Additional Questions for the Record and Responses by Celeste Drake, AFL-CIO

The Honorable Jan Schakowsky

1. In testimony submitted prior to the Subcommittee hearing on April 18, 2013, you wrote that "rights provided to foreign investors should not exceed rights of domestic investors." At the hearing, you expanded on this statement with a discussion of the legal impact of investor-state dispute settlement (ISDS) mechanisms and other provisions of international trade agreements that could place U.S.-based companies – especially small and medium-sized enterprises – at a disadvantage.

    a. I am interested in understanding in greater detail the potential consequences of such provisions. For instance, I have heard that it might be possible for a foreign firm to challenge a domestic regulation, enacted by democratically-elected leaders, because the regulation would have an impact on future expected earnings. Is this an example of a where a foreign firm essentially could have greater rights than a domestic firm? On what claims – specifically, claims domestic firms could not make in the courts in which they have standing – could foreign firms base legal action at an international body?

ANSWER:

Yes, foreign investors whose "home country" is a country with which the United States has a "bilateral investment treaty" (BIT) or "free trade agreement" (FTA)[1], in addition to using all domestic avenues available (including lobbying at the federal, state, and local levels; participating in rulemaking, such as through the Administrative Procedures Act; and accessing state and federal courts), can pursue claims before a private, unaccountable, undemocratic arbitration panel. The types of property interests that a foreign investor may seek to protect in the arbitration go far beyond U.S. law, and include such speculative concepts as the "expectation of gain" and the "assumption of risk." A typical, *non-exhaustive* list of the forms an investment may take is included in the Peru FTA:

> **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**:
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> (a) an enterprise;
> (b) shares, stock, and other forms of equity participation in an enterprise;
> (c) bonds, debentures, other debt instruments, and loans; [12, 13]
> (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;[14, 15] and
> (h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges;

[1] With the exceptions of the U.S.-Australia and U.S.-Jordan FTAs.

[12] Some forms of debt, such as bonds, debentures, and long-term notes, are more likely to have the characteristics of an investment, while other forms of debt, such as claims to payment that are immediately due and result from the sale of goods or services, are less likely to have such characteristics.
[13] Loans issued by one Party to another Party are not investments.
[14] Whether a particular type of license, authorization, permit, or similar instrument (including a concession, to the extent that it has the nature of such an instrument) has the characteristics of an investment depends on such factors as the nature and extent of the rights that the holder has under the law of the Party. Among the licenses, authorizations, permits, and similar instruments that do not have the characteristics of an investment are those that do not create any rights protected under domestic law. For greater certainty, the foregoing is without prejudice to whether any asset associated with the license, authorization, permit, or similar instrument has the characteristics of an investment.
[15] The term "investment" does not include an order or judgment entered in a judicial or administrative action.[2] (emphasis added)

The types of property rights potentially protected here are extensive, and the provisions open the door to "regulatory takings" not compensable under U.S. takings law. For example, In *Metalclad v. Mexico* (2000), a panel awarded a U.S.-based company more than $15 million from the Mexican government after municipal authorities refused to allow Metalclad to build and operate a toxic waste facility on environmentally-sensitive land. Local residents opposed the facility, arguing that it threatened their water supply. In the end, Mexico was punished for responding to its public as a democratic government should. Foreign investors should not have access to challenge such land use, zoning, and permitting decisions in ways that domestic investors cannot. These disadvantages for domestic investors are compounded for small and medium sized domestic businesses, which may lack the resources to even use the variety of domestic legal options available.

In 1999, the Canadian company Methanex used NAFTA's ISDS provisions to bring a claim for $970 million in damages against the U.S. government because California had banned a chemical additive (MTBE) in order to protect the water supply. As the company's lawyer explained, the corporation chose ISDS because NAFTA "clearly create[s] some rights for foreign investors that local citizens and companies don't have … that's the whole purpose of it."[3] Corporations that lose U.S. court cases can even seek compensation for adverse decisions, including jury awards that they consider excessive. This provides foreign investors with an opportunity to attack domestic court decisions in a private process—something domestic investors cannot do.[4]

In a particularly outrageous claim, Veolia has used the ISDS mechanism to launch a case against Egypt, complaining that changes to local labor laws—including increases in the minimum wage—adversely affected the company.[5] Such a claim made against a state or local decision to

[2] The full text of the Peru FTA is available here: http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text.
[3] William Greider, The Right and US Trade Law, The Nation, 2001 http://www.thenation.com/article/right-and-us-trade-law-invalidating-20th-century#.
[4] "Loewen" NAFTA Case: Foreign Corporations Unhappy with Domestic Jury Awards in Private Contract Disputes Can Demand Bailout from Taxpayers, Public Citizen Available at http://www.citizen.org/documents/Loewen-Case-Brief-FINAL.pdf
[5] Little is known about the case given the secretive nature of ISDS tribunals. The case is mentioned in International Arbitration Reporter, Jul. 1, 2012 (Vol. 5, No. 12), available by subscription only here: http://www.iareporter.com/categories/20120214.

increase minimum wages in the U.S. could the federal government responsible for paying a ransom to foreign investors who objected to the increase and is inconsistent with U.S. property law.

b. The current policy statement of the National Conference of State Legislatures (NCSL), "Free Trade and Federalism," which is enclosed for your review, states that the organization "will not support Bilateral Investment Treaties (BITs) or Free Trade Agreements (FTAs) with investment chapters that provide greater substantive or procedural rights to foreign companies than U.S. companies enjoy under the U.S. Constitution." Please review the enclosed document and comment. In your opinion, what is the importance of this policy statement, and what does it indicate about the potential impact of ISDS on U.S. states, their small and medium-sized enterprises, and their workers?

ANSWER:

This NCSL policy statement is of particular importance because it demonstrates that state-level elected officials recognize the dangers to democratic decision-making of providing foreign investors with a special forum in which to bring extraordinary claims. Procedural rights are as important as substantive rights; the ability to access a different process (private investment panels) means that foreign investors, by design, also have access to different substantive rights. Foreign investors can and do bring "regulatory takings" claims and claims that the U.S. (through state or local governments) has violated an investor's right to a "minimum standard of treatment"—a substantive concept that only exists in international law. These private investment panels need not consider legal concepts commonplace under domestic law, such as "sovereign immunity" or whether a law has a "rational basis."

Many of the measures and decisions challenged by foreign investors—including those referenced above (*Methanex* and *Metalclad*) are state and local measures. Even though it is the responsibility of the federal government to defend such claims, states that want to defend their choices and protect future policy space expend precious resources to help mount defenses—resources that could be better used serving their residents. The NCSL statement recognizes that every ISDS challenge, even unsuccessful ones, can contribute to a "chilling effect" on state policy makers, who would prefer to expend scarce state resources on activities other than defending democratic choices against claims by foreign investors. Moreover, the NCSL policy statement recognizes that home-grown enterprises and foreign enterprises should have a level playing field and access to the same forms of democratic participation and legal redress. The AFL-CIO shares the NCSL's concerns about "investment chapters that provide greater substantive or procedural rights to foreign companies than U.S. companies enjoy under the U.S. Constitution."

2. At the Subcommittee hearing on April 18, 2013, a member of Congress expressed concern over foreign firms dumping goods into the U.S. market, and asked you to comment. If you did not have time to answer in full, please do so in writing.

ANSWER:

"Dumping" is a type of predatory pricing behavior in international trade that occurs when an entity sells a good in a foreign market below its price in its home market or below its cost of

production. A good may also be underpriced because it has been subsidized by its home government in ways violate international trade law. The U.S. prohibits such behavior, provides a forum in which to bring complaints, and, when applicable, provides redress in the form of "anti-dumping" or "countervailing" duties.

However, if instead of sending a dumped or subsidized good produced in country X through international commerce to the U.S. for sale at a below-market price, a producer based in country X could decide to invest in the U.S. and produce the product here. In doing so, the producer may still continue to receive illegal subsidies from its home government, including, for example, low- or no-cost capital or intermediate inputs. Even if the producer from country X imported the subsidized capital or dumped components parts into the U.S., it is not clear that U.S. trade law could reach such behavior: the behavior may not necessarily violate domestic laws when the final product is offered for sale. It is also unclear when the subsidized or dumped component parts, which do not change ownership when they cross the U.S. border, have "entered U.S. commerce."

How would a domestic, U.S. manufacturer bring a dumping or illegal subsidy claim against a producer that is producing down the street instead of across the ocean? As the U.S. seeks to promote additional foreign investment, in particular from countries with very different economic models than our own, lawmakers should consider how to address this very important predatory pricing issue. In addition, the proposed review in Section 4 of the Global Investment in American Jobs Act of 2013 should include an analysis of whether CFIUS should be expanded to cover economic impact issues such as those discussed in this answer. Failure to include an economic benefits test in CFIUS could disadvantage U.S.-based producers.

3. At the Subcommittee hearing on April 18, 2013, you spoke about the particular impact of foreign direct investment on the U.S. auto industry. After considering that example, it is clear that foreign direct investment could presumably have very different effects on different parts of the U.S. economy. Do you believe that the proposed review in Section 4 of the Global Investment in American Jobs Act of 2013 should assess the differing impact of foreign direct investment on different parts of the U.S. economy? If so, how do you believe that this part of the review would improve understanding of the impact of foreign direct investment?

ANSWER:

The review proposed in Section 4 of the Global Investment in American Jobs Act of 2013 should assess the differing impact of foreign direct investment on different parts of the U.S. economy. Generalized statements about average wages paid by foreign investors can hide as much information as they disclose. For example, averages can be pulled up by extraordinary performance in a single industry (just as Bill Gates' presence in a room brings up the average income of the room's occupants). Accurate statements about averages can also fail to provide specifics about various regions or industries.

Just as it is important to study the progress of relevant ethnic and socioeconomic subgroups when describing student learning, it is important to study the impact of foreign investment on the wages and benefits paid in various industries or in various regions of the country. By looking at the finer detail, if we discover that foreign investment is actually pulling down wages in a particular sector (or sectors), lawmakers can then consider how to address this negative impact

(for instance by providing greater resources to address the use false "independent contractors") even while maintaining the positive impacts of foreign investment in other sectors. Without this additional, more granular data, lawmakers may be oblivious to the potential harms being caused to industries in their home states.

4. In your written testimony, you suggested that the Department of Commerce should analyze not only best practices in attracting foreign direct investment but also those unsuccessful state, regional, and local efforts to subsidize foreign investment that, in your words, represent "poorly-designed incentives that fail to create good jobs." What are some examples of these unsuccessful incentives, and what would be the importance of requiring an assessment of their impact through the review and report under Section 4 of the legislation?

ANSWER:

In the 2011 report, "Money for Something: Job Creation and Job Quality Standards in State Economic Development Subsidy Programs,"[6] the authors found that programs "without any wage requirement—which together cost more than $8 billion a year—can potentially result in jobs that pay so little that workers must rely on social safety net programs such as food stamps, Medicaid, State Children's Health Insurance and the Earned Income Tax Credit."

Even those program *with* a wage requirement (such as Oklahoma's Investment/New Jobs Tax Credit, which has had an annual wage floor of only $7,000—less than half of the federal minimum wage—since 1980) can leave the state on the hook for social safety net programs in addition to the outlay of $8 billion in direct costs. Program with low or no wage floors and no "fringe benefits" requirements, may create some jobs, but are unlikely to "create **good** jobs."

Moreover, in the 2013 report, "The Job Creation Shell Game: Ending the Wasteful Practice of Subsidizing Companies that Move Jobs from One State to Another,"[7] the authors conclude that:

> What states euphemistically call "business recruitment" is often nothing more than the pirating of jobs by one state from another. This piracy is bankrolled by property, sales and income tax breaks, land and infrastructure subsidies, low-interest loans, "deal-closing" grants, and other subsidies to footloose companies. . . . Worse than zero-sum, this is a net loss game, with footloose companies shrinking the tax base necessary for the education and infrastructure investments that benefit all employers.

The authors provide several examples of wasteful spending on this shell-game, including businesses that move repeatedly across the Missouri-Kansas border in the Kansas City metro area and businesses lured from Memphis, Tennessee by nearby Mississippi.

The Department of Commerce, in its analysis, should investigate not only programs that "create jobs," but programs that save the state social safety net costs and that do not simply poach jobs from nearby cities or states. Good Jobs First, the publisher of both reports cited here, provides some useful recommendations that the Department of Commerce may wish to consider as part of its work.

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[6] The complete report is available here: http://www.goodjobsfirst.org/sites/default/files/docs/pdf/moneyforsomething.pdf.

[7] The complete report is available here: http://community-wealth.org/content/job-creation-shell-game-ending-wasteful-practice-subsidizing-companies-move-jobs-one-state.

5. In written testimony submitted to the Subcommittee, you wrote:

> [T]he AFL-CIO recommends that the study [required by Section 4 of the legislation] limit itself to reviewing policies that ***uniquely apply to foreign direct investment***.
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> The reason for such a limitation is clear: as a nation, we have placed great value on having clean air, clean water, safe workplaces, safe food and stable financial markets. That is why we have adopted strong laws and regulations. …
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> Thus, we urge the Committee to avoid including regulations of general application in this review. …
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> If the Committee retains its interest in studying regulations of general applicability, we encourage you to ensure that the Department of Commerce will address the benefits of a strong and effective regulatory environment on attracting foreign direct investment instead of simply assuming that regulations generally impede such investment.

In response to a question at the hearing, you mentioned that if we found that in certain sectors foreign investment was negatively affecting wages and benefits, we should change our policy so that foreign direct investment would be beneficial for workers. Perhaps this response led a member of Congress to conclude that you may want the Global Investment in American Jobs Act of 2013 to review labor laws.

Please clarify what you believe to be the appropriate scope of the review and the report that would be required by the legislation.

ANSWER:

I appreciate the opportunity to clarify my answer. For the reasons explained in my written testimony, the AFL-CIO strongly recommends that the policies under review include those that *uniquely apply to foreign direct investment*. The AFL-CIO does not view labor laws, health and safety laws, financial services regulations, or other public interest measures as impediments to investment. Rather, they make the U.S. an attractive place to do business.

Separately, if, after studying the impacts of foreign investment as proposed by Section 4 of the bill, Congress learns that foreign investment overall, or, more likely, in a particular industry, sector, or region, is hurting rather than helping workers, Congress may wish to consider additional ***compensatory measures or enforcement regimes*** that would ensure that foreign investors are not skirting labor, environmental, or other public interests laws, nor are such investors driving wages down instead of up.

Therefore, rather than including in the review laws of a general nature that apply to all employers equally, the AFL-CIO is recommending that, if the review recommended in Section 4 produces information regarding negative impacts on workers as a result of foreign direct investment, that Congress consider ways to prevent FDI from inflicting those negative impacts or to fully compensate workers for such impacts.