



Trans-Pacific Partnership Negotiations

The Obama Administration has begun negotiations on the Trans-Pacific Partnership (TPP), a trade and investment agreement intended to begin the process of integrating the economies of the Americas and East Asia. The United States initiated negotiations in March 2010 with seven countries: Singapore, Chile, New Zealand, Brunei, Australia, Peru, and Vietnam. Other countries, such as Colombia, may be invited to join the negotiations or sign onto the completed agreement down the road.

There is some speculation that the TPP might be seen as creating a counterbalance in the region to China's increasing economic and political influence. The TPP might also be seen as an instrument for pressuring the relative economic heavyweights of Southeast Asia -- Thailand, Malaysia, and Indonesia -- to come to terms with the United States. All three countries have been reluctant to sign free trade agreements (FTAs) with the United States, in part because of the implications for national sovereignty of investment, services, and intellectual property provisions of the U.S. model FTA.

The U.S. Negotiating Model for the TPP. Will the United States seek a TPP agreement, based on the essentially libertarian U.S. model for Free Trade Agreements developed by the Clinton and two Bush Administrations starting with NAFTA? Or, will the Obama Administration chart a new course, putting more emphasis on social concerns? Few observers are predicting the latter. Skepticism about any imminent change of course in U.S. trade policy seems justified given that the economic policies of most of the partners in the current TPP negotiations are, compared to the international norm, strongly market oriented. The libertarian Cato Institute regards the Singapore, Chile, New Zealand, and the United States as among the five most "economically-free" in the world (among the Cato top five, all are Pacific Rim countries, except for Switzerland).¹

Trade in Goods. TPP negotiations will be very much about trade in goods: oil from Brunei; agricultural products from New Zealand; agricultural products, natural gas, iron ore, and other minerals from Australia; copper and agricultural products from Chile; textiles, electronics, and agricultural products from Vietnam; biotechnology, electronics, and chemicals from Singapore; copper, zinc, gold, textiles, and fish meal from Peru.

Issues on trade in goods, especially agricultural and manufactured goods, can be contentious, as has been demonstrated by the reluctance of Congress to move forward on the U.S.-Korea Free Trade Agreement because of concerns about non-tariff barriers to U.S. beef exports to Korea and the prospect of even more Korean auto imports to the United States.

What are the implications of the TPP for the huge U.S. deficit in trade in goods? U.S. Trade Representative Ron Kirk believes that U.S. export of goods will flourish under the TPP. "The Asia Pacific's robust economies," he says, "offer huge opportunities to grow U.S. exports, thereby creating

¹ James Gwartney, Robert Lawson, *Economic Freedom of the World: 2009 Annual Report*, Cato Institute, 2009, available at, <http://www.cato.org/pubs/efw/index.html>.

and retaining high quality, high paying jobs in the United States.”² Trade skeptics, however, point to America’s “huge, chronic trade deficits –most of them with East Asia,” and ask how the TPP would create a balanced exchange of manufactured and agricultural goods.³

Trade in Services & Financial Regulation. Access to Pacific markets will be a key to future growth of U.S. exports of services, including financial services, a sector where Americans enjoy a competitive advantage. Among the U.S. negotiating partners on the TPP, only Singapore is a sophisticated exporter of financial and other service products, but it is a small city-state.

At the same time, given the recent financial crisis, the United States and its TPP negotiating partners must be able to regulate financial services and to take other necessary emergency measures without exposing themselves to international lawsuits based on the TPP services or investment chapters. The coverage of financial services under the proposed TPP could exacerbate this problem by expanding the pool of foreign financial institutions that could challenge financial regulations.

In this connection, there are potential problems in the text of the current U.S. model for international investment agreements, in particular. Although existing U.S. investment agreements contain an exception that purports to preserve the right of governments to take “prudential” measures to protect investors or the stability of the financial system,⁴ the text of the exception may contain a significant loophole. The prudential measures exceptions in U.S. agreements typically state that where regulations do not comply with other provisions of the agreement, “they shall not be used as a means of avoiding the Party’s commitments” under the agreement.⁵ Does this mean a measure is permissible only so long as it does not violate the agreement?

The TPP Investment Chapter. Will a TPP agreement provide for investor-state dispute resolution mechanisms? International investor-state dispute resolution grants greater rights to foreign corporations and investors compared to the rights enjoyed by Americans.⁶ As a consequence, U.S. states and localities

² USTR Fact Sheet: Trans –Pacific Partnership.

³ Alan Tonelson, “Trans-Pacific Partnership: Another Obama Trade Fantasyland,” U.S. Business and Industry Council, January 2010.

⁴ See, e.g., U.S.-Panama TPA, art. 12.10(1); United States Model Bilateral Investment Treaty, art. 20(1), 2004 [hereinafter U.S. model BIT], available at http://www.ustr.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf

⁵ *Id.* U.S. trade and investment agreements typically establish an elaborate process to determine the applicability of the prudential measures exception. Should a respondent invoke the provision during investor-state arbitration, the competent financial authorities of both state parties are to determine whether and to what extent it applies. However, in the event that these authorities cannot agree, the determination passes to the arbitral tribunal, just as it would have in the absence of such elaborate procedure. See, e.g., U.S. Model BIT, art. 20(3); U.S.-Panama TPA, art. 12.19.

⁶ The U.S. model for protecting foreign investments has its origins in the 1970s when the United States concluded bi-lateral investment treaties (BITS) with several developing countries. Among the distinguishing features of BITS are: (1) broad and largely undefined provisions for protecting the property rights of foreign investors, such as “indirect expropriation,” (2) an investor-to-state dispute resolution mechanism, which provides standing for an individual foreign investor to invoke international arbitration against a nation-state, based on allegations that a governmental measure violates treaty provisions protecting foreign property rights, and (3) enforcement of international tribunal decisions with awards of money damages to foreign investors in compensation for such treaty violations. See, Matthew C. Porterfield. “International Expropriation Rules and Federalism,” Stanford Environmental Law Journal, Vol. 23, No. 1, January 2004, pp.36-39.

face potential challenges. Among the substantive provisions in the current U.S. model investment chapter, three stand out:

- The scope of the protected property interests under an overbroad definition of investment⁷;
- The unresolved definition of when government regulation constitutes an indirect expropriation for which compensation must be provided⁸; and
- The almost total lack of definition of what it means for a government to fail to meet the minimum standard of treatment of a foreign investor under international law⁹.

All recently-concluded regional and bi-lateral free trade agreements negotiated by the United States, with one exception, include provisions for “investor-state dispute resolution.” The exception is Australia, an English-speaking country with a common-law legal system. U.S. negotiators had proposed an investor-state provision for the U.S./Australia agreement, but this move was opposed not only by U.S. state and local governments, but also by Australian states, which viewed investor–state arbitration as a deal breaker. Consequently, it was dropped.¹⁰ Will TPP negotiations, however, reopen the question of a U.S./Australian investor-state process? And, will Singapore, New Zealand, Chile, and Brunei seek investor-state protections for their wealthy corporations and investors doing business in the United States?

⁷ International investment agreements (IIAs) signed by the United States contain complex definitions of investment that cover a broad range of economic interests. Large numbers of state and municipal laws are therefore covered by IIAs. These definitions of investment are broader than the constitutional standards used under domestic constitutional law in the United States. The U.S./Peru FTA definition, for example, includes “assets having characteristics of an investment” such as expected profits, assumption of risk, and the commitment of capital. Forms of investment include not just enterprises, but also stocks, bonds, debts, contracts, resource-extraction concessions, and business licenses. See, section C., article 10.28, U.S./Peru Free Trade Agreement.

⁸ The vague expropriation standard in U.S. investment agreements combined with the broad discretion enjoyed by tribunals means that state and local governments are not able to predict with certainty when their laws and other measures may be in violation. Tribunals set up to hear these investment cases do not agree on the scope of expropriation rules. Arbitrators have room to read the vague language of expropriation articles broadly or narrowly. Thus, one tribunal following the rule in the *Methanex* case might find no expropriation violation, while a second tribunal could come to the opposite conclusion. *Methanex v. United States*, Final Award, part IV, chapter D, paragraph 7 (2005). In sharp contrast to the rule in *Methanex*, the NAFTA panel in *Pope & Talbot* said economic regulation, even when it is an exercise of the state’s traditional police powers, can be a prohibited indirect or “creeping” expropriation under customary international law if it is “substantial enough.” *Pope & Talbot v. Canada*, Interim Award by Arbitral Tribunal, In the Matter of an Arbitration Under Chapter Eleven of The North American Free Trade Agreement Between Pope & Talbot Inc. and The Government of Canada (April 10, 2001), pp. 33-34, available at <<<http://www.naftaclaims.com>>>.

⁹ The “minimum standard of treatment,” which includes the right to “fair and equitable treatment,” is also a vague standard that permits foreign investors to challenge government actions on the grounds that they are either procedurally or substantively unfair. Again, these vague concepts allow international investment tribunals considerable discretion in their deliberations.

¹⁰ There was concern that Australian investors would aggressively file claims against the United States in the same fashion that Canadian investors sued under NAFTA chapter 11 after that agreement was approved. Australia has a large investor class with economic interests in the United States and a sophisticated international corporate bar that might pursue claims outside the U.S. court system to protect Australian investments, particularly in mining, media, and services industries in the United States.