a great deal of de facto unintentional picking and choosing going on between institutions. We have no idea what the potential upside of our liabilities are, in that respect.

Chairman LEVIN. Mr. McDermott, I think we will turn it over to Mr. Etheridge, and then we can come back. Mr. Etheridge.

Mr. ETHERIDGE. Mr. Chairman, thank you. And let me thank you all for spending the time here this morning. I know it has been a long morning, and I appreciate it.

Mr. Posner, let me ask you a question, since you have—as someone who has worked at the corporate level, as well as having been staff level, you have a little bit more of a unique perspective—and then I will ask the others to comment.

And my question is, are there specific changes that you would recommend to our FTAs and BITs that would provide legal certainty, and facilitate investment that would help provide economic growth to American companies, companies here in the United States?

Mr. POSNER. I think that the short answer is no. I think what you have in our current model is a core set of protections that Ambassador Larson alluded to earlier.

When the U.S. investor goes overseas, sets up shop in the territory of another country, really these are the main protections. This is the essence of what it's looking for in its relationship with that other country. It wants to know that it won't be discriminated against. It wants to know that if its property is taken, that it will be compensated promptly, effectively, and adequately. It wants to know that it will be entitled to a certain minimum standard of treatment.

So I think those core elements have been there since 1982. They continue to be there. What we have done in the intervening 27 years is to make certain adjustments, I would say, at the margins to start to take into account the fact that, as we enter into these agreements with bigger economies—with economies that are making investments in the United States, there is a possibility we might be sued. And there has been more thought given to how we would respond to that.

So, the short answer to your question, Mr. Etheridge, is no, I can't think of any change that I would make.

I would, if I can sort of just tack on one sentence in response to Professor Stumberg's point, with respect to the prudential exception for financial services, in fact, it is not a one-sentence exception. There is an entire page that sets out a special procedure where financial regulators of the two countries that are Parties get together and work through these issues, the same way they would if there were a complaint made with respect to a tax measure.

So if a country were challenging a tax measure of the United States or Peru or Chile, or whatever other country, and said that's expropriatary, there would actually be a dialog that takes place between taxing authorities to sort that issue out before you even ever got to a panel.

It is the same with prudential measures. So it illustrates the point, I think, that we have a good balance. I can't think of anything that I would change, because I think if you did you would move in one direction or the other, and that would really disrupt the balance and crater the program.

Mr. ETHERIDGE. Anyone else?

Mr. STUMBERG. Sure, if I could respond. Hopefully there is always that kind of dialog in investor-state disputes. The procedures require the parties to try to get together and work out a pragmatic solution first.

In this case, what the investment chapter requires is that that dialog must include the taxing authorities, or the prudential authorities of the country. If they don't agree, then the case still goes forward to an arbitration panel.

So, Ted is right to point out the fact that there is built-in dialog here. But it is part and parcel of the usual process. It is just much more explicit.

Mr. ETHERIDGE. Ms. Lee.

Ms. LEE. Mr. Etheridge, in answer to your question about whether there are any reforms, there is a short list on page five of Professor Stumberg's testimony, that I think is a good summary of the areas that you would want to look into. There are some suggestions for how to narrow some of the definitions and the standards, and clarify where the language is unclear, where the language has been interpreted differently by different dispute panels over the years. We have put ourselves in a vulnerable position, where we are hoping that the dispute panel will decide in a certain direction, and that they will take one tack over another. When we have something as important as this issue, which affects both the United States, as well as the outward investment and unions and our brothers and sisters in developing countries, we should narrow the language so it says exactly what we want it to, and we won't have this problem with differing interpretations, or hoping for the best out of a dispute panel, because we will have clarified that language.

Mr. ETHERIDGE. Mr. Larson.

Mr. LARSON. Very briefly, I tend to the view that these issues have been though through very, very carefully. So I don't want to give the impression that what we have now has—is necessarily bad. I do think that we have been assigned to have a look and see if it can be made better. We need to do that.

One area that certainly is different today, looks different today than it did five years ago, is financial services, and the whole issue of safety and soundness. And you can look at it from two perspectives. One is there is more regulation and more attention on what governments ought to do to ensure safety and soundness of institutions. That is for sure. There is also a very clear recognition, I think, that investment from abroad has been a very important contributor to the ability of our financial system to respond to the crisis that we've faced over the last 2 years.

So, we have work to do. I just don't have a pre-conceived answer to your question.

Ms. MENGHETTI. If I might, I tend to agree with my colleague, Mr. Posner, that we don't need to see new improvements. I am happy to discuss them, I think they always should be discussed. I am quite alarmed, in fact, by the proposals made at the end of Professor Stumberg's testimony, which I have just been looking at. And with the Committee's permission, I would probably like to submit something for the record on those.

What I think we really need is more of these treaties. There are over 2,000 of these BITs around the world. The United States is party to about 40, and about 15—with 15 countries in our FTAs. The United Kingdom, Germany, others have very strong BITs, and they have them with countries like Korea, with investor-state. Germany and The Netherlands have a BIT with China that has strong expropriation standards and investor-states. Our companies, our economy, and our workers are losing the competitive battle with the lack of more BITs that we don't have.

Mr. ETHERIDGE. Thank you, Mr. Chairman. I yield back.

Chairman LEVIN. Mr. Pomeroy.

Mr. POMEROY. Mr. Chairman, thank you for this hearing. And I apologize for missing so much of it, in light of conflicts that I just simply couldn't avoid.

The inquiry, I believe, is so extremely important, because this notion that the way we have been doing trade is the way we will do trade going forward, bring on the next trade deal, would be a very erroneous notion, relative to the feeling across the country, and certainly the feeling in this congress.

And so, essentially, this kind of inquiry—where are the soft spots in the trade deals, how do we make certain that legitimate questions that people have about the wisdom of what we've done are being addressed, and how can we make sure we don't repeat errors going forward, all of this is extremely important inquiry.

Having missed virtually the entire hearing, I am not going to ask questions that have probably been covered already. I will continue to review the statements and, again, appreciate very much your leadership on this panel. And I hope, with the spirit of bipartisan accord, we can continue this type of inquiry. I think it is very, very important to the institution we represent on trade. Thank you.

Chairman LEVIN. Well, thank you. Let me just ask—do you have a few more minutes? I mean, you have been very patient. Are you willing?

I think the importance of this subject, and also the spirit expressed by Mr. Pomeroy, which I think you know is very much mine, makes it, I think, useful if we spend a few more minutes. Okay?

Kevin, Mr. Brady, do you have anything further?

Mr. BRADY. Sure. Just again, I—Chairman, thanks for holding this hearing. I do think it's important for us to be looking for ways to improve issues.

This provision has proven to be very helpful to our ability to sell U.S. products overseas, to sell our services. And it has been, I think, critical in attracting investment. Just like a company, you would rather be one that people want to invest in than a country (sic) you don't. And this has been critical in attracting investment that supports five million U.S. jobs—also critical.

I want to address a couple of points that have been raised very thoughtfully by our Members. One is the concern that in Panama, or in any place, that some shell company could locate there, and then bring a cause of action against their or U.S. law.

Up on the screen is the language from the Panama trade promotion agreement that deals with the issue. And, basically, it says to the point if the enterprise has no substantial business activities in that territory, other than just owning or controlling, that their benefits may be denied under this chapter. In other words, the shell company, I guess, could file a claim, but not very likely to succeed.

There has been concerns, perhaps, a foreign company could locate in the U.S., again, use a shell company or otherwise, and challenge our U.S. environmental, state, and local environmental regulations but also—again, because of improvements to the provision language in our agreements and investment treaties—say "except in rare circumstances, non-discriminatory regulatory actions by party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment do not constitute indirect expropriations."

Again, we took efforts and actions to limit the likelihood that that would occur. So I think some of these issues have been addressed, and have proven to be good improvements to this provision.

But I wanted to ask Mr. Posner, I guess, because you raised it in testimony. You talked about the balance that, as we provide and seek greater protections for our ability to sell American products throughout the world. That reciprocity exists, so you have to weigh that balance against the rights that are provided in a reciprocal trade agreement.

Can you talk—since you were so instrumental in 2002 improvements—can you talk a little about that? Because I actually think that is an area we don't spend much time thinking about in this provision.

Mr. POSNER. Sure. Going back to 2001, 2002, you had started to see more and more claims against the United States under NAFTA. You saw the Methanex claim that Congressman McDermott alluded to earlier. There was a claim involving an infrastructure project in Massachusetts. There was the Loewen case, the so-called Mississippi funeral homes case. So you had a number of cases which caused observers of these agreements to think more carefully about what happens when the United States is sued. Are we adequately protected?

In response to that concern, we did a number of things. One is with respect to expropriation, and the annex that some people have referred to. There was a concern that an investor-state arbitration tribunal might interpret the concept of expropriation in a more expansive way than a U.S. court would interpret the concept, the parallel concept, of takings.

To ensure that that did not happen—as Ms. Menghetti referred to—we created this annex. And in drafting that annex, what we did was we went back to the seminal Supreme Court cases in the area of regulatory takings, the famous Penn Central case which many are familiar with——

Mr. BRADY. Yes.

Mr. POSNER [continuing]. We looked at the factors that the U.S. Supreme Court and lower courts looked to in determining whether a regulatory action constitutes a taking. We drew on those principles, and put them into the annex. So I think that was one very important thing that we did.

We also were mindful of the fact that, in a sense, there is a connection between the risk of being sued and transparency. We thought if the process is more transparent, stakeholders will become familiar and more comfortable with it. They won't see this as some star chamber that is deciding things in an untoward way. We insisted upon transparency. That has now become a cornerstone of our investor-state processes.

There was also a question back in 2001 about the meaning of the so-called minimum standard of treatment. In particular, there was a concern that an arbitration panel would take a concept like fair and equitable treatment, and say, "Well, that is an entirely subjective concept, a standardless concept. I can decide—I, as arbitrator—can decide what it means."

There is a concept in the world of international arbitration that goes by the Latin term ex aequo et bono, that an arbitrator can decide based on what it thinks is fair. And there was a concern that panels would take that provision in U.S. treaties and interpret it in that way.

So, we closed that door by saying, "No, you interpret that concept in accordance with the customary international law of minimum standard of treatment." And there is a very well-developed law, over a century old, on what that concept means.

Those were the main features that we put in there in recognition of precisely the concerns that you have identified. Thank you.

Chairman LEVIN. Okay. I think——

Mr. BRADY. And, Chairman, the only point in asking that last question was that I think it is important to keep improving our agreements at every shot, but also it's important not to sort of fall to the temptation that everything before us is bad. There have been good improvements in this provision that we ought to embrace as we work forward. Thank you.

Chairman LEVIN. Okay. And then, as I turn to colleagues, language that we know regarding shell is there.

I think an issue has been raised here—and perhaps the subcommittee will consider this—where the entity in another country is not a shell. And this is going to occur more and more during globalization, right, where you have a subsidiary that isn't a shell, but a real thing. And I think the question becomes does that subsidiary—which, let's assume is a true subsidiary, it doesn't call all the shots, you know, et cetera, et cetera—would it have access to an arbitration panel which would not be true otherwise, of its home corporation?

That is a different issue, is it not, than—Ted, Mr. Posner, do you want to——

Mr. POSNER. Yes. I will just say briefly, first of all, the denial of benefits article, which Congressman Brady has distributed and put up on the screen, that's one half of the picture. So you can't—a mere shell could not bring a case against the United States. We all agree on that.

Your question, Mr. Chairman—if it had substantial business activity in the other country, could it bring a claim? And the answer is, yes, if it's bringing a claim with respect to an investment that it has made in the United States.

So, if you had a situation—take a big U.S. corporation that establishes a small subsidiary in Panama or some other country. The mere fact of its having substantial business activity in the territory of that other country is not enough for it to bring just any claim against the United States. It would have to bring a claim with respect to an investment that it owns in the United States, that it, the foreign subsidiary owns. That's a pretty high bar.

The prospect of a company arranging its business dealings on the possibility that one day it might want to bring a claim against the United States with respect to an investment that the subsidiary owns in the United States I find rather implausible.

Chairman LEVIN. Yes, Professor Stumberg, and then I will turn to my colleagues. Yes?

Mr. STUMBERG. Well, Ted——

Chairman LEVIN. By the way, this is why we are having this hearing, to raise these issues and have the responses. Professor, take a minute, and then I will turn it to one of my colleagues.

Mr. STUMBERG. Well, to my colleague, Mr. Posner, I would say the law school I went to taught me that one of the lawyer's chief roles is to help one's corporate clients structure their operations, to create an architecture that takes advantage of a complex array of legal features: tax law, corporate law, environmental and economic regulation.

The State of Delaware is a living monument in the United States to the legal imagination, and how frequently lawyers do, in fact, help their clients structure the architecture of which subsidiary is incorporated where, to take advantage of legal opportunities.

Ms. MENGHETTI. One——

Chairman LEVIN. At this point—is there an example, I guess?

Ms. MENGHETTI. Could I——

Chairman LEVIN. Yes?

Ms. MENGHETTI. I was going to suggest the example is this. We have an over 20-year-old bilateral investment treaty with Panama. We have never seen this case. We have never seen that type of structuring that Ms. Posner described would have to happen to come within the treaty——

Chairman LEVIN. How about other places than Panama? Has that happened?

Ms. MENGHETTI. Not against the United States, it hasn't. And that is probably, in significant part, because the United States has such a good legal system.

Chairman LEVIN. All right, Mr. Doggett, you are next.

Mr. DOGGETT. Thank you very much, Mr. Chairman. Ambassador Larson, the Joint Committee you have seems to me to be a constructive step forward in trying to address some of the concerns that I have, even though we may have a somewhat different perspective about how far-reaching those are.

Do you have a feeling at this point as to when you will have any kind of report that a Committee might benefit from?

Mr. LARSON. Not as specific, Congressman, as I would like to be able to give you today. Ms. Lee and I had a conversation in the last couple of days with representatives of the government, USTR and the State Department. We—I think we have collectively agreed that she and I and the government need to sit down and map out the next steps. We want to hear those issues that the executive branch thinks are very high on their list. We have heard a lot out of the conversation today, and I would like to thank the chairman for the opportunity to, you know, get this input to our work.

One of the things we have to talk about is time table. I know that there is a hope that this could be expeditious, but we also know that these are thorny issues, and——

Mr. DOGGETT. And I suppose it doesn't have to be all at once. You may resolve some issues without resolving all issues.

And so, hearing from you, I would just say it would be constructive—the kind of conversation from the differing perspectives that you and Ms. Lee have in addressing these issues is very much the kind of conversation that I think the chairman is facilitating in this committee for the first time, not just the first time today, but trying to get a discussion of what a more modern trade policy would look like.

And I would ask you, Ms. Lee, as you do that, to look at this issue of when it's appropriate, as a preliminary matter, to have an investor tribunal of this type. It is appropriate, in some circumstances. Despite the questions that I have about it, I would hate to be investing in some countries if I had to rely just on their local courts.

But I think that USTR in the past, under Democratic and Republican Administrations, has had a tendency to just listen to whoever might have a business claim there, the fraternity of trade lawyers, and not consider the broader issues. And I think we need to look at the forum non conveniens law, and at other considerations, to determine what is appropriate.

Ms. Menghetti, I hope you will give a full critique of what Professor Stumberg is talking about, because I can see issues with some of these, and some of them are somewhat appealing to me, as ways to try to address this.

And I want to ask you, Professor Stumberg, about one of those. I know there was a time in this country—in fact, it concerned President Roosevelt a great deal—that, you know, it was viewed as a taking of a company's profits if you had a child labor law, or if you set minimum standards for how many hours a week someone had to work. No one is suggesting that we're going back to those kind of conditions on those issues, but the decisions of the courts of the 1930s and the 1920s, and substantive due process are very different, though there are, certainly, jurists in recent times who have urged that point of view.

What does it mean to say that you believe we should follow the position of the U.S. brief in Glamis, with reference to minimum standard?

Mr. STUMBERG. Well, it's about due process. There are two flavors of due process, going back to the Supreme Court cases before 1934. One flavor, which is alive and robust today, is procedural due process, the basic ideas of fairness in courts and agencies.

The now obsolete notion in terms of U.S. Constitutional law is called substantive due process, by which the courts put themselves in a position to second-guess and overturn legislation. The Lochner case you referred to was about workers' hours.

It is substantive due process that was the mechanism used by the arbitrators in the financial services case, the Saluka case, which came down 2 years ago out of the Czech Republic. That's why I am concerned that the DNA of substantive due process is alive, and arbitrators are using it to second-guess the policy determinations of National Governments in terms of how to manage their bail-out strategies, and which economic emergency measures are appropriate.

Mr. DOGGETT. Thank you. And I hope you will flesh out your specific proposals, just as Ms. Menghetti would give the critique of it.

And I would just say, in closing, Mr. Chairman, thank you for—again, for doing this. I think when the congress approves an investor-state tribunal, we are making a decision that our open federal justice system is not the appropriate forum, that we need to move to an unelected tribunal to do it. It has great potential consequences for the taxpayer, who might ultimately be called on to fund one of these judgements, and it has great potential for harm to the ability of our governments to enact reasonable environmental, health, and safety laws.

That has to be considered in balancing it against the need to protect our investors at home and abroad. And I think today's hearing takes us a step forward in trying to reach a reasonable balance. Thank you very much.

Chairman LEVIN. And, of course, one dilemma we face is if we insist on a tribunal in terms of actions of another country, can we insist that they use our courts? And we have thrashed—we have talked about these kinds of issues, and we did, in terms of worker rights provisions, if I might say so, where we insisted that there be parity.

And so, you raise an important issue, but I think we need to look at it—I know you agree—kind of in a well-rounded way.

Well, are we done? Yes, Mr. McDermott.

Dr. MCDERMOTT. Mr. Chairman, I know you all see those cameras up there on the wall behind us. And for those people who are watching this, it looks like a pretty arcane subject. And I am not a lawyer, and I am not a banker, and I am not involved in international trade. But what I am interested in is that Members of Congress have the opportunity to establish good public policy, and then not have it taken away by some trade agreement or arbitrary group of tribunals some place.

So, Mr. Stumberg, I would like at least your observation as to what you think is the most protective of the public common good that we could do in these laws to change, alter—I understand money is important. I mean, God knows, we cannot do without money, right? But money does not necessarily, in my view, trump the common good.

So, I want a system of trade agreements that does not trump the common good, whether it is in Honduras or the United States. And I would like to hear from you what you think we ought to do with this issue.

Mr. STUMBERG. Let me limit my answer to the two most important investor protections. Recall earlier what you were talking about America's defense team and the offense team. The defense team is a crack squad of lawyers at the U.S. State Department, and they successfully defended the California measures in the Methanex case, which we should all celebrate.

My radical proposal, Linda, for improving the——

Dr. MCDERMOTT. Let me just stop you right there. One thing on that bunch, on the defense side.

Mr. STUMBERG. Yes?

Dr. MCDERMOTT. Have there been things done in the last Administration to weaken that division of the State Department, and their ability to protect the common good?

Mr. STUMBERG. Not to my knowledge.

Dr. MCDERMOTT. No?

Mr. STUMBERG. They are healthy and thriving.

Dr. MCDERMOTT. Okay.

Mr. STUMBERG. They won the Methanex case, and they got the arbitrators to adopt the following one-sentence conclusion about the scope of expropriation. May I read it to you? I am proposing this as yet a further improvement.

> "As a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process, and which affects the foreign investor, is not deemed an expropriation." That is more protective of the public interest than even the crafted language that Mr. Posner was talking

about before. I would submit that idea as the best the State Department's lawyers have accomplished: it is the high water mark of clarity in an arbitral decision.

And then, with respect to the other investment protection, the minimum standard of treatment, the so-called substantive due process issue, the brief of the State Department's lawyers in the Glamis case is a masterpiece.

Unfortunately, it is a long masterpiece. But if you look at page 221, you will see that——

Chairman LEVIN. It is long.

Mr. STUMBERG. You will see that definition——

Dr. MCDERMOTT. I will have my staff write down, "221."

Mr. STUMBERG. And I will leave it for you. The customary international law treatment of aliens, which the State Department lawyers have, in scholarly fashion, illuminated in a way that is a logical, tight and unambiguous definition. It is tighter, more clear, and less risky than even the improved language in the draft Panama and Korea—free trade agreements.

So, I would submit page 221 of the brief of the State Department is the United States Government's lawyers' best guidance on how to clarify this investor protection.

Dr. MCDERMOTT. Okay, anyone else want to make a quick comment? You have got a minute. Ms. Lee.

Ms. LEE. I just wanted to make a quick comment about the broad issue here. I certainly understand, from the point of view of American companies, that they want the strongest possible protections when they go overseas. I sympathize with that.

But I also think it is important that we clarify that the interests of the United States are not entirely synonymous with the interests of U.S. multi-national corporations. Particularly when I talk about my members, working people, the outward foreign direct investment in many cases—not every case, but many cases—is about taking our jobs and moving them to another country, and then seeking the kinds of protections in that country that they would have had if they had stayed home in the United States of America.

So, it is not an irrelevant issue, it's not an arcane issue for our members. This is the intersection of trade and investment. It is all about globalization and outsourcing and offshoring and who is taking care of workers and communities and the environment back home.

And we care also, as you do, I know, about whether this is good governance for developing countries, whether they are giving up too many rights because the corporations in the United States are so powerful and have the best lawyers and good teams, and they can afford—they have deep pockets. U.S.-based multinational corporations can bring these cases to challenge domestic laws in other countries. For example, in Mexico, Metalclad challenged the Mexican government's decision not to grant the permits to have a toxic waste disposal in a place where they thought it wasn't environmentally appropriate.

The issues are tremendously important. The competitiveness of U.S. companies is not the same as the profitability of U.S. companies operating abroad. We would define competitiveness as the ability of U.S. companies who are operating on American soil to survive and thrive in a global economy.

We just need to remind ourselves what the ultimate goal is of our trade and investment policy—that it's not to have more trade and investment for the sake of that, it is to make sure that trade and investment is serving the social goals. Thank you.

Dr. MCDERMOTT. I yield back the balance of my time.

Chairman LEVIN. Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman. Ms. Menghetti, we frequently hear the allegation that U.S. companies that have investments abroad have somehow turned their back on the United States in search of low-cost labor and other weak regulatory standards. I am pleased that some of my colleagues have joined me today in pushing back on that notion.

The facts simply tell a different story. Foreign operations complement U.S. operations. One particular fact that caught my eye is that the overwhelming majority of existing outbound U.S. foreign direct investment goes to developed country markets, like Europe and Canada, that have strong labor protections. Right now, only 1 percent of U.S. foreign investment goes to China, for example.

Ms. Menghetti, how does the fact that most U.S. investment is in high-wage countries reconcile with the perception some people have that this investment is simply offshoring American jobs to low-wage countries in search of increased profits?

Ms. MENGHETTI. I think it absolutely contradicts that type of allegation about outsourcing. As you indicated, most U.S. investment abroad is in high-wage countries. When companies go overseas to invest, they do so for many, many reasons. They do so, in primary part, to be able to access the 95 percent of the consumers outside the United States, and those with the greatest purchasing power. And those are in the highest wage countries.

I believe Congressman Brady said at the outset the very striking statistic that the output of U.S. subsidiaries overseas, the vast majority of it, over three-quarters of it—stays outside the United States. Or, actually, it's much higher than that, it's 95 percent of the U.S. output of U.S. subsidiaries overseas stays overseas. About five to 7 percent comes back to the United States. This isn't about outsourcing. This is about making the U.S. economy, U.S. industries, and our U.S. workers stronger.

I have companies who tell me that one dollar out of every four that they pay their U.S. employees is because of their overseas operations. Overall, for U.S. companies that are globally engaged, about half of all their income comes from their operations overseas.

Foreign investment strengthens U.S. companies. It strengthens the U.S. economy, and provides very good-paying jobs for U.S. workers, and strengthens the ability of companies to have those workers here in the United States.

Mr. HERGER. Thank you. And, Ms. Menghetti, in your testimony you talked about how important it is for the U.S. service sector to be able to establish foreign operations to serve customers in those markets. That statement seems to reconcile with data I have seen from the Commerce Department that shows that virtually all the growth in the employment of U.S. companies' foreign operation has been in sectors other than manufacturing. Would you agree with that conclusion?

Ms. MENGHETTI. I absolutely would, Congressman. For U.S. service suppliers, the vast majority of their sales have to be sales from their overseas subsidiaries to the local market. There is some—cross-border services sales, but most of it is affiliate operations.

You can't provide banking services, you can't provide other services sitting here, in the United States, for the most part. And that is exactly why the United States service sector, one of our most vibrant sectors, has really been able to benefit from overseas investment. And that helps us back here, in the United States, because a lot of the basic documents that those service providers use in their overseas markets—policies, manuals, and other research and development—that still stays back here, in the United States, and grows the U.S. companies back here, home, as well.

Mr. HERGER. Thank you very much for your testimony. This is very important. It is so easy to get caught up on the thought that these issues are hurting our economy when, in essence, we need to be encouraging this type of effort and investment, because it ultimately helps us and helps our workers, and helps the U.S. economy.

So, thank you very much. And, Mr. Chairman, I yield back.

Chairman LEVIN. Okay. I will resist the temptation to comment on that. Because my plea is that we try to look at various sides of an issue. Mr. Herger, when you say, "ultimately, it benefits," it doesn't always.

And this isn't a hearing on manufacturing, but if it were I think I could give you some very prime examples of where it is more complicated than that. And we are going to be in the manufacturing area in the next days, discussing the very issue of the interaction of globalization and how it works out for people who work here.

And so, indeed, I think the thrust of this hearing is to—and it has been, I think, extremely, very useful—is to try to take a fresh and a well-rounded view of these issues. And, Ms. Lee and Ambassador Larson, you are now charged to carry that on. And we wanted to have this hearing, in part, so we could provide input, and in part because we want there to be a lot of interaction in the days ahead.

So, Ms. Menghetti, you are going to send us some further material. I think, Professor Stumberg, you have been asked by Mr. Doggett to send some further material. And the others of you, if you would like to do that, do so, I think in the case of the ambassador and Ms. Lee, you probably will refrain from that as you undertake your responsibilities. And we are hopeful that, as you say, you will proceed expeditiously.

Well, I want to thank my colleague, the Ranking Member, and my colleagues on all sides. This, I think, has set an example of the kind of approach of hearing we are going to have as we craft a comprehensive new trade policy for the United States of America.

Thank you very much. We are now adjourned.

[Whereupon, at 1:07 p.m., the Subcommittee was adjourned.]

[Submissions for the Record follow:]

Statement of Chevron Corporation

Pursuant to the notice for the May 14, 2009 Subcommittee Hearing on *Investment Protections in U.S. Trade and Investment Agreements*, Chevron is pleased to submit these comments for the record. The issue of international investment protection is critically important to Chevron. We are a leading international oil company with major operations in the world's most important oil and gas regions. We have extensive international investments in refining, fuels and lubricants. Other interests range from chemical production and mining to energy research and nanoscience. We also operate power facilities and are the world's largest producer of geothermal energy. We urge the Committee to support a strong program to expand investment protection agreements and resist weakening the high quality standards reflected in the 2004 Model Bilateral Investment Treaty (BIT), which risks further narrowing of the provisions vital to protect U.S. interests abroad.

Investment protection is an issue with real-world implications—a substantial portion of Chevron's overseas investments are made in countries without high-quality investment protection agreements with the United States, even as many of these countries pursue investment agreements with other trading partners. Sustained progress toward a comprehensive global investment protection regime is necessary to both reduce the risk associated with overseas investments and to ensure that U.S. companies are not disadvantaged against foreign competitors whose investments are protected by such agreements. High-quality investment protection agreements, along with measures to promote good governance and the rule of law, are indispensible to provide a level playing field for U.S. companies operating abroad and to ensure that we have the tools available should we be subject to expropriation or nationalization of our assets.

High-quality investment rules are crucial to maximizing global economic growth, and investment protection has particular relevance for energy investments. The International Energy Agency estimates that around $26 trillion in new investments will be needed to meet rising global demand for energy between 2007 and 2030. These investments will not only underpin global economic growth, but they also represent important investment opportunities for U.S. companies and the countries where we undertake the investment.

In addition to providing important energy supplies, these investments can represent excellent opportunities for engagement and delivering long-term socioeconomic benefits. Chevron's approach is anchored in partnerships with governments, communities, local and international nongovernmental organizations, and development agencies. We have built a number of partnerships on trust, transparency, mutual learning and a common purpose to promote human progress and economic development. We address social issues by working together and delivering results "on the ground." Our community engagement programs enhance our ability to conduct business in many parts of the world. In 2008, we invested $160 million in our community engagement initiatives. Most was invested in our three primary focus areas—improving access to basic human needs, enabling education and training opportunities, and promoting sustainable livelihoods.

Energy projects require substantial capital commitments and tend to be very long term. Free trade agreements with strong investment chapters and bilateral investment treaties reduce the risks associated with these projects and ensure benefits for both U.S. energy supplies and consumers at home and abroad. These agreements also benefit the FTA or BIT partner, making them more attractive for foreign investment and foreign capital.

The United States plays an important role promoting a global investment protection regime

Chevron believes that the U.S. government's trade and investment agenda should continue to include a long-term commitment to improved investment disciplines and progress toward investment agreements with critical energy suppliers and consumers, including countries like Angola, Brazil, Cambodia, China, India, Indonesia, Iraq, Kuwait, Malaysia, Nigeria, Russia, Saudi Arabia, South Africa, Korea, Thailand, Venezuela, and Vietnam. The U.S. can retain a leadership role by ratifying pending trade agreements which contain quality investment chapters and by continuing to pursue active BIT negotiations with China and willing countries that demonstrate a commitment to economic openness and reform.

Chevron believes that investment disciplines in the FTA Investment Chapters and Model BIT Must Be Preserved

Chevron believes that the U.S. government should work to ensure that future agreements continue to reflect the high-quality standards established in the 2004 Model BIT. These important provisions include:

- Fair and equitable treatment of investors (e.g., due process and access to additional rights in accordance with international law).
- Full protection and security of investments.
- Clear limits on expropriation of investments and prompt, fair compensation when expropriation occurs.
- Free transfers of capital.
- Access to reliable, independent, international third-party dispute resolution (e.g. investor-state arbitration).
- Coverage of existing investments.

As noted above, Chevron's operations have global reach. Our ability to continue to do business in foreign jurisdictions and to protect our shareholder investments is dependent on strong contractual provisions backed by strong mechanisms for resolving disputes, including international arbitration. Any further restriction to our access to international arbitration for our international investments would dramatically shift the risk profile for those investments, and put us at a disadvantage compared to foreign competitors covered by treaties which contain such provisions.

In our view there is no justification to modify the language of the 2004 Model BIT and further narrow its provisions in response to the specific concerns cited in the hearing notice. (In fact, these issues were addressed at the direction of Congress in the development of the 2004 BIT language; further narrowing would signal an important reverse of a longstanding U.S. commitment to trade and investment). In particular, we want to focus on investor-state arbitration and offer a specific example to illustrate the critical importance of international dispute resolution to U.S. business.

The importance of investor-state arbitration provisions

Chevron operates with high ethical standards and values engagement and partnership, and we rarely expect to arbitrate international disputes. We diligently seek to resolve disagreements before they require adjudication and note that the availability of an investor-state arbitration mechanism increases the likelihood that good faith negotiations can be successfully concluded. This is an important point that cannot be overemphasized. The presence of a treaty enables the investor to pursue more meaningful discussions with a host government and settle most disputes on an equal basis. Nonetheless, there are circumstances where investor state arbitration is the only way a fair hearing can be obtained and it remains an important last resort.

Chevron operates in countries whose laws do not provide adequate safeguards and protections for our investment, and lack the institutional capacity and resources to administer the rule of law in an effective and transparent manner. A very real example of this situation exists in Ecuador, where Chevron is involved in a long-standing dispute about who is responsible for acknowledged environmental impact in part of Ecuador's Amazon region.

Texaco Petroleum (TexPet, a subsidiary of Texaco Inc. which merged with Chevron in 2001) was a partner with the Ecuadorian state oil company in a consortium that shared on an equity basis all revenues, costs, and liabilities derived from the consortium operation of an oil concession. Although opportunities for environmental remediation were identified as the Concession Agreement expired in 1992, the state oil company (Petroecuador) refused to participate with its equity share of the remediation costs. In 1995, a Settlement Agreement was signed by the Republic of Ecuador, Petroecuador and Texpet, by which Texpet agreed to conduct remediation in accordance with a scope of work proportional to TexPet's equity share in the former consortium, at its sole cost and under close government and partner supervision and approval. Upon execution of the 1995 Settlement Agreement, the Republic of Ecuador and Petroecuador released TexPet of any further environmental liabilities with regard to all sites not included in the scope of work for which TexPet was responsible, and Petroecuador, as the sole owner and operator of the former consortium fields, assumed the responsibility for the remaining remediation required in the areas excluded from the TexPet scope of work. In 1998, after a site by site certification and approval process by inspectors representing four agencies of the Government of Ecuador, the Republic of Ecuador and Petroecuador granted TexPet and its affiliated companies a full and complete release from any further environmental liability arising out of the former consortium operations.

After the partnership ended, Petroecuador continued to operate the former consortium fields by itself for years with a well-documented record of oil spills and other serious environmental mismanagement. In 2003, private plaintiffs filed a lawsuit in Ecuador against Chevron alone—not Petroecuador—for environmental remediation of the entire former concession area, seeking the retroactive application of a law enacted in 1999. As part of the evidence production in the process, the parties have requested the court to conduct judicial inspections at a number of sites. The first and only judicial inspection completed, with a report issued by five independently court appointed settling experts, confirmed that the remediation work conducted by TexPet at that site met all parameters of compliance mandated by the Government, and that the remediated areas pose no significant risk to the health of human beings at that site.

After this setback, the plaintiffs then began a successful campaign of political pressure which has resulted in unfair treatment and a denial of due process to Chevron. Unfortunately, Petroecuador did not fulfill its obligations to clean up the sites and has also been operating for almost nineteen years without sufficient attention to the type of environmental safeguards common under international practices. Furthermore, there have been a number of developments in the proceedings against Chevron since 2007 that have compromised Chevron's ability to get a fair judicial hearing, including presidential interference, unethical conduct by plaintiff's attorneys and a judicial process that has failed to respect the law.

A U.S. State Department report issued earlier this year concluded that "systematic weakness and susceptibility to political or economic pressure in the rule of law" and "corruption and denial of due process" are common in Ecuador, and noted in particular that disputes with U.S. companies have become politicized. Transparency International consistently ranks Ecuador near the bottom among countries it surveys in the region. Ecuador ranked 151 out of 180 countries surveyed for Transparency International's Corruption Perceptions Index 2008 and received a score of 2 out of 10 (10 highly clean, 0-highly corrupt). In recent years, and especially since the election of President Rafael Correa, Chevron has experienced increasing unfairness and denial of justice in the case. Multiple international observers have concluded that Ecuador's judiciary today is dominated by the executive and legislative branches, and ample evidence supports that proposition. President Correa has pledged his full support to the plaintiffs and their supporters. His government has repeatedly proclaimed Texaco and Chevron guilty, and his administration's open support for the plaintiffs and intervention in the legal proceedings show a corrupt and ongoing joint effort to impugn the reputation of Chevron and its employees, to try to shift Petroecuador's liabilities to Chevron.

This example illustrates the importance of investor-state arbitration provisions which exist in the current U.S.—Ecuador Bilateral Investment Treaty. Even though TexPet fulfilled all of its responsibilities in accordance with the executed agreements, it and its affiliates have been victims of a denial of justice and lack of due process in the Ecuadorian courts. Only when we obtain a full and fair hearing in a legitimate court or international tribunal will the facts in this case be considered on an impartial basis, and only then will Chevron and its affiliate receive fair and impartial justice. Without investor-state arbitration in this case, we would be facing a massive and fraudulent verdict against us with no means of redress.

Moving forward

As the Committee reviews this important issue and the Administration reviews the 2004 Model BIT, we urge that any changes to the BIT seek to improve the protection afforded to U.S. investors and bring benefit to the U.S. economy, energy security, companies and workers alike. Narrowing protections and restricting access to investor state-arbitration will disproportionately impact U.S. companies abroad, and set a precedent that will move us farther from the goal of achieving a strong global international investment protection regime. U.S. leadership is imperative to ensure that U.S. companies can compete on a level international playing field.

Chevron appreciates this opportunity to provide input to the Subcommittee and would welcome further dialogue.

Statement of the Coalition of Service Industries

The Coalition of Service Industries (CSI) appreciates the opportunity to submit a statement for the record on investor protections in U.S. trade and investment agreements. CSI is the leading business association dedicated to reducing barriers to U.S. services exports and investment and mobilizing support for policies that enhance the global competitiveness of U.S. service providers.

The importance of services in the U.S. economy has been increasing for decades. Services comprise 78% of U.S. private sector GDP and 80% of private sector employment. U.S. services companies are the world's most innovative and competitive, but with 95% of the world's consumers living outside the United States, these companies must increasingly look overseas if they are continue to grow and create American jobs.

Why Invest Abroad

New customers abroad can expand U.S. companies' revenues and profitability much more than can the U.S. market alone. Despite the large size of our economy, the past generation has seen slower growth in the U.S. compared with much of the rest of the world. From 1990–2008, U.S. GDP grew at an average below that of the rest of the world, and significantly below that of emerging and developing economies as a whole.[1]

Direct investment is one of the principal ways by which U.S. services companies compete in the global marketplace. Sales of services through direct investments in foreign markets account for the largest share of global trade in services. U.S. sales of services through companies' affiliates in foreign markets are significantly larger than crossborder exports of services; such sales totaled $806 billion in 2006, up from $413 billion in 2000.[2]

Investment in foreign markets is an imperative for many U.S. services companies for a variety of reasons. In some cases, a physical presence may be a legal requirement in order to supply a service. In many other cases, the inherent nature of the service is such that it cannot be supplied crossborder, but must be provided directly to clients and customers via an on-the-ground presence in a foreign market.

SALES OF SERVICES BY U.S. FOREIGN AFFILIATES

(U.S. $ millions)

	2004	2005	2006
All Countries	**642,840**	**725,036**	**806,310**
Canada	65,166	77,651	88,826
Europe	366,899	412,624	457,921
Latin America & other Western Hemisphere	63,652	72,414	80,084
Africa	8,108	10,008	10,469
Middle East	3,446	4,026	5,478
Asia & Pacific	135,569	148,313	163,533

Source: U.S. Bureau of Economic Analysis

The Benefits of Foreign Investment

Economic activity abroad by U.S. firms complements domestic activity. U.S. companies' presence in foreign markets has contributed strongly to productivity growth in the United States, and thus to higher living standards.[3] According to one study, each dollar of additional foreign capital spending is associated with $3.50 of additional domestic capital spending. Further, U.S. firms' expansion of employment abroad is associated with expanded employment in the United States.[4] It is often assumed that U.S. companies are "exporting jobs" when they hire workers in foreign countries, but the historical data show the opposite: when U.S. companies expand their employment abroad, they also generally tend to expand domestically. Viewed over the longer term, the data demonstrate that, rather than being substitutes for one another, the domestic and foreign operations of U.S. companies have been complementary.[5]

The United States also benefits tremendously from inward investment by foreign companies, and *services related* foreign investment constitutes the bulk of total foreign investment in the U.S. Such investment supported 3.2 million American jobs in 2006, or about 60% of all jobs supported by foreign investment in the United States.[6] Inward foreign direct investment contributes to productivity growth, provides a source of financing for the current account deficit, and generates high-paying jobs for American workers.

Foreign investors participate in a wide variety of services activities in the United States. Among the 50 states, services-related foreign investors are particularly large employers in California, New York, Texas, Florida, New Jersey, Pennsylvania, Massachusetts, George, and North Carolina. (See Annex I for more detail).

In short, both inward and outward foreign direct investment contribute to higher levels of productivity and employment in the United States.

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[1] Slaughter, Matthew. "How Multinational Companies Strengthen the U.S. Economy." Published by the Business Roundtable and United States Council Foundation, Spring 2009.

[2] Bureau of Economic Analysis, Survey of Current Business, October 2008. Data cited are the latest available.

[3] Economic Report of the President, February 2007, p. 168.

[4] Ibid., p. 184.

[5] Ibid, pps. 185–6.

[6] Bureau of Economic Analysis, Interactive Data Tables.

The need for investor protections

Foreign investments are by nature long-term commitments, and require high levels of investor confidence. Sufficient investor protections are in turn crucial for investor confidence, and in creating a climate in the host country in which high-quality, long-term investment can be attracted. Predictability, the rule of law, contract sanctity, and property rights are all essential. For those reasons, CSI members place great importance on bilateral investment treaties, and on the investment chapters of our bilateral free trade agreements.

These agreements provide for market access or the right to establish a commercial presence, and they protect U.S. investment abroad while attracting U.S. investment and trade to the partner economies. They encourage the adoption of market-oriented domestic policies that treat private investment in an open, transparent, and nondiscriminatory manner and encourage services companies to secure a physical presence in a foreign market.

CSI seeks several characteristics in BITs and in the investment chapters of FTAs.

- —The investor-state arbitration mechanism. This is one of the most crucial elements of a sound investment regime. The investor-state dispute settlement mechanism can ensure U.S. investors that their investments are protected against arbitrary, discriminatory and unfair government actions.
- —A broad definition of "investment," which includes portfolio investment, not solely cross-border investments with long-term aims.
- —Appropriate protections against direct and indirect expropriation and guarantees of prompt, adequate and effective compensation when it occurs.
- —The ability to transfer all payments related to an investment.
- —Retrospective application of investment protections. That is to say, the protections should apply to pre-existing investments, as has been in the case in our earlier bilateral investment treaties.
- —A ban on performance requirements, such as the requirement to export a certain portion of output, or to hire certain numbers of host country nationals.
- —Pre-establishment provisions, under which national treatment is extended to investors prior to establishing in a market.
- —Use of a negative list, stating the specific services that will be exempted from coverage in the agreement, with all other services open to investment.

Conclusion

Employing 80% of the U.S. workforce and accounting for 78% of our GDP, the service sector is a driver of U.S. economic growth and jobs. Central to sustaining the growth of this dynamic sector is the ability of U.S. companies to expand abroad to provide services to customers in fast-growing foreign markets. Investment abroad is therefore part and parcel of continued U.S. economic growth, as is investment in the United States by foreign service providers. The confidence and predictability that are afforded by strong investor protections help make such investments viable, with important economic benefits for both the investor and the host country alike.

ANNEX I: U.S. EMPLOYMENT SUPPORTED BY FOREIGN INVESTMENT

Employment Supported by Foreign Investment
By State and Industry Sector, 2006
(thousands of employees)

	Total	Manufacturing	Services & other
Alabama	73.6	45.6	28
Alaska	12.2	2.7	9.7
Arizona	71.1	20	51.2
Arkansas	33.7	23.6	10.1
California	572.5	187.2	385.2
Colorado	75.9	24.5	51.4
Connecticut	104.9	38	66.9
Delaware	25.2	11.2	14.1
District of Columbia	17.3	3.2	14.1
Florida	248	66.8	181.2
Georgia	173.6	62.9	110.8
Hawaii	28.5	2.9	25.6
Idaho	13	4.3	2.7
Illinois	243.1	90.1	153
Indiana	148	95.9	52.1

ANNEX I: U.S. EMPLOYMENT SUPPORTED BY FOREIGN INVESTMENT—Continued

Employment Supported by Foreign Investment
By State and Industry Sector, 2006
(thousands of employees)

	Total	Manufacturing	Services & other
Iowa	40.2	21.5	9.3
Kansas	46.5	26.1	20.4
Kentucky	91	47	44
Louisiana	49.7	16.3	33.4
Maine	24.4	7.9	3
Maryland	104.1	26.6	77.5
Massachusetts	173	49	124
Michigan	195.5	119.6	75.9
Minnesota	86.5	28.4	58.1
Mississippi	25.7	10.4	15.4
Missouri	85.7	47.1	15.1
Montana	6.8	1.8	5
Nebraska	18.7	10.7	3.6
Nevada	35.9	9.1	9.3
New Hampshire	37.1	20.2	16.9
New Jersey	230.5	79.5	150.9
New Mexico	14.2	2.4	11.9
New York	389.3	69.7	319.8
North Carolina	209.4	98.6	110.8
North Dakota	8.3	3.9	1
Ohio	213.3	114.7	98.6
Oklahoma	35.9	*	6
Oregon	44	15.7	28.4
Pennsylvania	249	112.4	136.6
Rhode Island	19.5	4	15.5
South Carolina	114.3	62	52.3
South Dakota	6.7	3.6	3.2
Tennessee	140.3	72.4	67.8
Texas	368.2	130.2	238
Utah	34.6	10.6	23.9
Vermont	9.8	3	1.1
Virginia	150.8	44.1	106.6
Washington	88.2	27.7	60.5
West Virginia	19.9	10.1	9.9
Wisconsin	87.2	44.6	42.6
Wyoming	8	2.1	5.8
TOTALS	**5,331**	**2,032**	**3,158**

* data suppressed to maintain confidentiality.
Note: totals may not match the sum of the 50 states due to suppression of some data to maintain confidentiality
Source: Bureau of Economic Analysis, Interactive Data Tables.

Statement of Kevin P. Gallagher[1]

Mr. Chairman, Members of the Subcommittee, thank you for the opportunity to speak to you today about this critical issue on behalf of the Working Group on Development and the Environment In the Americas, a group of economists that I co-chair from across the Western Hemisphere that has been studying the economic impacts of foreign investment liberalization under U.S. investment and trade agreements in our respective countries.

We particularly applaud you for expressing concern about the extent to which "the FTAs and BITs give governments the "regulatory and policy space" needed to pro-

[1] Professor of International Relations, Boston University, Senior Researcher, Global Development and Environment Institute, Tufts University. This testimony presents the views of the author only and not those of either university.

tect the environment and the public welfare." It is to these concerns that we address this testimony.

As I mentioned, we conducted a comprehensive review of the impacts of foreign investment liberalization in Latin America and show how foreign investment liberalization through Bi-lateral Investment Treaties (BITS) and Preferential Trade Agreements (PTAs) has fallen far short of stimulating broad-based economic growth and environmental protection in the region. Given this finding, in a report for policy-makers and in a peer-reviewed book we recommend that the "policy space" for policies that enable foreign investment to stimulate growth and sustainable development should be accommodated in future BITS, PTAs and in the global trade regime.[2]

Our research, outlined below, suggests a number of specific measures that should be honored in terms of policy space for development-oriented policies in U.S. BITS and FTAS:

- The right to exercise pre-establishment screening of firms wishing to enter a market, including but not limited to an environmental impact assessment of the investors.
- The right to deploy capital controls and other counter-cyclical policies to prevent and recover from economic crises.
- The right to deploy selective performance requirements such as, but not limited to, joint venture requirements, environmental technology requirements, and other instruments that will encourage broad-based growth in the host country.
- The right, post establishment, for host nations to seek and publicize information from a potential investor, including environmental, labor, and social information.
- Our research also suggests that host nations should also deploy their own national innovation, competitiveness, employment, labor rights, and environmental regulations. And most importantly that upon entering an agreement with the United States that these issues become part of an institutionalized and longer run agenda for reform and harmonization.
- Finally, our research suggests that treaties should designate a venue, such as the international court in The Hague, where conflicts between BITS, FTAS and other regional and multi-lateral treaties can be resolved.

Summary of Research

In our research, development and environmental economists from the United States, Mexico, Brazil, Argentina, Chile, and Costa Rica wrote the report based on original research from across the region. In case studies on Argentina, Brazil, Bolivia, Chile, Costa Rica, Ecuador, Mexico, Uruguay, and Venezuela. The Working Group examined how foreign investment during the reform period has affected economic growth, environmental policy and performance, and the countries' political economies.

Beginning in the early 1990s, nations in the Americas began to liberalize their regimes for foreign investment. Pursued unilaterally or BITS or PTAs, a typical set of reforms included the elimination of performance requirements such as requirements to source from domestic firms or to export a certain percentage of production, restrictions on the ability to exclude certain sectors from FDI and to "screen" foreign investment for development goals, restrictions on the ability to require joint ventures or research and development facilities, and so forth. Moreover, such reforms alter the nature of settling disputes over foreign investment. Whereas trade agreements have traditionally relied on states to settle disputes among themselves in international fora, newer trade and investor agreements have "investor-state" dispute systems where foreign firms can directly sue a national or local government without host government oversight.

These policies were advocated by the U.S. government, the World Bank, and the International Monetary Fund and endorsed enthusiastically by many governments across the Americas. They have become enshrined in the 1994 North American Free Trade Agreement (NAFTA) between the U.S., Canada and Mexico, which became the template for subsequent regional and bilateral accords, including agreements on the U.S.-Chile Free Trade Agreement, the U.S.-Dominican Republic-Central Amer-

[2] The policy report, titled Foreign Investment and Sustainable Development: Lessons from the America can be downloaded at: http://ase.tufts.edu/gdae/WorkingGroup_FDI.htm. The book and full-length studies, Rethinking Foreign Investment for Sustainable Development: Lessons from Latin America, is available at: http://www.amazon.com/Rethinking-Foreign-Investment-Sustainable-Development/dp/1843313162.

ica Free Trade Agreement (CAFTA), the U.S.-Peru Free Trade Agreement and countless numbers of Bilateral Investment Treaties (BITS). Investment liberalization of course, has been part of a larger effort broadly referred to as the Washington Consensus. The broader reforms include a package of economic policies that promote economic development by opening national economies to global market forces. Over the last twenty years, governments throughout Latin America have reduced tariffs and subsidies, eliminated barriers to foreign investment, restored fiscal discipline by reducing government spending, and have generally reduced the role of the state in all aspects of the economy.

The promise, among others, of following these policies is that FDI by multinational corporations will flow to developing countries and be a source of dynamic growth. Beyond boosting income and employment, the hope was that manufacturing FDI would bring knowledge spillovers that would build the skill and technological capacities of local firms, catalyzing broad-based economic growth; and environmental spillovers that would mitigate the domestic ecological impacts of industrial transformation.

These policies and agreements have raised concerns, in part because they have shown poor results. Economic growth in per capita terms in the region was slower than in the last decades of the import substitution period—less than 2% since 1990, the period of the reforms. A major finding of our work is that slow growth is in part explained by the fact that FDI failed to lead to more total investment into Latin American economies.

Among our main findings are:

1. FDI was concentrated in a small handful of countries in the region. Brazil, Mexico, Argentina, Chile and Venezuela received more than 80 percent of all the FDI in the region;
2. Foreign firms by-and-large located in Mexico and the Caribbean tend to serve as export platforms to the United States, whereas those that located in South America tend to sell to domestic markets in that region.
3. FDI was attracted by traditional determinants, not necessarily whether a nation has a regional or bilateral trade and/or investment treaty or if it can serve as a pollution haven for foreign firms;
4. When FDI did come, foreign firms tend to have higher levels of productivity and higher wages and generally increase trade in the region; yet
5. FDI fell far short of generating "spillovers" and backward linkages that help countries develop, and in many cases wiped out locally competing firms thereby "crowding out" domestic investment.
6. The environmental performance of foreign firms was mixed, sometimes leading to upgrading of environmental performance, and in others performing the same or worse than domestic counterparts.

Working Group studies documented and analyzed the track record in specific countries and sectors as well:

- In Brazil, Argentina, Mexico—three countries that have received the lion's share of FDI in the region—and Costa Rica it found that:
    - Foreign firms have higher wages, productivity, and trade *vis a vis* domestic firms
    - However, linkages with national firms and the domestic economy in general are weak, specially in Mexico and Costa Rica
    - Although foreign firms may bring the technologies generated in their headquarters, they do not contribute to an increase in R&D expenditures in the host economies
- In Brazil, Mexico, Chile, and Argentina
    - Virtually all foreign firms transferred environmental management systems to host countries; however
    - It is not clear that such firms were actually in compliance with host country laws and in Brazil there is little indication that foreign firms were more likely to be in compliance than domestic firms were;
    - There it little evidence that foreign firms are greening their supply chains (given that so many supply chains were wiped out from FDI); and
    - In some instances such as the forestry sector in Chile, foreign firms that exported through fair trade certification schemes were "upgrading" to higher levels of environmental standards;
    - In others, such in Mexico's electronics sector, foreign firms were not exporting to meet strong standards in Europe given that their chief export market, the United States, does not have such standards.

- In Venezuela, Bolivia, Ecuador, and Uruguay
  - A Uruguayan BIT constrained the set of policies available to solve a conflict over foreign investment and transboundary environmental problems with Argentina; whereas
  - BITs in Bolivia, Ecuador, and Venezuela were refused by governments that were able to renegotiate the terms of contracts with foreign hydrocarbon firms.

New Directions for FDI and Sustainable Development

The Working Group found—in agreement with the broader literature on the subject—that investment regime liberalization-led FDI has had at best a limited success in Latin American countries.

Hence, it comes as no surprise to find that virtually all newly elected governments in Latin America, and now your committee, are rethinking the role of FDI in their economies. While some countries are just beginning to debate the issue, others are going so far as to nationalize foreign firms. Yet, most governments are looking for a more balanced approach. What our research makes clear is that new policies are needed. Based on the research abovementioned, three broader lessons can be drawn out as principles for policy-making in this field:

1. **FDI is not an ends but a means to sustainable development. Simply attracting FDI is not enough to generate economic growth in an environmentally sustainabe manner.** The report shows that even in the nations that received the lion's share of FDI in the region—Brazil, Argentina, and Mexico—FDI fell short of generating spillovers and sustained economic growth. FDI needs to be part of a comprehensive development strategy aimed at raising the standards of living of the nation's population with minimal damage to the environment.
2. **FDI policy needs to be paired with significant and targeted domestic policies that upgrade the capabilities of national firms and provide a benchmark of environmental protection.** There are numerous country-specific policies that are either being implemented or debated regarding ways in which Latin American nations can overcome information and coordination externalities, access to credit problems, and competitiveness issues on the part of their domestic firms. In this regard, lessons from Asia may be drawn, since many nations in that region have put in place targeted industrial policies to link domestic firms to foreign firms to enable domestic firms to develop into competitive exporters themselves.
3. **International agreements, whether at the World Trade Organization (WTO) or at the level of BITS and PTAs need to leave developing nations the "policy space" to pursue the domestic policies necessary to foster sustainable development through FDI.** The emerging international regime of international investment rules is restricting the ability of developing nations to pursue some of the policy instruments that have been successful at channeling FDI for development in Asia and elsewhere. When acting collectively under the auspices of the WTO developing nations have largely succeeded in blocking proposals that would further restrict such policy space. However, slower movement in global trade talks has led to a proliferation of BITS and PTAs between developed and developing countries where developing countries have much less bargaining power and end up exchanging policy space for market access.

Final Remarks

I would like to thank and congratulate the Chairman and the Subcommittee for holding this hearing today. In the wake of the current financial crisis it is both timely and important to review the elements of investment obligations in U.S. trade and investment agreements. The 2004 model U.S. BIT outlaws measures such as capital controls, performance requirements, and technological transfer—all measures that the economics profession endorses and that the U.S. is advocating that nations across the world deploy and that we ourselves are conducting at home.

Your hearings are an important first step in a more comprehensive review of U.S. trade and investment policy. I look forward to your questions, and to constructively working with you on these issues into the future.

Statement of Linda Menghetti

The hearing on "Investment Protections in U.S. Trade and Investment Agreements," held by the Subcommittee on Trade of the House Committee on Ways and Means on May 14, 2009, provided an important opportunity to consider several of the key issues relating to investment protections and their importance for U.S. investors and the U.S. economy. I appreciated the opportunity to testify at that hearing and very much welcome the additional opportunity to provide further views on the proposals made at that hearing at the request of the Chairman and Members of Subcommittee during the hearing. These comments address the proposals set forth by Professor Stumberg and others during the hearing and in written testimony presented that day. These comments are meant to supplement my own written testimony, submitted in conjunction with the hearing, which provides important background information on these long-running debates.

These additional views are submitted on behalf of the Emergency Committee for American Trade—ECAT—an association of the chief executives of leading U.S. business enterprises with global operations. ECAT was founded over four decades ago to promote economic growth through expansionary trade and investment policies. Today, ECAT's members represent all the principal sectors of the U.S. economy—agriculture, finance, high technology, manufacturing, merchandising, processing, publishing and services. The combined exports of ECAT companies run into the tens of billions of dollars. The jobs they provide for American men and women—including the jobs accounted for by suppliers, dealers, and subcontractors—are located in every state and cover skills of all levels. Today, the annual sales of ECAT companies exceed $2.7 trillion, and the companies employ more than 6.4 million people.

Professor Stumberg included numerous proposals in his written testimony, many of which were also raised and rejected during the drafting of the 2004 U.S. Model BIT. I will address each issue in turn. But first, these proposals should be placed in appropriate context.

As you know, the investment-related negotiating provisions of the Bipartisan Trade Promotion Authority Act of 2002[1] directs U.S. negotiators to pursue strong investment protections. The Act was the product of vigorous debate, both in the House and Senate, and reflects a careful balancing of the United States' so-called "offensive" and "defensive" interests with respect to cross-border investment. In view of this legislation, and in the interest of maintaining consistency between BITs (which, technically, were not covered by the 2002 Act) and investment chapters in free trade agreements, in 2003 and 2004 the Executive Branch undertook to revise the United States' Model BIT in accordance with the 2002 Act's investment negotiating objectives.

I was an active private sector participant in the Administration's review of the Model BIT in 2003 and 2004, along with many other stakeholders. I can tell you that the debates were intense, that they included input from all stakeholders, and that the agreement that was ultimately forged reflected the input of all of these stakeholders. The same careful balancing of U.S. interests that was embodied in the Act was also reflected in the 2004 Model BIT.

Many of the changes Professor Stumberg and others now propose were considered and debated during the last review. The compromise positions that were worked out, and that are embodied in the 2004 Model BIT, narrowed the legal protections available to U.S. investors abroad—a significant cost to ECAT companies and other globally active U.S. businesses. That compromise was the result of a careful weighing of offensive positions—the interest of U.S. investors in protecting their investments abroad and obtaining a remedy for any adverse treatment by foreign governments—and defensive positions—the concerns of certain domestic constituencies interested in minimizing the theoretical possibility of the United States being held liable for the adoption or enforcement of challenged measures (although, of course, this has not happened to date).

Professor Stumberg's proposals would reopen these issues in order to further narrow, and weaken, the current legal protections available to U.S. investors abroad. These changes, which might look minor to a casual observer, would, in effect, constitute a dramatic reversal of longstanding, bipartisan U.S. policy. They would also put at risk billions of dollars of U.S. investment abroad, investment that provides strong benefits to the U.S. economy, U.S. economic activity, U.S. companies and U.S. workers.

I now turn to address each of the proposals raised during the May 14th hearing.

[1] Enacted as part of the Trade Act of 2002, Title XXI, Section 2102(c), Pub. L. 107–210 (2002).

Selective Negotiation of Investor-State Dispute Settlement

During the hearing, Professor Stumberg questioned the need for investor-state dispute settlement with certain countries, particularly with respect to the Korea-United States Free Trade Agreement (KORUS FTA) and bilateral investment treaty (BIT) negotiations with China. It was also suggested that the negotiation of binding investor-state dispute resolution provisions not be a consistent U.S. negotiating objective, but should depend on the adequacy of the other country's judicial system.[2]

In fact, investor-state dispute settlement is vitally needed in both those cases, as well as in other ongoing and future negotiations, to ensure that U.S. companies have a level playing field in those markets and can ensure that the obligations that those other countries undertake can be fully enforced before neutral tribunals.

Notably, both Korea and China have concluded BITs with other OECD member countries that incorporate investor-state dispute settlement, and the United States and its investors should not be treated any differently.

- Korea, for example, has BITs in place with investor-state dispute settlement with the following major developed countries: Austria, Belgium, the Czech Republic, Denmark, Finland, Germany, Italy, Japan, the Netherlands, Spain, Sweden, and the United Kingdom.
- China has BITs in place with investor-state dispute settlement with Finland, Germany, and the Netherlands and trade agreements with investment chapters and investor-state dispute settlement with Singapore, among other major countries.

As explained at the hearing, the United States has far fewer BITs than most other major capital exporting nations. Removing investor-state arbitration from the Korea-U.S. FTA or excluding it from an eventual U.S.-China BIT would put U.S. investors and their workers at a disadvantage vis-à-vis competitors from other countries with which Korea and China have treaties, including those in Europe and Asia.

Investor-state dispute settlement is a vital tool for U.S. investors to ensure a level playing field in foreign countries, many of which, like Korea and China, have maintained significant barriers to foreign investment. In these and many other countries, the investment commitments in these instruments are not reflective of the country's own domestic legal protections and investor-state dispute settlement would provide the only way for investors to ensure that countries keep their commitments to these basic standards. ECAT was very disappointed that the investor-state dispute settlement process was not included in the U.S.-Australia FTA. Obviously, U.S. investors will still have recourse to Australia's legal system and its respected judiciary, but U.S. investors lack the ability to take all of the same types of claims that would have been available under the FTA before Australia's own court system. Australia's refusal to accept this provision, particularly after it was included in Australia's FTA with Singapore, puts U.S. companies at a competitive disadvantage. ECAT notes that the FTA contemplates that the availability of an investor-state dispute settlement mechanism can be revisited.

The investor-state mechanism also has the important benefit of allowing claims to proceed in a de-politicized manner. Before the advent of investor-state dispute settlement, U.S. investors would need to request the State Department to espouse their claims on their behalf. Unlike other dispute settlement processes in an FTA or the WTO where oftentimes entire industries are affected, the espousal of an individual investor's claim elevates an essentially private dispute to a political and diplomatic one, raising unnecessary irritants in foreign relations. From the perspective of investors, relying solely on the government to espouse their claims will most often lead to no claim being brought as governments have larger issues to address with their foreign counterparts.

Investor-state dispute settlement is both vital and appropriate for investors given that investors have a unique relationship with capital at risk in the foreign territory of another government. Notably, an investor's rights are limited to bringing invest-

[2] There was some discussion at the hearing that a *forum non conveniens* approach might be used to determine with which countries the United States should enter into a relationship with investor-state dispute settlement. This common law doctrine—that allows a court the discretion to reject jurisdiction over a case when it finds that another judicial forum is adequate, available and more appropriate—generally focuses less on the adequacy of the other forum and more on the availability of witnesses and other evidence. This doctrine is simply not appropriate or viable to use as a proxy to pick and choose with which countries the United States should enter into an investment treaty with investor-state dispute settlement and would represent a step backwards in strong legal protections that are vitally important for U.S. investors overseas and the economic growth and opportunities that they support here in the United States.

ment claims only before an investor-state dispute settlement panel, not other claims that might fall under a broader trade agreement. The proposal raised at the hearing by Ms. Lee that non-investor stakeholders in an FTA should have similar rights to bring individual actions against a foreign government for non-investment claims is neither feasible, nor appropriate. Notably, an investor acquires legal rights in that foreign country as result of its investment, rights that other stakeholders who are not investors simply does not have. No international instrument creates such a private right for non-investors, and it is not clear that any government, including the U.S. government, would agree to create a new right of action for a class of stakeholders that do not have the relationship that an investor has by virtue of its investment in a foreign territory, an investment that brings with it domestic legal rights.

Minimum Standard of Treatment

In his written testimony, Professor Stumberg proposes to "[n]arrow the minimum standard to the elements of customary international law as explained in the U.S. brief in *Glamis*." The United States, in its Counter-Memorial in the *Glamis* case, suggests that minimum standards of State conduct have been established "in only a few areas," citing as examples the requirements: (1) to provide the "customary international law obligation of full protection and security;" and (2) to ensure that a "denial of justice" does not occur. As a preliminary matter, the U.S. Counter-Memorial does not, as Professor Stumberg appears to suggest, set forth an exhaustive list. Like the 2004 Model BIT discussed below, the U.S. Counter-Memorial provides these as examples.

Professor Stumberg's proposal is an overly narrow interpretation of customary international law and its adoption would be detrimental to U.S. interests.

One of the effects of Professor Stumberg's proposal would be to significantly narrow the minimum standard of treatment, particularly the fair and equitable treatment standard included in the 2004 Model BIT. While the 2004 Model BIT provides that fair and equitable treatment *includes* the obligation not to deny justice, it lists denial of justice as only one example. Thus, the Model BIT allows for other elements of the fair and equitable treatment standard—*e.g.*, an investor's legitimate expectations created by government commitments—to be considered as part of the minimum standard of treatment. Professor Stumberg's proposal would eliminate this possibility, which is a widely accepted part of customary international law.

Further, by defining the minimum standard of treatment to include only those principles of customary international law specifically identified in the *Glamis* brief, the United States would forgo the benefits of the evolutionary nature of customary international law. As BITs proliferate, and state practice improves (often led by the example of the United States), the minimum standard of treatment required by international law continues to evolve. U.S. investors abroad would thus be deprived of the evolution of these protections in the years to come.

Professor Stumberg's concern appears to be that the "minimum standard of treatment" prescribed by customary international law could be greater than the protections guaranteed under U.S. law. The risk that Professor Stumberg has identified is negligible. As I discussed in my written testimony, and at the hearing, the United States already provides strong protections both to its own citizens and to foreign investors, who have full rights to use our courts and seek the protection of our Constitution and other governing laws. The protections are embodied in the Takings, Due Process and Equal Protection Clauses of the Fifth and Fourteenth Amendments to the Constitution, the Administrative Procedure Act (APA), as well as other U.S. laws that establish strong protections for U.S. property rights in the United States. These laws protect U.S. citizens and foreign investors alike.

In fact, Congress recognized the strength of U.S. protections in the Report of the Senate Committee on Finance on the investment negotiating objectives contained in the 2002 Act. Specifically, as I noted in my written testimony, that Report found that "protections of investor rights under U.S. law generally *equal or exceed* international law standards (including the non-discrimination and investment protection obligations described above)." [3]

Such protections, however, often do not exist in host countries where U.S. companies and individuals invest. Ironically, the State Department seemed to recognize this in *Glamis*. As the State Department explained, "a minimum standard of treatment is necessary where protections under treaty-based national treatment obligations do not adequately protect aliens because the host State treats it own nationals

[3] Report 107–139 of the Senate Committee on Finance, Bipartisan Trade Promotion Authority Act of 2002 (H.R. 3005) at 13 (emphasis added).

unjustly or egregiously, and accords aliens like treatment."[4] Providing broad, not narrow, investment protections—including under the fair and equitable treatment standard—provides an important check against such unfair treatment of U.S. investors, while posing no appreciable risk to the United States.

Expropriation

Professor Stumberg proposes that the U.S. should "[n]arrow indirect expropriation so that it does not apply to nondiscriminatory regulations as explained in the *Methanex* award." *Methanex* provides, in pertinent part, that "a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and which affects, *inter alia*, a foreign investor or investment is not deemed expropriatory and compensable. . . ."[5] Professor Stumberg's proposal would significantly narrow an investor's rights and would be inconsistent with international law.

Of course, it is the right of a sovereign government to take private property, *provided that* it is taken for a public purpose, in a non-discriminatory manner, on payment of prompt, adequate, and effective compensation, and in accordance with due process of law. This is the recognized standard under customary international law, and under U.S. law as well. The government may do so directly—*e.g.*, by exercising eminent domain—or indirectly—*e.g.*, by exercising regulatory authority. International and domestic law recognizes that indirect expropriation requires compensation because a government measure can impair the value of property to such an extent as to be equivalent to a direct taking.

Professor Stumberg's proposal would limit the right to compensation for indirect expropriation to measures that are discriminatory or serve illegitimate purposes. This would be inconsistent with customary international law, (and, in most cases, domestic law), which does not limit compensation to improperly motivated government takings of property. In fact, under international and domestic law, a government's motives are largely irrelevant for determining whether expropriation has occurred. Even when the government takes property for the most noble of public purposes, compensation may be owed to those whose property is taken. Indeed, as provided in Annex B—Expropriation of the 2004 Model BIT, which itself was based on the landmark U.S. Supreme Court case *Penn Central Transp.* v. *New York City*,[6] the analysis of whether there has been a compensable indirect expropriation is a case-by-case analysis where the following factors, among others, are considered:

- The economic impact of the government action;
- The extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
- The character of the government action.

Professor Stumberg's suggestion reflects a concern expressed by some that rules prohibiting indirect expropriation somehow discourage or prevent proper government regulation of labor standards or the environment. International businesses recognize that it is an important right and duty of sovereign governments to regulate labor and environmental standards. The purpose of the indirect expropriation provision (and of the Takings Clause of the U.S. Constitution,[7] as well) is not to discourage regulation, but simply to ensure that regulations do not force one set of investors to bear the full costs of regulations that should be borne by society as a whole.

In any case, there is no need to amend the 2004 Model BIT, which already provides significant limitations on an investor's right to claim compensation for indirect expropriation. According to Annex B of the 2004 Model BIT, "non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations," except in "rare circumstances."

Further modification to that language is simply not warranted. As I warned at the hearing, proposals that would create a safe harbor for government regulation for environmental or other public purposes would put in jeopardy important U.S. national economic and other policy goals. Exempting environmental government regulation, for example, would allow other governments to expropriate U.S. environmental technology with impunity, undermining the ability of U.S. companies to cre-

[4] U.S. Counter-Memorial, *Glamis Gold Ltd.,* v. *United States of America*, September 19, 2006, at p. 220.

[5] *Methanex Corporation* v. *United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, August 3, 2005, at Part IV—Chapter D, para. 7.

[6] 438 U.S. 104 (1978).

[7] *See, e.g., Penn Central Transp.* v. *New York City*, 438 U.S. 104 (1978); *Lucas* v. *South Carolina Coastal Council*, 505 U.S. 1003, 1018 (1992).

ate and maintain green jobs here in the United States and to develop innovative new technologies.

Definition of Investment

Professor Stumberg proposes to narrow the definition of investment in the 2004 Model BIT, which he claims currently "extends beyond the kinds of property that are protected by the takings clause of the U.S. Constitution." By tying the treaty definition of investment to the Constitution's Takings Clause, Professor Stumberg's intent appears to be to limit the type of property that can be expropriated. However, the current provisions of the 2004 Model BIT already adequately address these concerns.

The protections against expropriation only apply if government action "interferes with a tangible or intangible right or property interest in an investment." [8] This restrictive language was introduced into the 2004 Model BIT based on the U.S. Constitution's Takings Clause jurisprudence. Earlier U.S. BITs defined expropriation in terms of "investment" (not in terms of "property") and thus provided a broader scope of coverage for U.S. investors overseas.

ECAT remains concerned that this 2004 change in language was itself unnecessary, given the already broad U.S. jurisprudence under the Takings Clause defining what constitutes property more broadly than many other jurisdictions or than Professor Stumberg suggests. The primary effect of further restrictions on the definition of investment is not to change the protections available to foreign investors here in the United States. The primary effect is that other countries, which have much more restrictive definitions of property interests than the United States, will have leeway to deny full protection for U.S. investors overseas.

Denial of Benefits to Subsidiaries of U.S. Corporations

Professor Stumberg proposes that the 2004 Model BIT be revised to "[l]imit 'denial of benefits' language so as to preclude claims by subsidiaries of U.S. corporations." Professor Stumberg's proposal could be interpreted in one of two ways. It could mean that no protections under the U.S. Model BIT should be provided to shell corporations owned and controlled by U.S. parent companies. It could also mean that no subsidiary of any kind of a U.S. corporation could receive protections under the Model BIT.[9]

If Professor Stumberg proposes to preclude claims against the United States by nominally foreign shell companies, where the ultimate owners and investors are actually U.S., not foreign, corporations, such a revision is unnecessary. The current Model BIT already allows the United States to deny the treaty's protections to such shell company foreign investors. Specifically, Article 17(2) of the 2004 Model BIT provides that a party may deny benefits under the BIT to an enterprise of the other party, or to investments of that investor, if the enterprise "has no substantial business activities in the territory of the other Party" and persons of a non-party or of a denying party "own or control the enterprise." In other words, the United States can deny BIT benefits to nominally foreign companies that are mere shells and that are actually owned by U.S. investors. This provision already protects the United States against such shell company claims.

If, on the other hand, Professor Stumberg wishes to preclude legitimate subsidiaries of U.S. corporations that are incorporated in and do business in other countries from being able to avail themselves of the protections afforded under the 2004 Model BIT when they invest in the United States, Professor Stumberg's proposal would impact a striking range of companies. This is true in particular given the interconnected nature of the global economy and of the corporate structures of multinational companies. There is no reason, however, to deny such companies the BIT's protections. If they are legitimate foreign corporations with substantial business activity in the territory in which they are incorporated, the protections afforded under the 2004 Model BIT should apply, whether or not there is a U.S. entity somewhere to be found in their corporate structure. Any contrary rule would ignore the distinct legal personality an entity acquires when it establishes a presence in another territory and does business in that territory. Notably, the theoretical concern that allowing such subsidiaries to pursue investor-state dispute settlement would result in an onslaught of cases against the United States has, of course, never materialized with any country, since the United States entered into its first BIT in 1983.

[8] 2004 Model BIT at Annex B.

[9] As phrased, it could even mean that *U.S.* subsidiaries of U.S. corporations could not invoke a U.S. BIT against a foreign government. I assume that that is not what he means given that such a result would negate the benefits of a BIT for the United States.

Emergency Stabilization Measures

Professor Stumberg argues that the 2004 Model BIT should be revised to incorporate "the NAFTA prudential exception as a model to safeguard emergency stabilization measures." This revision is unnecessary from a defensive point of view, and it threatens to subject U.S. investors abroad to unfair and unpredictable discrimination.

From a defensive perspective, addition of a NAFTA-style prudential exception for emergency stabilization measures is unnecessary because the United States may already take appropriate stabilization measures pursuant to Article 20 of the 2004 Model BIT, without risk of claims from foreign investors.

Article 20 provides that "a Party shall not be prevented from adopting or maintaining measures relating to financial services for prudential reasons, including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or to ensure the integrity and stability of the financial system." A footnote further clarifies that "[i]t is understood that the term 'prudential reasons' includes the maintenance of the safety, soundness, integrity, or financial responsibility of individual financial institutions."

Article 20 provides that disputes arising under the prudential carve-out are to be settled by consultations between the two states, and, if necessary, state-to-state arbitration that is binding on any subsequent investor-state arbitration. A broader exception simply is not necessary to protect the United States' defensive interests.

Further, a broader NAFTA-style exception would potentially subject U.S. investors to unfair and discriminatory treatment abroad, by broadening the opportunity provided for a foreign government to take adverse action against a U.S. investor. The government would only need to state that the measure taken was "reasonable" in order to be able to deny U.S. investors protections afforded under the BIT. The prudential measures exception under NAFTA must be understood in context. It is part of a separate, detailed set of reciprocal commitments involving the financial services sector. There is no basis for such a broad exception in the U.S. Model BIT.

Capital Controls

Professor Stumberg proposes that the 2004 Model BIT be amended to "[a]llow countries to impose capital controls in response to a financial crisis." There is no defensive justification for such a provision. More importantly, the overwhelming consensus of economists is that encouraging capital controls would be devastating both for U.S. investors abroad and for the domestic markets in which capital controls are implemented.

This issue was carefully debated in the development of the 2004 Model BIT. There is no reason to reopen the debate now. Article 7, which provides that each party "shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory," appropriately reflects the fact that capital controls generally increase the risk that investors face and discourage foreign investment flows that BITs are designed to facilitate. Additionally, Article 7 already recognizes that a government may impose certain limitations on the right to transfer investment returns, such as when the government applies its bankruptcy, securities trading, or criminal laws, so long as the laws are equitable, non-discriminatory and applied in good faith.

Exhaustion of Local Remedies

Professor Stumberg proposes that the U.S. Model BIT should be revised to "require investors to exhaust domestic remedies before using investor-state arbitration." Such a proposal would introduce unnecessary costs and delay into the process, and would run contrary to current international legal practice, undoing a half-century of progress in international law.

As with many of Professor Stumberg's proposals, the question of whether to require investors to first seek domestic remedies was carefully considered during the drafting of the 2004 Model BIT. The proposal was rejected. Importantly, requiring the exhaustion of local remedies adds unnecessary cost and delay to the dispute resolution process. It is expensive to bring a lawsuit in local courts—the investor has to hire local counsel and prepare a case, and, in some instances, pursue a trial. In the United States this can take years and cost millions of dollars. In countries with less sophisticated legal systems, this could take decades.

More importantly, however, requiring that investors return to a system of mandatory local proceedings would require a U.S. investor to seek first to resolve the dispute through foreign local courts. But foreign law (unlike U.S. law) may not incorporate any of the BIT's protections, making the requirement to resort to local courts a fruitless exercise. The key objective of the U.S. BIT network is to provide U.S. investors with legal protections that may not otherwise exist in the foreign country.

A requirement to resort first to local courts would also deprive an investor of a neutral forum where its claims can be heard, which lies at the heart of investor-state arbitration. International law has steadily progressed away from requiring the exhaustion of local remedies. A return to that system would be damaging to the investment climate, and would represent a remarkable regression of international law in an area where the United States has done so much to promote progress.

Diplomatic Review

Professor Stumberg proposes that the 2004 Model BIT should be amended to "[e]nable a country to block a claim in sensitive sectors or to clarify the self-judging nature of key exceptions for security and prudential measures." As a general matter, exceptions to investment protections should be limited in number and narrowly defined. Otherwise, such exceptions could be used to erode important investor protections.

This is particularly true, for example, with respect to the first half of what Professor Stumberg proposes—*i.e.*, enabling a country to block a claim in so-called "sensitive sectors." Such a proposal is rife with the potential for abuse. It would allow a government to identify any sector in the economy as a "sensitive sector" and, accordingly, to block a claim against it in that sector. Singling out particular sectors would provide other governments the same ability to do so, with the result that those sectors of the economy with the most valuable foreign investment would be least likely to be protected. Consider the case of Venezuela, which is expropriating U.S. investment in a number of different sectors which it considers sensitive.

Requiring reviews and allowing countries to designate sensitive sectors would change what should be a private dispute to a politicized one, as governments would weigh in with each other to try to stop cases from going forward. This type of review would negate one of the purposes of investor-state dispute settlement to keep private disputes private and non-politicized.

In addition, the second half of Professor Stumberg's proposal—*i.e.*, clarifying the self-judging nature of exceptions for security and prudential measures—is unnecessary given the security exception in Article 18 and the broad prudential measures exception in Article 20 of the 2004 Model BIT. With respect to the essential security exception, the 2004 Model BIT provides a country with the ability to take actions "that it considers necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests." The addition of the phrase "that it considers necessary" significantly broadens the exception beyond that which was contained in the 1996 Model BIT. Indeed, ECAT is concerned that this language may be misconstrued and misused to allow foreign governments to evade responsibility in cases that do not involve essential security interests or in cases in which the foreign government's policies created the perceived threat to essential security interests. The result is that the United States faces no constraints in its ability to enact reasonable measures necessary for its national security. From a defensive point of view, this is as strong a position as possible.

In addition, and as I already discussed above, Article 20 provides a broad exception for countries to implement measures relating to financial services for "prudential reasons" or "to ensure the integrity and stability of the financial system." Thus, the United States has also reserved for itself the discretion necessary to enact prudential measures without stating that it can self-judge when the exercise of discretion is justified. If a measure is truly necessary to ensure the integrity of the financial system, the United States will be able to demonstrate the necessity of such a measure not only on a subjective but also an objective basis. Moreover, the omission of self-judging language in Article 20 protects U.S. investors abroad. Were the provision self-judging, it could allow host governments to discriminate against U.S. investors without limit under the guise of the prudential measures exception.

Investment Court

Professor Stumberg suggests that it is necessary to "[e]stablish stronger conflict of interest standards for arbitrators and eventually replace private arbitrators with an investment court that uses independent judges with tenure." Professor Stumberg's proposals are unnecessary and would infringe on the party-driven nature of arbitration.

Professor Stumberg's conflict of interest proposal appears to be a solution without a problem. The current conflict of interest rules work. Generally, the government and the investor each select an arbitrator and then those two arbitrators select a third person to serve as the presiding arbitrator. The appointed arbitrators must disclose all actual and potential conflicts, and each side has an opportunity to challenge the appointed arbitrators. Where genuine concerns have been raised, arbitrators generally have stepped down or have been replaced.

To the extent Professor Stumberg's proposal for an investment court stems from a concern over inconsistent awards, such concerns have proven over time to be unfounded. The threat of divergent and inconsistent awards has not materialized. There is no need for a standing body to impose consistency, which instead emerges as more cases are decided over time.

Private Right of Action

Professor Stumberg's suggestion that implementing legislation be enacted to "[e]nsure that BITs do not create a private right of action for investors to enforcing their treaty rights in U.S. courts" is unnecessary and inappropriate. Professor Stumberg's proposal is unnecessary because under U.S. law a treaty does not create rights that may be enforced in U.S. courts unless it is (i) self-executing or (ii) Congress creates such rights through legislation. No U.S. court of which I am aware has made such a determination with respect to a U.S. BIT or FTA investment chapter. Indeed, there is no evidence that investors have successfully prosecuted any such claims or are seeking to use U.S. courts over arbitration panels to bring BIT claims. Even if such claims were raised, that is a matter for the judiciary and does not require additional changes to the BIT text or U.S. implementation of a BIT. Like many of the proposals raised, this is a solution lacking a problem.

This proposal is also problematic in relation with the exhaustion of local remedies proposal also made by Professor Stumberg. While foreign investors in the United States still have the benefit of strong legal protections under the U.S. legal system regardless of a BIT, the same is not true for U.S. investors overseas. While Professor Stumberg's proposal only applies to the United States, it would be likely for any negotiating partner of the United States to follow the same approach which, if combined with the exhaustion of local remedies proposal, would preclude U.S. investors from having the benefits of the protections negotiated. That is, U.S. investors would, on the one hand, be required to exhaust local remedies and, on the other, be precluded from enforcing their rights in those local courts.

Federal Preemption

Professor Stumberg's final proposal is that Congress should "[e]stablish protections against federal preemption and unfunded federal mandates that BITs and FTAs can impose on states as a result of investment disputes." The assumptions underlying Professor Stumberg's proposal are incorrect. Any award that might someday be rendered in favor of an investor would run against the U.S. Federal Government, not against any state or locality. As well, it is the U.S Department of State's Office of the Legal Advisor that handles the claim for the United States, just as if the claim had been brought on the basis of a federal law, not on the basis of state or local law. Input and information is sought from states and localities, but no significant burden is placed on them to defend their own laws or actions. In addition, investment treaty tribunals do not require host governments to change their laws. Rather, if they find for an investor, an arbitral tribunal awards monetary compensation. Thus, there appears to be no need for the putative "protections" proposed by Professor Stumberg.

Seeking to create a blanket carve out for state and local action, however, would undermine a major benefit of the BIT—the protection that U.S. investors seek to obtain in foreign states, provinces and localities. The United States simply would not be able to negotiate a one-sided agreement, covering its federal actions only, while covering the foreign government's central and sub-central government actions. Failing to have such coverage would greatly diminish the value of the investment instrument for the United States, since U.S. investors oftentimes find themselves the subject of discriminatory, unfair or expropriatory actions at the sub-central level.

Conclusion

On behalf of ECAT, I appreciate the opportunity to provide these additional comments. As the Administration undertakes its review of the 2004 Model BIT, ECAT looks forward to working with you, the Congress and the Administration in support of international investment instruments that continue to expand the benefits for our economy, our industries, our workers and our broader national interest.

As discussed at the hearing and in written testimony, the 2004 Model BIT represents a substantial modification from the earlier 1994 Model. It incorporated provisions that narrowed the scope of key protections to address many of the same concerns that were raised again at the May 14th hearing.

The proposed changes discussed herein seek to address theoretical concerns that have not materialized either before or after the 2004 Model BIT was adopted. Indeed, most of these proposals were made at the time of the last BIT review and were rejected. Adoption of these changes going forward would weaken core investment protections at the expense of U.S. companies and their workers, to the detriment of U.S. economic interests. ECAT strongly urges that changes to the 2004 Model BIT be considered carefully and promote stronger, not weaker, protections for U.S. investors overseas.

Statement of Mark Hudson Botsford

I am a U.S. citizen who recently returned home to Washington, D.C., after spending many years in Argentina, as a private business consultant. I invested in local Argentine Treasury Bills, in October 2001, prior to the declaration of the largest sovereign debt default in history. After the default was declared, I found comfort in the fact that the IMF has a lending into arrears article, which declared that any country in default, must enter into good faith negotiations with all of its creditors in a transparent forum to determine capacity and willingness in any restructuring. Unfortunately, my hopes were dashed as the U.S. government supported the Argentine government and failed to insist on these negotiations, thereby allowing Argentina to extend deadlines on loans. In 2005, the SEC approved the restructuring process, as the majority of bonds were issued under New York State Court Jurisdiction. Again, the SEC failed to use precedent, and signed off on the largest haircut ever proposed, 70%. I did not enter the voluntary restructuring and am presently awaiting a new offer from the Argentine authorities. In 2006, the CRS submitted a report to Congress on this restructuring, which stated that the creditors were unable to generate much sympathy from Congress. As the CRS points out, I believe this is due to the fact that, by then, the nature of the creditors had changed. Prior to the default of December, 2001, Argentina had succeeded in aggressively marketing its debt for the first time to individuals in addition to institutions. After the default, since neither the U.S., through the IMF nor the SEC were effective in protecting U.S. investors overseas, the majority of these individuals sold their holdings at a big loss to large commercial banks and hedge funds. I have returned to seek a non legal solution to the problem of Argentina's continuing default, and to try to impede other countries, such as Ecuador, from following in her footsteps. However, one avenue I will not proceed on, is that which is afforded to me by the breach of the U.S. Argentina BIT. It is much too costly and time consuming, and even if I get a ruling in my favor, the lack of enforcement provisions make any effort in this regard fruitless. The Argentine successfully characterizes her creditors as vulture funds and opportunistic international banks. The reality was that individual investors, such as myself, saw their life savings evaporate, while the international community looked the other way. In a time when major banks and multinationals are teetering on bankruptcy, we should not be seen as promoting sovereign debt defaults around the world.

Statement of Sarah Anderson [1]

Thank you for the opportunity to submit comments on this important issue. I share many of the concerns raised by other witnesses regarding the investment protections in U.S. trade and investment agreements. As the Director of the Global Economy Project at the Institute for Policy Studies, I have published several relevant reports, drawing on interviews with policymakers and legal experts, as well as individuals directly affected by investor-state cases in the United States and several other countries. My overall view is that reforms of these rules are needed to correct the current imbalance between the broad public interest and the interests of private foreign investors.

This testimony focuses on one particular set of investment protections—the provisions that restrict the use of capital controls. Particularly in light of the current

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See, for example: Sarah Anderson, "Policy Handcuffs in Financial Crisis: How U.S. Trade and Investment Policies Limit Government Power to Control Capital Flows," Institute for Policy Studies, February 2009 (http://www.ips-dc.org/getfile.php?id=329) and Sarah Anderson and Sara Grusky, "Challenging Corporate Investor Rule," Institute for Policy Studies and Food and Water Watch, April 2007 (http://www.ips-dc.org/getfile.php?id=146).

global financial crisis, these provisions deserve much greater attention. My testimony can be summarized with the following three points, elaborated in detail below:

1. **The capital control restrictions in U.S. trade agreements and bilateral investment treaties are outmoded.** Particularly since the Asian financial crisis of the late 1990s, there has been growing consensus among noted economists that such measures, while not a panacea, can be effective tools for preventing and responding to financial instability.
2. **Allowing other governments the authority to apply sensible capital controls is in the interest of the United States.** In a globalized world, expanding the policy options to combat financial crisis makes sense for U.S. businesses, workers, and the environment. Eliminating the preferential treatment for foreign investors in current capital transfer rules could also help prevent foreign policy conflicts.
3. **Capital control provisions are ripe for reform.** The current crisis has opened an important opportunity to construct new rules and institutions that can prevent future crises and advance stable, sustainable development. Allowing governments greater flexibility to use capital controls would be one important step towards that goal, and important precedents exist that could point the way.

Detailed Discussion

1. The capital control restrictions in U.S. trade agreements and bilateral investment treaties are outmoded.

The International Monetary Fund (IMF) abandoned its blanket opposition to capital controls after several countries used these measures effectively to avoid the worst impacts of the Asian crisis in the late 1990s."[2] In recent years, the Fund has advised at least two countries, Bulgaria and Croatia, to strengthen one type of capital control, reserve requirements on capital inflows.[3] And when Iceland imposed controls on capital outflows in the aftermath of the country's banking sector meltdown, the IMF advised the government "not to lift these restrictions before stability returns to the foreign exchange market."[4]

A March 2009 IMF report notes that "The existence of capital controls in several countries and structural factors have helped to moderate both the direct and the indirect effects of the financial crisis."[5] Former IMF chief economist Kenneth Rogoff underscored this point in a *New York Times* article about India, in which he stated that the country's stringent capital controls were helping to insulate that nation from the current crisis.[6]

Columbia University economist Jagdish Bhagwati, a strong advocate of trade liberalization, and many others have pointed out that there is little to no evidence that capital account liberalization is necessary for developing countries to attract foreign investment. In fact, six of the top ten non-OECD foreign direct investment recipients (China, Hong Kong, Russia, Brazil, Saudi Arabia, and India) have never signed a U.S. agreement restricting capital controls.[7] In Congressional testimony, Bhagwati charged that the inclusion of capital control restrictions in trade agreements "seems therefore to be ideological and/or a result of narrow lobbying interests hiding behind the assertion of social purpose."[8]

Rogoff and Bhagwati are among a growing number of prominent economists who are speaking out in support of allowing governments the authority to impose capital controls, including Nobel Prize winners Joseph Stiglitz and Paul Krugman, Harvard

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[2] Akira Ariyoshi, Karl Habermeier, Bernard Laurens, Inci Otker-Robe, Jorge Iván Canales-Kriljenko, and Andrei Kirilenko, "Capital Controls: Country Experiences with Their Use and Liberalization," International Monetary Fund, May 17, 2000. http://www.imf.org/external/pubs/ft/op/op190/index.htm.

[3] Daria Zakharova, "One-Size-Fits-One: Tailor-Made Fiscal Responses to Capital Flows," International Monetary Fund, December 2008. http://www.imf.org/external/pubs/ft/wp/2008/wp08269.pdf.

[4] International Monetary Fund, "Interview with IMF mission chief for Iceland, Poul Thomsen," December 2, 2008. http://www.imf.org/external/pubs/ft/survey/so/2008/INT111908A.htm.

[5] International Monetary Fund, "The Implications of the Global Financial Crisis for Low-Income Countries," March 2009. http://www.imf.org/external/pubs/ft/books/2009/globalfin/globalfin.pdf.

[6] Kenneth Rogoff, "Rogoff: The Exuberance of India," *New York Times,* January 31, 2009. http://dealbook.blogs.nytimes.com/2009/01/31/rogoff-the-exuberance-of-india/.

[7] UNCTAD, *World Investment Report 2008*.

[8] Jagdish Bhagwati, "U.S. House of Representatives Committee on Financial Services Testimony Subcommittee on Domestic and International Monetary Policy, Trade and Technology," April 1, 2003. http://www.columbia.edu/~jb38/testimony.pdf.

University's Dani Rodrik, and former President of the International Economic Association Guillermo Calvo.[9]

2. Allowing governments the authority to use sensible capital controls is in the economic and foreign policy interest of the United States.

Businesses, workers, and the environment in this country are undermined by instability in other parts of the world, as crisis countries purchase fewer U.S. products, cut environmental spending, and expand the global pool of unemployed labor. And when governments are constrained in their use of capital controls, they have few other tools to prevent speculative bubbles or stem panic-driven capital flight. Mexico, for example, has extremely limited authority to apply capital controls under the investment rules in the North American Free Trade Agreement. In the face of massive capital flight (foreign investors withdrew more than $22 billion in the last few months of 2008),[10] the government has struggled to prop up the value of its currency by auctioning off nearly 18 percent of its foreign reserves.[11]

Depleting reserves to fight devaluation not only reduces the funds available for development, it also raises the risk of even further capital flight, as low reserve levels undermine investor confidence. In another attempt to restore confidence, the Mexican government has opened a $47 billionline of credit with the IMF, raising the prospect of another debt crisis that could undermine development and stability in the United States' southern neighbor for many years to come.

Daniel Tarullo, recently appointed to the Federal Reserve Board, has described the U.S. government's insistence on including capital control restrictions in trade agreements as not only "bad financial policy and bad trade policy," but also "bad foreign policy." [12] In testimony during the debate over the Chile and Singapore free trade agreements in 2003, Tarullo laid out what would likely happen if a government bound by these rules were to use short-term capital controls during a severe financial crisis: "As the country struggles to emerge from its recession . . . U.S. investors file their claims for compensation. And, of course, under the bilateral trade agreement they are entitled to that compensation. Thus the still-suffering citizens of the country are treated to the prospect of U.S. investors being made whole while everyone else bears losses from an economic catastrophe that has afflicted the entire nation. Regardless of what one thinks of the merits of capital controls, one would have to be naïve not to think that an anti-American backlash would result." [13]

This gloomy scenario has even greater resonance today, at a time when ordinary taxpayers here and around the world are being asked to shoulder the bulk of the risk and cost of financial recovery. This is an important time to ensure that international rules achieve a proper balance between the public interest and private financial interests.

3. Capital control provisions are ripe for reform.

The investment rules in U.S. trade and investment agreements should be revised to allow governments greater flexibility to use capital controls as one tool for preventing or responding to financial instability. The following is a list of possible reforms, based on existing precedents.

Dispute settlement: Given the sensitive context in which many governments turn to capital control measures, there is a strong argument that the right to investor-state dispute settlement should not apply to capital transfers provisions. At the very least, there should be a government screening process to examine investor claims and prevent those that would have a significantly negative impact on the public interest from moving forward. The U.S. model bilateral investment treaty sets a relevant precedent by requiring that appropriate authorities of the two gov-

[9] See box of quotes from noted economists on pages 10–11 of the report "Policy Handcuffs in Financial Crisis: How U.S. Trade and Investment Policies Limit Government Power to Control Capital Flows," by Sarah Anderson, Institute for Policy Studies, February 2009. http://www.ips-dc.org/getfile.php?id=329.

[10] Roberto González Amador, "Inversionistas externos sacaron del país $22 mil 190 millones," *La Jornada*, Dec. 18, 2008. http://www.jornada.unam.mx/2008/12/18/index.php?section=economia&article=024n1eco.

[11] http://www.businessweek.com/ap/financialnews/D94Q2SJ89.htm.

[12] Daniel Tarullo, "Testimony before the Subcommittee on Domestic and International Monetary Policy, Trade and Technology, Committee on Financial Services, U.S. House of Representatives," April 1, 2003. http://financialservices.house.gov/media/pdf/040103dt.pdf.

[13] Daniel Tarullo, "Testimony before the Subcommittee on Domestic and International Monetary Policy, Trade and Technology, Committee on Financial Services, U.S. House of Representatives," April 1, 2003. http://financialservices.house.gov/media/pdf/040103dt.pdf.

ernments make determinations that are binding on arbitral tribunals with regard to financial services and taxation-related claims.[14]

Balance of payments derogation: Many existing international agreements allow for restrictions on capital transfers in circumstances in which a host country is confronted with a balance of payments crisis. The World Trade Organization's General Agreement on Trade in Services, the OECD's Capital Movements Code, and the IMF's Articles of Agreement allow capital controls in such crisis periods, as long as they are temporary and non-discriminatory.[15] In February 2009, the ASEAN nations also agreed to an investment agreement that includes a balance of payments safeguard, as well as an exception for circumstances in which "movements of capital cause, or threaten to cause, serious economic or financial disturbance in the member state."[16]

Article 2104 of NAFTA also allows for temporary capital controls in times of "serious balance of payments difficulties."[17] However, the agreement includes two pages of conditions limiting the use of such measures, even in such crisis periods. For example, governments opting to use this policy tool must agree to enter into consultations with the IMF and adopt the Fund's policy recommendations on "economic adjustment measures." This is extremely controversial, as the IMF has been widely criticized in past crises and in the current one for imposing anti-cyclical conditions, such as freezes in stimulatory social spending and unemployment benefits, tax increases, and service rate hikes. Capital control measures under NAFTA must also meet the legal standards of being "no more burdensome than necessary" and "avoid unnecessary damage" to the interests of the other Party. Thus, while NAFTA technically offers a balance of payments exception, the hands of government officials are still quite tightly bound.

Exceptions for crisis periods were further watered down in subsequent U.S. trade agreements and are completely absent from U.S. bilateral investment treaties. The governments of Singapore and Chile reportedly requested waivers for capital control rules during crisis periods in the U.S. trade agreements with those countries. The Bush administration refused, offering only to create special dispute settlement procedures for claims related to capital transfers. Under these procedures, foreign investors can still sue for damages over measures that "substantially impede transfers"—they just need to wait an extra six months before filing their claims. A senior IMF legal counsel called the U.S. refusal to grant such a waiver "draconian" and complained that the rules might interfere with the IMF's own power to request that a government adopt capital controls.[18]

Broader exception for financial stability measures: Allowing exceptions during times of crisis would be a positive, but insufficient step forward. Many economists argue that capital control measures are most useful if they are enacted "when the sun is shining." Once the dark clouds of crisis become evident, it can be too late for such controls to be effective.

Chile's *encaje* ("strongbox" in Spanish) is often cited as an example of effective use of capital controls through an ongoing policy. Throughout most of the 1990s, the Chilean government subjected capital inflows to a one-year, non-interest paying deposit with the central bank. The deposit requirement varied from 10 to 30 percent, and the penalty for early withdrawal ranged from 1 to 3 percent. Chile faired better than most other Latin American countries during the Mexican peso crisis in 1994 and the Asian crisis a few years later. An IMF research review concluded that the encaje, combined with other financial sector reforms, allowed the government more monetary policy autonomy and shifted the composition of foreign investment from "hot money" towards the longer term.[19] After entering into discussions of a possible trade agreement with the United States, the Chilean government eliminated the

[14] 2004 U.S. Model Bilateral Investment Treaty. http://www.ustr.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf.

[15] United Nations Conference on Trade and Development, "Transfer of Funds," 2000. http://www.unctad.org/en/docs/psiteiitd20.en.pdf.

[16] ASEAN Comprehensive Investment Agreement, February 26, 2009. http://www.aseansec.org/22218.htm.

[17] North American Free Trade Agreement Final Text, Article 2104. http://www.nafta-sec-alena.org/en/view.aspx?x=343&mtpiID=155#A2104.

[18] Deborah Siegel, "Using Free Trade Agreements to Control Capital Account Restrictions: Summary of remarks on the Relationship to the Mandate of the IMF," 10 *ISLA Journal of International Comparative Law*, 2004. http://www.aprnet.org/index.php?a=show&c=Volume%2015%20June%202007&t=journals&i=46.

[19] Akira Ariyoshi, Karl Habermeier, Bernard Laurens, Inci Otker-Robe, Jorge Iván Canales-Kriljenko, and Andrei Kirilenko, "Capital Controls: Country Experiences with Their Use and Liberalization," International Monetary Fund, May 17, 2000. http://www.imf.org/external/pubs/ft/op/op190/index.htm.

encaje in 1998. In recent years, however, numerous countries have used Chilean-style controls on inflows.[20]

One example of a broader exception for capital controls to support financial stability can be found in the Norwegian government's 2007 model bilateral investment treaty. This agreement allows for restrictions on capital flows when necessary to ensure compliance with laws and regulations concerning financial security or the prevention and remedying of environmental damage.[21] The treaty requires equitable, non-discriminatory and good faith application of the laws. Similar language could be added to the current list of exceptions to the capital control restrictions in U.S. trade and investment agreements.

Conclusion

I would like to thank the Subcommittee for taking on the task of reviewing the investment rules in U.S. trade and investment agreements to ensure that they advance the public interest. This is particularly timely in light of the current financial crisis. The U.S. Congress has a tremendous opportunity to apply lessons from past crises and work with counterparts in other nations to build a more equitable, sustainable, and stable global economy.

Statement of Todd Tucker

I thank Subcommittee Chairman Levin and the other Members of the Ways & Means Committee for this opportunity to submit written testimony on behalf of Public Citizen for the record for the Hearing on Investment Protections in U.S. Trade and Investment Agreements. My testimony can be summarized with the following three points, elaborated in detail below:

1. **The record of the North American Free Trade Agreement (NAFTA) demonstrates why removing harmful investment provisions from international agreements is in the interest of the United States and its trading partners.** NAFTA's investment chapter provides incentives to offshore jobs by removing many of the costs and risks of relocating production offshore. It also subjects U.S. environmental, consumer and other public-interest laws to challenge by foreign investors empowered to demand U.S. government compensation directly in foreign tribunals for domestic laws they deem to undermine their expected future profits. The investment chapter of the Central America Free Trade Agreement (CAFTA) expanded on the definition of foreign investments that were provided special protections and rights. Instructions in the 2002 Fast Track—that U.S. trade agreements not provide greater rights to foreign investors than are provided to U.S. investors under the U.S. Constitution—have been systematically ignored by U.S. negotiators. As a result, CAFTA, various FTAs approved after CAFTA, and the three leftover Bush "Free Trade Agreements" (FTAs) all contain provisions that provide greater substantive and procedural rights to foreign investors. Not one word of the investment chapters of the FTAs was altered to remedy these problems in the May 2007 revisions to the Bush FTAs. The non-binding preambular language added to these agreements has no legal effect and fails to address the investment chapters' problems.
2. **We support President Barack Obama's campaign pledges to overhaul the investment provisions of U.S. trade agreements.**
3. **In order for President Obama to fulfill these commitments, a set of specific changes must be made to current and prospective trade and investment agreements.**

[20] Eduardo Levy Yeyati, Sergio L. Schmukler, Neeltje Van Horen, "Crises, Capital Controls, and Financial Integration," Policy Research Working Paper 4770, World Bank, November 2008. http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2008/11/06/000158349_20081106083956/Rendered/PDF/WPS4770.pdf.

[21] Norway model bilateral investment treaty, 2007. http://ita.law.uvic.ca/documents/NorwayModel2007.doc.

1. The record of NAFTA demonstrates why removing harmful investment provisions from international agreements is in the interest of the United States and its trading partners.

NAFTA's investor protections were among the most controversial aspects of the pact, and an expanded version of these were also included in later trade agreements. These pacts grant foreign investors a private right of action to enforce their trade-agreement foreign-investor rights. Through these, they can challenge government policies in international tribunals at the World Bank and United Nations and demand host-government compensation for policies that they consider to have impaired their new trade-agreement rights. This includes compensation for lost profits when government regulatory policy undermines their "expectation of gain or profit." [1] The special foreign-investor privileges eliminate the uncertainty and costs of having to use "host" country courts to settle many common disputes. Thus, effectively, these investment rules facilitate the relocation of investment offshore to low-wage venues by eliminating many of the costs and risks of such relocation for U.S. investors and firms.

Specifically, the investment chapters in NAFTA, CAFTA and various NAFTA-style FTAs set a "minimum standard of treatment" that signatories must provide foreign investors,[2] prohibit foreign investors from being treated less favorably than domestic investors,[3] ban common performance requirements on foreign investors (such as domestic-content laws),[4] and forbid limits on capital movements, such as currency controls.[5] Additionally, these pacts provide foreign investors operating in the United States with greater compensation rights for extended categories of "expropriation" or "takings" than U.S. companies have under domestic law, including for "indirect takings" or measures "tantamount to" a takings.[6] These trade-pact investor rules contain no sovereign-immunity shield for governments, a radical departure from longstanding U.S. protections.

During the debate surrounding the 2002 grant of Fast Track authority, dozens of groups and organizations representing state and local legislative and judicial officials weighed in, demanding that Fast Track contain provisions to ensure that foreign investors would not be granted "greater rights" in trade-agreement investment chapters than U.S. firms have under the U.S. Constitution. These groups include the Conference of Chief Justices, National Association of Attorneys General, U.S. Conference of Mayors, National Association of Counties, National Association of Towns and Townships, National League of Cities, and National Conference of State Legislatures.[7] The next trade agreements negotiated did contain some improvements with regard to the transparency of trade-tribunal operations but unfortunately failed to meet the demands by state and local officials and others—again providing foreign investors greater rights than the U.S. Constitution provides to U.S. businesses and citizens.

During the time-period which Fast Track was operational from 2002–2007, the Bush administration sought to expand NAFTA-style investor rights to new countries via bilateral and regional trade agreements, including the U.S.-Chile FTA, U.S.-Singapore FTA, U.S.-Morocco, CAFTA, U.S.-Oman FTA, U.S.-Peru FTA, and proposed agreements with Panama, Colombia, and Korea. USTR also has pushed to put these extraordinary foreign-investor privileges into the WTO, but the majority of WTO member countries have flatly refused. The raft of new agreements with the foreign-investor privileges are sure to spawn new cases and new liability for U.S. taxpayers, who must foot the bill if foreign investors succeed in challenging state or federal laws—as well as face the consequences of not having vital environmental health, safety and zoning policies enforced.

Public Citizen has uncovered 59 of these claims filed thus far by corporate interests and investors under NAFTA's Chapter 11. While only a small number of these cases have been finalized, the track record of cases and claims demonstrate an array of attacks on public policies and normal regulatory activity at all levels of government. The cases have a common theme: they seek compensation for government actions that would not be subject to such demands under U.S. law, and claim violations of property rights established in NAFTA that extend well beyond the robust

[1] For instance, NAFTA Article 1105.
For instance, U.S.-Peru FTA Article 10.28.
[2] See e.g. NAFTA Article 11.5 or CAFTA Article 10.5.
[3] See e.g. NAFTA Article 11. 2 or CAFTA Article 10.3
[4] See e.g. NAFTA Article 11.9 or CAFTA Article 10.6.
[5] See e.g. NAFTA Article 11.9 or CAFTA Article 10.8.
[6] See e.g. NAFTA Article 11.10 and 11.39 or CAFTA Article 10.7 and 10.28.
[7] Letters from these groups and others can be accessed at: http://www.citizen.org/trade/subfederal/inv.

property rights the U.S. Supreme Court has interpreted are provided by the U.S. Constitution.

Under NAFTA, around $69 million has been paid out by governments in corporate challenges against toxic-substance bans, logging rules, operating permits for a toxic-waste site, and more.[8] Although not explored in detail in this testimony, similar troubling provisions exist in U.S. bilateral investment treaties. Appendix I contains information on both concluded and pending NAFTA investor-state cases through the beginning of 2009, while pages 4–7 of this testimony include a lengthier critique of specific aspects of the NAFTA-style investor rights that have been included as Chapter 10 in more recent FTAs, such as the Bush administration's U.S.-Panama FTA.

2. We support President Barack Obama's campaign pledges to overhaul the investment provisions of U.S. trade agreements.

President Obama campaigned on a whole series of specific trade-reform commitments. Whether he will meet his pledges to the American people will be tested by whether the Obama administration continues with more Bush NAFTA-style FTAs, such as the Panama FTA, or conducts the promised repair of the existing trade agreements and develops a new policy that, as President Obama said, benefits the many, not only a few special interests. Specifically, President Obama pledged to remedy the following investment provisions that the Panama FTA would replicate:

- Obama answered "yes" to the question: **"Will you commit to renegotiate NAFTA to eliminate its investor rules that allow private enforcement by foreign investors of these investor privileges in foreign tribunals and that give foreign investors greater rights than are provided by the U.S. Constitution as interpreted by our Supreme Court thus promoting offshoring?"**[9]
- He also said: "While NAFTA gave broad rights to investors, it paid only lip service to the rights of labor and the importance of environmental protection. We should amend NAFTA to make clear that fair laws and regulations written to protect citizens in any of the three countries cannot be overridden simply at the request of foreign investors."[10]

Similar language was included in the Democratic Party platform, which stated: "We will not negotiate free trade agreements that stop the government from protecting the environment, food safety or the health of its citizens, give greater rights to foreign investors than to U.S. investors, require the privatization of our vital public services, or prevent developing country governments from adopting humanitarian licensing policies to improve access to life-saving medications. We will stand firm against agreements that fail to live up to these important benchmarks."[11]

Campaigning on these themes stretched beyond the presidential races, to congressional races in both chambers of Congress, from Florida to New Mexico, from Colorado to New York. Indeed, successful candidates in the 2006 and 2008 races ran on a resounding platform of fundamental overhaul of U.S. trade and economic policies. In the two cycles, there was a combined shift of 72 members in the fair-trade composition of Congress.[12]

Concerns with trade-pact investment provisions have long stretched across party lines and throughout the Democratic Caucus, as shown by these quotes from the debate around the Central America Free Trade Agreement (CAFTA). Conservatives, such as former Rep. Butch Otter, now the Republican governor of Idaho, expressed concern with FTA investment provisions, saying: "I'd like to draw your attention to the fact that CAFTA contains 1,000 pages of international law establishing, among other things, property rights for foreign investors that may impose restrictions on U.S. land-use policy. Chapter 10 of CAFTA outlines a system under which foreign investors operating in the United States are granted greater property rights than

[8] Mary Bottari and Lori Wallach, "NAFTA Threat to Sovereignty and Democracy: The Record of NAFTA Chapter 11 Investor-State Cases 1994–2005," Public Citizen's Global Trade Watch, February 2005.

[9] http://www.citizenstrade.org/pdf/QuestionnairePennsylvaniaFairTradeCoalition040108FINAL_SenatorObamaResponse.pdf.

[10] http://www.citizen.org/documents/TXFairTradeCoalitionObama.pdf.

[11] Democratic National Convention Committee, "The 2008 Democratic Party Platform: Renewing America's Progress," August 25, 2008. Available at http://www.democrats.org/a/party/platform.html.

[12] Todd Tucker, "Fair Trade Gets an Upgrade," Public Citizen's Global Trade Watch, November 2008.

U.S. law provides for our own citizens! Mr. Speaker, that's not encouraging free trade. That's giving away our natural resources and our national sovereignty."[13]

Meanwhile, New Democrat Coalition member Rep. Jane Harman (D–Calif.) and other representatives said:

> "We wanted to draw your attention to—the threat that the investor rights rules in the Central America-Dominican Republic Free Trade Agreement (CAFTA) pose to important state and local laws and regulations that protect the environment and public health. Like Chapter 11 of NAFTA, the investor rights provisions of CAFTA give foreign corporations the power to demand payment from the U.S. when public interest protections affect a company's commercial interests . . . The State of California has now joined state and local government groups in saying that U.S. trade negotiators failed to heed the lessons of NAFTA in their negotiation of the investor rights rules in CAFTA. We hope you will join us in opposing CAFTA."[14]

The concern about these expansive foreign investor rights and their private enforcement across party and caucus lines is logical, since NAFTA–CAFTA-style foreign investor provisions can undermine areas of concern across the entire political spectrum in Congress and the country.

3. In order for President Obama to fulfill these commitments, a set of specific changes must be made to current and prospective trade and investment agreements.

The Investment chapters of the Panama, Colombia, and Korea FTAs need the fundamental changes listed below in order to deliver on President Obama's campaign commitments. These changes are also necessary to meet the concerns raised by the AFL–CIO, Change to Win, Public Citizen, and other groups in 2007, when Democratic congressional trade committee leaders and the White House discussed renegotiating aspects of the four Bush-negotiated agreements. (Indeed, this section of the testimony closely tracks the documents describing necessary fixes to the FTA investment chapters submitted by many environmental, consumer, and labor organizations at that time.) These changes are also necessary for ensuring pacts meet the 2002 Trade Promotion Authority standard of not providing foreign investors with greater rights than those provided to domestic firms/investors by the U.S. Constitution. (The Articles below refer to the Panama FTA, but similar if not identical articles can be found in each agreement, meaning similar if not identical changes are needed in the Colombia and Korea FTAs as well.)

1. To conform with U.S. taking laws, the Panama FTA's definition of investment at Article 10.29 must be bifurcated so that the current expansive definition does not apply to claims for compensation for expropriation under Article 10.7(1). The current definition covers all provisions of the investment agreements and extends beyond the commitment of capital or the acquisition of real property or other tangible assets. To comply with U.S. takings law, the highly subjective standards used to define an investment subject to compensation—including expectation of gain or profit, or the assumption of risk—must be removed, as such actions are not considered forms of property under U.S. law regarding expropriation claims. **To bring the FTA standard into compliance with U.S. property rights takings law, Article 10.29 must be amended to strike the categories of property that extend beyond commitment of capital or the acquisition of real property or other tangible assets.**[15] The expectation of gain or profit, or the assumption of risk should *not* qualify as investment as it does in the Panama FTA and the other past and current Bush FTAs. Finally, the renegotiated definition must establish that a mere *pledge* of capital does not establish an investment, but rather "investment" must be defined to include the actual physical presence of capital.

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[13] Rep. Clement LeRoy "Butch" Otter (R–Idaho), Floor Statement on CAFTA, July 29, 2005.

[14] On file with Public Citizen.

[15] The Article 10.29 text would have to be modified to exclude the stricken clauses below: "investment means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, ~~the expectation of gain or profit, or the assumption of risk~~. Forms that an investment may take include: ~~(a) an enterprise; (b) shares, stock, and other forms of equity participation in an enterprise; (c) bonds, debentures, other debt instruments, and loans;7~~ 8 ~~(d) futures, options, and other derivatives; (e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; (f) intellectual property rights; (g) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law;9 10 and other tangible or intangible, movable or~~ immovable property, an~~d related property rights, such as leases, mortgages, liens, and pledges~~."

2. The Panama FTA must be amended to explicitly state that the minimum standard of treatment grants no new substantive rights and no greater due process rights than what U.S. citizens currently possess under the due process clause of the U.S. Constitution. Currently, the "fair and equitable" language, if viewed as an independent standard, would invite an investment tribunal to apply its own view of what is "fair" or "equitable," unbounded by any limits in U.S. law. Moreover, those terms are inherently subjective. The Annex that was added to CAFTA and included in recent FTAs—which seeks to define "the minimum standard of treatment" that is guaranteed to foreign investors—fails to accomplish Congress' goal of foreclosing arbitral panels' discretion to read new substantive rights into this standard unbounded by U.S. law limits. **This can be remedied by replacing the Panama FTA's circular Annex 10–A language [16] with the following: "The Parties confirm their shared understanding that the minimum standard of treatment, defined at Article 10.5 as 'fair and equitable treatment,' grants no new substantive rights and no greater due process rights than what U.S. citizens currently possess under the due process clause of the United States Constitution."**

3. U.S. takings jurisprudence permits compensation for direct takings of real property, but only allows compensation in the rarest of situations when government action does not involve an actual expropriation, but some lesser interference with property rights. Democrats successfully defeated a 1990s push to establish "regulatory takings" compensation in U.S. law so as to preclude demands for compensation arising from the costs of complying with environmental, land-use and other regulations. To conform with the no-greater-rights standard, the FTAs must permit compensation only for direct takings and indirect takings that meet the extremely narrow U.S. law standard of a complete and permanent destruction of all value of the entirety of a property. (The holding in *Penn Central Transportation Co.* v. *New York City*, 438 U.S. 104 (1978).) **This problem can be remedied by adding the following clause to the Panama FTA's Annex 10–B(4): "government actions that merely diminish the property's value but do not destroy all value of the entire property permanently is not an indirect taking."**

4. To be consistent with U.S. law (i.e. not provide greater rights) investor-state compensation should be available only for instances of direct expropriation of a foreign investors' *tangible* property. Further, there should be *no,* not "rare," circumstances when non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, constitute an indirect expropriation. An Annex added to recent FTAs in response to Congress' concerns that trade-agreement investment rules provide compensation for regulatory takings actually creates a new conflict with U.S. property rights law. Under U.S. law, there are *no* circumstances when non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives that do not extinguish all value of a property would be subject to compensation. The Panama FTA's Annex 10–B(4)(b) states that only in "rare circumstances" can such policies be the basis for compensation. **This can be remedied by striking the words "either" and "or indirectly" in Article 10.7(1), striking "or intangible" from Annex 10–B(2) and striking "Except in rare circumstances" from Annex 10–B(4)(b), and (as noted) adding the following clause to Annex 10–B(4): "government actions that merely diminish the property's value but do not destroy all value of the entire property permanently is not an indirect taking."**

5. One of the most controversial provisions of investment chapters is the investor-state dispute resolution mechanism. As we have seen under NAFTA, the investor-state mechanism has been used to challenge legitimate public-interest measures. It should be sufficient that an investor make use the domestic legal systems to bring a claim or, if not satisfied, push his/her respective government for state-state dispute settlement. The state-state approach has precedent in the U.S.-Australia FTA. The above amendments limit to U.S. law the standards that would be applied by investor-state tribunals. However, the above fixes do not remedy the core violation of the no-greater-rights standard—which is the very opportunity for a foreign investor operating within the United States to seek remedy before an investor-state tribunal, while U.S. investors and firms are limited to seeking remedy in U.S. courts.

[16] Annex 10–A: "Customary International Law: The Parties confirm their shared understanding that 'customary international law' generally and as specifically referenced in Articles 10.5, 10.6, and Annex 10–B results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 10.5, the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens."

To remedy the violation of the no-greater-rights standard, the Panama FTA's Section B (Articles 10.15–10.27) of the Investment Chapter must be stricken. Government-government enforcement action, based on the re-negotiated terms described above, would provide recourse for actual acts of direct expropriation, while safeguarding legitimate public-interest laws from challenge and ensuring foreign investors are not provided greater rights than domestic investors operating domestically.

6. We are deeply concerned that the provisions on transfers, Article 10.8, would limit governments' ability to use legitimate measures designed to restrict the flow of capital in order to protect themselves from financial instability. Without adequate measures to prevent and respond to such financial instability, particularly in developing countries, broad sustainable development will remain out of reach for many developing countries. The increased frequency and severity of financial crises also hurts U.S. economic interests, as crisis-stricken countries devalue their currencies and flood the U.S. market with under-priced exports in order to recover. **Thus, Article 10.8 should be amended to provide for reasonable capital controls.**

In conclusion, recent attempts to change aspects of the NAFTA investor template—including language inserted into the 2002 Fast Track (which resulted in the yet-more-expansive CAFTA investor terms), or the May 10, 2007 agreement between the Bush administration and certain Members of Congress (which did not change a word of the FTAs' investment chapters),—did not address these issues. In particular, the May 10 deal's insertion of non-binding preambular language to the FTAs is galling. As a matter of law, the actual binding provisions of the FTAs' investment chapters described above trump the non-binding preambular language which bizarrely states that "foreign investors are not hereby accorded greater substantive rights with respect to investment protections than domestic investors under domestic law where, as in the United States, protections of investor rights under domestic law equal or exceed those set forth in this Agreement"—even though in fact that is precisely what the agreement's binding legal text does. No arbitral tribunal is bound to the FTA's hortatory preambular language. Rather, future cases would be decided on the actual agreement text, which as noted above is severely flawed. That no changes were made to the investment chapter is a point about which the Bush administration bragged in its fact sheets on the May 2007 deal.[17] Only by changing the binding language through renegotiation can the problems discussed above be remedied.

APPENDIX I: MORE DETAIL ON NAFTA INVESTOR–STATE CASES [18]

CASES IN WHICH INVESTORS OBTAINED PAYMENT FOR CHALLENGES OF PUBLIC–INTEREST AND OTHER LAWS

Corporation or Investor v. Country	Venue	Damages Sought	Status of Case	Issue
Ethyl v. Canada **April 14, 1997***	UNCITRAL	$201 million	**Settled; Ethyl win, $13 million**	U.S. chemical company challenged Canadian environmental ban of gasoline additive MMT. July 1998: Canada loses NAFTA jurisdictional ruling, reverses ban, pays $13 million in damages and legal fees to Ethyl.

[17] USTR suggested that "the four pending FTAs (as well as the other FTAs we have concluded in the past five years) fully achieve" the congressional requirement that no foreign investors not be accorded greater rights than U.S. investors operating in the United States. S*ee* http://ustr.gov/assets/Document_Library/Fact_Sheets/2007/asset_upload_file146_11282.pdf.

[18] Key: * Indicates date Notice of Intent to File a Claim was filed, the first step in the NAFTA investor-state process, when an investor notifies a government that it intends to bring a NAFTA Chapter 11 suit against that government.

** Indicates date Notice of Arbitration was filed, the second step in the NAFTA investor-state process, when an investor notifies an arbitration body that it is ready to commence arbitration under NAFTA Chapter 11.

CASES IN WHICH INVESTORS OBTAINED PAYMENT FOR CHALLENGES OF PUBLIC–INTEREST AND OTHER LAWS—Continued

Corporation or Investor v. Country	Venue	Damages Sought	Status of Case	Issue
S.D. Myers v. Canada July 22, 1998* Oct. 30, 1998**	UNCITRAL	$20 million	**S.D. Myers win, $5 million**	U.S. waste treatment company challenged temporary Canadian ban of PCB exports that complied with multilateral environmental treaty on toxic-waste trade. November 2000: Tribunal dismissed S.D. Myers claim of expropriation, but upheld claims of discrimination and determined that the discrimination violation also qualified as a violation of the “minimum standard of treatment” foreign investors must be provided under NAFTA. Panel also stated that a foreign firm’s “market share” in another country could be considered a NAFTA-protected investment. February 2001: Canada petitioned to have the NAFTA tribunal decision overturned in a Canadian Federal Court. January 2004: The Canadian federal court dismissed the case, finding that any jurisdictional claims were barred from being raised since they had not been raised in the NAFTA claim. The federal court judge also ruled that upholding the tribunal award would not violate Canadian “public policy” as Canada had argued.
Pope & Talbot **Dec. 24, 1999*** **March 25, 1999****	UNCITRAL	$381 million	**P&T win, $621,000**	U.S. timber company challenged Canadian implementation of 1996 U.S.-Canada Softwood Lumber Agreement.

CASES IN WHICH INVESTORS OBTAINED PAYMENT FOR CHALLENGES OF PUBLIC–INTEREST AND OTHER LAWS—Continued

Corporation or Investor v. Country	Venue	Damages Sought	Status of Case	Issue
				April 2001: Tribunal dismissed claims of expropriation and discrimination, but held that the rude behavior of the Canadian government officials seeking to verify firm's compliance with lumber agreement constituted a violation of the "minimum standard of treatment" required by NAFTA for foreign investors. Panel also stated that a foreign firm's "market access" in another country could be considered a NAFTA-protected investment.
Metalclad v. Mexico **Dec. 30, 1996*** **Jan. 2, 1997****	ICSID	$90 million	**Metalclad win, $15.6 million**	U.S. firm challenged Mexican municipality's refusal to grant construction permit for toxic waste facility unless the firm cleaned up existing toxic waste problems that had resulted in the facility being closed when it was owned by a Mexican firm from which Metalclad acquired the facility. Metalclad also challenged establishment of an ecological preserve on the site by a Mexican state government. August 2000: Tribunal ruled that the denial of the construction permit and the creation of an ecological reserve are tantamount to an "indirect" expropriation and that Mexico violated NAFTA's "minimum standard of treatment" guaranteed foreign investors, because the firm was not granted a "clear and predictable" regulatory environment.

CASES IN WHICH INVESTORS OBTAINED PAYMENT FOR CHALLENGES OF PUBLIC–INTEREST AND OTHER LAWS—Continued

Corporation or Investor v. Country	Venue	Damages Sought	Status of Case	Issue
				October 2000: Mexican government challenged the NAFTA ruling in Canadian court alleging arbitral error. A Canadian judge ruled that the tribunal erred in part by importing transparency requirements from NAFTA Chapter 18 into NAFTA Chapter 11 and reduced the award by $1 million. In 2004, the Mexican federal government's effort to hold the involved state government financially responsible for the award failed in the Mexican Supreme Court.
Karpa v. Mexico **Feb. 16, 1998*** **Apr. 7, 1999****	ICSID	$50 million	**Karpa win, $1.5 million**	U.S. cigarette exporter challenged denial of export tax rebate by Mexican government. December 2002: Tribunal rejected an expropriation claim, but upheld a claim of discrimination after the Mexican government failed to provide evidence that the firm was being treated similarly to Mexican firms in "like circumstances." December 2003: Canadian judge dismissed Mexico's effort to set aside award.
ADM/Tate & Lyle v. Mexico **Oct. 14, 2003*** **Aug. 4, 2004****	ICSID	$100 million	**ADM win, $33.5 million**	U.S. company producing high fructose corn syrup sought compensation against Mexican government for imposition of a tax on beverages made with HFCS, but not Mexican cane sugar. Mexico argued that the tax was legitimate because the U.S. had failed to open its market sufficiently to Mexican cane sugar exports under NAFTA.

CASES IN WHICH INVESTORS OBTAINED PAYMENT FOR CHALLENGES OF PUBLIC–INTEREST AND OTHER LAWS—Continued

Corporation or Investor v. Country	Venue	Damages Sought	Status of Case	Issue
				November 2007: NAFTA tribunal ruled that the HFSC tax was discriminatory and a NAFTA-illegal performance requirement, but did not find it was an expropriation. This issue was also litigated in the WTO, which issued a ruling against Mexico and in favor of the U.S. in 2006.
Corn Products International v. Mexico **Jan. 28, 2003*** **Oct. 21, 2003****	ICSID	$325 million	**Corn Products win, amount pending**	U.S. company producing high fructose corn syrup (HFCS), a soft drink sweetener, sought compensation from Mexican government for imposition of a tax on beverages sweetened with HFCS, but not Mexican cane sugar. April 2009: January 2008 award finally become public. Tribunal ruled for CPI on the merits then began a monetary damages assessment. Panel dismissed most claims but found that Mexico violated the national treatment rule by "fail[ing] to accord CPI, and its investment, treatment no less favourable than that it accorded to its own investors in like circumstances, namely the Mexican sugar producers who were competing for the market in sweeteners for soft drinks."

CASES IN WHICH THE U.S. "DODGED THE BULLET" ON PROCEDURAL GROUNDS

There have been four cases against the United States that have made it to arbitration; these were dismissed on largely procedural grounds.

1. **Loewen case**: In 1998, a Canadian funeral conglomerate, Loewen, used NAFTA's investor-state system to challenge Mississippi's rules of civil procedure and the amount of a jury award related to a case in which a Mississippi firm had sued Loewen in a private contract dispute in state court. A World Bank tribunal issued a chilling ruling in this NAFTA case, finding for Loewen on the merits.[19] The ruling

[19] ICSID, Decision on hearing of Respondent's objection to competence and jurisdiction, *The Loewen Group, Inc. and Raymond L. Loewen* v. *United States of America*, Jan. 5, 2001, Case No. ARB(AF)/98/3.

made clear that few domestic court decisions are immune to a rehearing in a NAFTA investor-state tribunal. However, the tribunal dismissed the case before the penalty phase thanks to a remarkable fluke: lawyers involved with the firm's bankruptcy proceedings reincorporated Loewen as a U.S. firm, thus destroying its ability to obtain compensation as a "foreign" investor.

2. Mondev case: In 1999, a Canadian real estate developer challenged Massachusetts Supreme Court ruling regarding local government sovereign immunity and land-use policy. In October 2002, the claim was dismissed on procedural grounds. The tribunal found that the majority of Mondev's claims, including its expropriation claim, were time-barred because the dispute on which the claim was based predated NAFTA.

3. Methanex: In 1999, a Canadian corporation that produced methanol, a component chemical of the gasoline additive MTBE, challenged California phase-out of the additive, which was contaminating drinking water sources around the state. In August 2005, the claim was dismissed on procedural grounds. The tribunal ruled that it had no jurisdiction to determine Methanex's claims because California's MTBE ban did not have a sufficient connection to the firm's methanol production to qualify Methanex for protection under NAFTA's investment chapter. Tribunal orders Methanex to pay U.S. $3 million in legal fees. The tribunal permitted NGOs to submit amici briefs and Methanex allowed hearings to be open to the public.

4. ADF: In 2000, a Canadian steel contractor challenged U.S. Buy America law related to a Virginia highway construction contract. In January 2003, the claim dismissed on procedural grounds. The tribunal found that the basis of the claim constituted "government procurement" and therefore was not covered under NAFTA Article 1108. Starting with CAFTA, FTA investment chapters have included foreign-investor protections for aspects of government procurement activities.

PENDING CASES AGAINST UNITED STATES CLOSEST TO COMPLETION

The United States may well dodge the bullet on procedural grounds again. While there has been no final action on the Glamis case, for instance, this case involving a mining company may not result in an award against the United States: Glamis may not be considered a foreign investor, because the company had claimed it was "a U.S. citizen" in order to take advantage of an 1872 mining law, which allows only U.S. citizens or domestically-incorporated firms to exploit federal lands. Also, there was also no evidence of losses. Glamis was never forbidden to mine on its claim. Rather, it was required to meet the same backfilling rules that such mines must meet in California. Glamis could have complied with the law and worked its claim. Alternatively, given that Glamis Gold's mining claims are more valuable with gold at $800 an ounce (as it has been recently) than when the case started (gold was $325), Glamis could have sold its valuable mining rights, but instead launched an investor-state claim. More detail on this and other pending cases is provided below.

1. Aspects of the state tobacco settlements, which have resulted in a dramatic drop in the rate of teenage smoking in the United States, are being challenged by Canadian tobacco traders.[20] Grand River Enterprises, is the Canadian company seeking $340 million in damages over 1998 U.S. Tobacco Settlement, which requires tobacco companies to contribute to state escrow funds to help defray medical costs of smokers.

2. A Canadian mining firm is bringing a NAFTA suit over a California law that requires reclamation of open-pit, cyanide heap-leach mining sites.[21] Glamis Gold, the Canadian company is seeking $50 million in compensation for the California law requiring backfilling and restoration of open-pit mines near Native American sacred sites. The company's American subsidiary had acquired federal mining claims and was in the process of acquiring approval from state and Federal Governments to open an open-pit cyanide heap leach mine. When backfilling and restoration regulations were issued by California, Glamis filed a NAFTA claim rather than proceed with its application in compliance with the regulations.

3. A Canadian drug company is suing the United States under NAFTA because it was not clearly granted the right to manufacture a generic version of a Pfizer

[20] UNCITRAL, "Notice of Arbitration Under the Arbitration Rules of the United Nations Commission on International Trade Law and the North American Free Trade Agreement between *Grand River Enterprises Six Nations, Ltd. et al. and Government of the United States of America*," March 11, 2004a. Available at: http://www.state.gov/documents/organization/30961.pdf.

[21] UNCITRAL, Notice of Arbitration Under the Arbitration Rules of the United Nations Commission on International Trade Law and the North American Free Trade Agreement, *Glamis Gold Ltd.* v. *the Government of the United States*, Dec. 9, 2003.

drug by the U.S. court system.[22] Apotex is a Canadian generic drug manufacturer sought to develop a generic version of the Pfizer drug Zoloft (sertraline) when the Pfizer patent expired in 2006. Due to legal uncertainty surrounding the patent, the firm sought a declaratory judgment in U.S. District Court for the Southern District of New York to clarify the patent issues and give it the "patent certainty" to be eligible for final FDA approval of its product upon the expiration of the Pfizer patent. The court declined to resolve Apotex's claim and dismissed the case in 2004, and this decision was upheld by the federal circuit court in 2005. In 2006, the case was denied a writ of certiorari by the U.S. Supreme Court. Because the courts declined to clarify the muddled patent situation, another generic competitor got a head-start in producing the drug. Apotex challenged all three court decisions as a misapplication of U.S. law, NAFTA expropriation, discrimination and a violation of its NAFTA rights to a "minimum standard of treatment." They are demanding $8 million in compensation.

4. Most recently, a consortium of Mexico-domiciled trucking groups is initiating a NAFTA Chapter 11 case over the ending of the NAFTA trucks pilot program, they may be seeking billions in damages, even though very few trucks from Mexico are likely to meet U.S. standards, be appropriate for very long international hauling, and even though very few such trucks participated in the recent Bush administration cross-border trucking program beyond the border zone. The claimants say because they pay certification fees they have an investment.[23]

After an initial wave of WTO cases and NAFTA investor-state challenges, enforcement of NAFTA and WTO non-trade policy constraints has gotten more subtle. Given that trade attacks on health and environmental laws draw terrible press and controversy and are expensive to litigate, foreign governments and investors have found that merely threatening challenges to chill initiatives rather than waiting for their passage and then formally filing against them is a cheaper and politically safer tactic.[24] For instance, after NAFTA threats were raised against a Canadian provincial proposal to institute a single-payer form of auto insurance, the proposal was dropped. Often these cases never come to public attention unless one party leaks the documents. Thus, while there is not a long list of formal WTO or NAFTA cases against U.S. state policies, increasingly state officials have been facing trade agreement threats against state policy initiatives. Moreover, the formal cases that have been launched are illustrative of the threats that the NAFTA–WTO model poses to normal state governmental activity and legislative prerogatives.

Statement of the U.S. Chamber of Commerce

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business—manufacturing, retailing, services, construction, wholesaling, and finance—is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S.

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[22] UNCITRAL, Notice of Arbitration Under the Arbitration Rules of the United Nations Commission on International Trade Law and the North American Free Trade Agreement, *APOTEX, Inc.* v. *the Government of the United States*, Dec. 10, 2008.

[23] See Luke Engan, "Mexican Truckers File NAFTA Investor Claim; DOT Gives Proposal To NSC," *Inside U.S. Trade,* April 10, 2009. See also, Canacar v. the United States of America, filed April 2, 2009, p. 6.

[24] For instance, the European Commission issues an annual list of U.S. regulatory policies at the federal, state and local levels that they consider trade barriers. On this list are many state policies with historical antecedents long preceding the WTO, such as state regulation of insurance and alcohol control states. A high-level forum called the Transatlantic Economic Council has also been developed to discuss the elimination of such "trade barriers" on both sides of the Atlantic. For the 2007 list of U.S. trade barriers see http://ec.europa.eu/trade/issues/sectoral/mk_access/pr150207_en.htm.

Chamber of Commerce's 112 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

In the 21st century, investment capital moves across national borders as never before. For the average citizen trying to follow who owns what—or which companies are buying or merging with others—the flow of international investment has caused confusion and uncertainty. However, the facts show that no one country or region is "buying" another. Rather, Americans derive great value on both sides of the investment equation.

The U.S. Chamber of Commerce is a preeminent defender of international investment. With scores of policy experts and lobbyists on staff, the Chamber works to defend America's traditional openness to international investment and to protect the investments U.S. firms make in other countries.

Investment from Abroad

Over the years, the United States has become one of the world's principal destinations for foreign direct investment (FDI). By 2007, the total stock of FDI in the United States totaled $2.1 trillion.[1]

Investments by foreign companies in our country have created more than 5.3 million American jobs with an annual total payroll of more than $350 billion. These numbers do not include the millions of people who work for companies that supply parts and materials to foreign-owned firms.

In 2007, U.S. subsidiaries of companies headquartered abroad reinvested nearly $70 billion in their U.S. operations. These foreign companies have invested heavily in the U.S. manufacturing sector, and foreign-headquartered manufacturers account for about a fifth of all U.S. exports of manufactured goods. It's impressive to note that U.S. affiliates of foreign companies spent $34 billion on research and development and $160 billion on plants and equipment in 2007.

Coupled with home-grown capital and ingenuity, these investments give the United States extraordinary access to cutting-edge technology and productivity tools. More than 90% of total assets owned by foreign companies are from firms based in the developed countries that are members of the Organization for Economic Cooperation and Development (OECD).

U.S. Investment Abroad

Americans also derive important benefits from U.S. investment abroad. The primary means by which U.S. firms deliver goods and services to foreign customers is by investing abroad and creating a foreign affiliate. Many workers hired by American companies abroad work for these affiliates as they service local markets.

All told, these affiliates generate substantial earnings for American companies. Their sales totaled $4.7 trillion in 2006[2]—a sum more than triple the export earnings of U.S. companies ($1.4 trillion in 2006). These earnings provide American companies with a growing pool of capital to help their companies grow, innovate, and create better jobs at home.

A common myth is that overseas hiring by U.S. corporations is all about finding cheap labor. While the search for affordable labor drives some investment decisions, 70% of U.S. direct investment abroad is concentrated in highly developed countries. Europe—a region not known for low wages—is home to more than one-half of all U.S. direct investment overseas.[3]

Even with significant investments overseas, about 70% of U.S. business investment (including employment and capital expenditures) occurs right here in the United States—not in other countries. About 85% of all research and development by U.S. multinationals is conducted in the United States.[4]

Some foreign workers are hired to produce low-cost goods that are shipped back to value-conscious American consumers. However, in developing economies, U.S. factories and facilities often stand out as models and contribute to raising local labor and environmental standards. Workers at these facilities routinely make more than

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[1] Unless otherwise noted, all statistics on investment are from the Bureau of Economic Analysis, U.S. Department of Commerce.

[2] Raymond J. Mataloni, Jr., "U.S. Multinational Companies—Operations in 2006," Bureau of Economic Analysis, U.S. Department of Commerce, November 2008.

[3] Ibid.

[4] Ibid.

they ever had the opportunity to earn in the past. U.S. companies active in the developing world are major contributors to social and charitable initiatives.

With lower-value products being produced overseas, Americans can focus on high technology, high-value manufactured products, and a broad range of professional and business services. In other words, America's position in the global economy helps us create and preserve high-skill, high-wage jobs.

Securing U.S. Investment Abroad

The U.S. Chamber is committed to ensuring strong protection of U.S. investments overseas. The rule of law, sanctity of contracts, and respect for property rights are the touchstones of respect for international investment, and the United States should fight for these principles in markets around the globe.

One critical mechanism for extending protections to U.S. investors overseas and improving their access to foreign markets is the U.S. bilateral investment treaty (BIT) program. This program has enjoyed bipartisan support throughout its existence. Over the past quarter century, the United States has concluded BITs with 47 countries, and similar provisions to protect investments are included in bilateral and regional free trade agreements (FTAs).[5] Over time, U.S. BITs have evolved to offer a high standard of protection for investors, as seen in the current U.S. "model BIT."

The BIT program has had the same basic objectives since it was launched in 1982: "protecting United States investment abroad; encouraging the adoption of market-oriented investment policies that treat private investment in an open, transparent, and nondiscriminatory way; and supporting the development of international legal standards consistent with these policies." [6]

Bilateral investment treaties provide a level playing field for investors by advancing the principle of "national treatment." Embraced by Democratic and Republican Administrations for more than two decades, this principle gives U.S. investors overseas the same rights, privileges, and responsibilities as domestic investors with limited exceptions (e.g., for national security).

Respect for the principle of national treatment is critical to job-creating investments and efficient global capital markets. The Chamber and its members believe the principle of national treatment should not be compromised directly or indirectly in ways that would create advantages or disadvantages for companies based on whether they are headquartered in the United States or elsewhere.

Investor-State Arbitration

In addition, the "investor-State" dispute settlement procedures established in BITs and FTAs provide for arbitral panels to resolve disputes under international legal standards. These proceedings mirror U.S. Constitutional protections against arbitrary government actions and against taking of property without compensation. In developing countries where local judiciaries are at times slow, ineffective, or corrupt, U.S. companies have benefited significantly from recourse to "investor-State" arbitration.

Investor-State arbitration is rarely employed. For example, a total of just over 30 cases was brought under NAFTA's Chapter 11 in all three countries over the first ten years after the agreement's entry into force. The value of the investments involved in these cases is small compared to the hundreds of billions of dollars that U.S. companies have invested in countries with which the United States has BITs or FTAs. However, even when arbitration is not used, these provisions serve as a positive admonition to governments to avoid arbitrary actions in commercial disputes lest the case wind up before an international arbitration panel.

In recent years, some critics of the BIT program have expressed concern that these provisions somehow grant foreign enterprises rights not given to U.S. companies. While the merits of that debate could be repeated, the bottom line is that policymakers have definitively taken this issue off the table. In 2007, the U.S. free trade agreements with Colombia, Panama, Peru, and South Korea were amended to clarify that "foreign investors are not hereby accorded greater substantive rights with respect to investment protections than domestic investors under domestic law where, as in the United States, protections of investor rights under domestic law equal or exceed those set forth in this Agreement." [7]

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[5] U.S. Department of State.

[6] **Daniel S. Sullivan,** Assistant Secretary for Economic and Business Affairs, U.S. Department of State, written testimony before the Senate Committee on Foreign Relations, Washington, D.C., June 12, 2006: http://montevideo.usembassy.gov/usaweb/paginas/2006/06-245aEN.shtml.

[7] This language was included in the text of the four free trade agreements mentioned.

The Path Forward

Looking forward, the U.S. Chamber strongly supports negotiating BITs with China, India, and Vietnam, and, when circumstances permit, with additional large economies such as Brazil and Russia. As other countries around the globe pursue their own BITs, decision-makers in Washington should be wary of how these may place U.S. companies at a competitive disadvantage should the United States lag in its own negotiations. In addition, where countries are not yet ready for a full-scale BIT, the United States should continue to help interested partners to build their own capacity to protect investments through Trade and Investment Framework Agreements (TIFAs), which help prepare countries for BIT negotiations.

In addition, it is noteworthy that the State Department's Advisory Committee on International Economic Policy (ACIEP) is preparing a task force to review the current "model BIT" mentioned above. As the United States considers negotiating BITs with additional countries with different economic structures, negotiators will have to take the particularities of local circumstances into consideration.

For instance, U.S. Chamber policy has long acknowledged that "governments often assist their firms through such means as mixed credits, co-financing, export credit subsidies and investment promotion to obtain and retain business in foreign markets and to capture portions of the United States market. These practices persist despite the efforts of the U.S. government to eliminate or control them through multilateral agreements and through other initiatives to convince foreign governments to cease their noncompetitive practices."[8] Chamber policy is to support collaboration between the U.S. government and business in framing international economic policy—including investment policy—especially "where foreign governments interfere with natural market forces, the consequence of which is to put American firms at a significant competitive disadvantage."[9] This position will continue to inform our advocacy relating to BITs and FTAs in the future.

Conclusion

Respect for international investment is a pivotal issue for the business environment—at home and abroad. For more than five million Americans, our openness to foreign capital means a good job. For millions more, it means economic growth, new sales, and enhanced competitiveness.

As U.S. companies invest around the world, ensuring respect for their investments is just as critical. As former Secretary of State Colin Powell said, "Capital is a coward; money flees uncertainty and corruption. To entice capital in and then keep it in, governments must recognize private property rights, deeds of trust, and the sanctity of contract, and they must enforce these rights transparently and fairly."

The principles of the rule of law, sanctity of contracts, and respect for property rights are at the heart of U.S. international economic policy. Their protection should always be at the fore of policymakers' concerns, even in countries where formal investment protection agreements remain a distant goal. The U.S. Chamber of Commerce is committed to working with Congress to ensure that investment treaties and free trade agreements help to advance these principles.

[8] U.S. Chamber of Commerce, Policy Declarations (approved by the Board of Directors).
[9] Ibid.