

Spring 1985

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Recommended Citation

George P Shultz, Trade, Interdependence, and Conflicts of Jurisdiction, 36 S. C. L. Rev. 295 (1985).

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SOUTH CAROLINA LAW REVIEW

VOLUME 36

SPRING 1985

NUMBER 3

TRADE, INTERDEPENDENCE, AND CONFLICTS OF JURISDICTION

GEORGE P. SHULTZ*

This is a year of some important anniversaries. Next month, on June 6, President Reagan will pay a visit to the Normandy beaches on the 40th anniversary of D-day. For those of us with an economic bent, this year is also the 40th anniversary of Bretton Woods—the historic conference of free nations that laid the foundation of the postwar economic system.

The essence of these postwar arrangements was to institutionalize cooperation in trade and finance in order to avoid the disastrous mistakes of the 1930's that had exacerbated and spread the Great Depression. The industrial democracies committed themselves to an open world economic system that promoted trade and the free flow of goods, services, and investment. They created new mechanisms of multinational action and new habits of economic policy. The result has been a generation of global economic expansion unprecedented in human history.

Over time, this postwar system has adjusted, of course, to new situations. The end of colonial empires brought into the global system scores of new nations which seek to develop and share in the new prosperity. Oil shocks, monetary disputes, and protectionist pressures have created stresses in the system. My

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subject this morning is another dimension of problems, often overlooked, which potentially could be more serious than any of the others. Ironically it is, in a sense, a product of the system's success.

You lawyers know it as the problem of "extraterritoriality" or more accurately as conflicts of jurisdiction. Sometimes the United States and other countries need to apply their laws or regulations to persons or conduct beyond their national boundaries. International disputes can arise as a result; sometimes, as in the case of the pipeline sanctions we imposed after martial law was declared in Poland, the legal disputes reflect disagreement on foreign policy.

My message today is twofold:

- In an interdependent world, such problems are bound to proliferate, because they are inevitably generated by the expanding economic and legal interaction among major trading partners in the expanding world economy.

- Secondly, unless they are managed or mitigated by the community of nations, these conflicts of jurisdiction have the potential to interfere seriously with the smooth functioning of international economic relations that is essential to continued global recovery.

So you can see why a Secretary of State, trained as an economist, has chosen such a topic to discuss before a distinguished bar association.

I. DIMENSIONS OF THE PROBLEMS

Let me give you a few examples of what I am talking about.

- An American company claiming injury by foreign companies operating in our market as a cartel may bring an antitrust suit against those companies, yet their cartel may be permitted, or even encouraged, by their own governments.

- An American grand jury investigating the laundering of drug money and tax violations may subpoena documents of a bank operating in a Caribbean banking haven—a country that prohibits the disclosure of such information.

- In our country, twelve states have adopted the unitary tax system, which taxes a local subsidiary not only on the basis of its own operations but also taking into account the operations of the corporate parent and other subsidiaries. Foreign companies

and their governments are protesting vigorously, because such a system can lead to double taxation.

- The Commission of the European Community, on the other hand, is considering regulations that would require European subsidiaries of American firms to disclose what the firms consider sensitive business information—plans for investment and plant closings, for example, even including those outside Europe.

- Finally, our allies may object strenuously when the United States attempts to prevent foreign subsidiaries and licensees of American companies from exporting certain equipment or technology to the Soviet Union or other countries for reasons related to our foreign policy objectives.

These examples show you the variety of different issues that can give rise to questions of conflicts of jurisdiction. And they suggest why, with the best of intentions, we are likely to run into many problems of this kind.

II. CONFLICTS OVER ECONOMIC ISSUES

The volume of international transactions has grown tremendously in the last three decades. The contribution of international trade as a proportion of American gross national product has doubled since 1945. American exports increased from \$43 billion to more than \$200 billion in the 1970's alone. The value of world trade more than doubled during that period. American direct investment abroad as of 1982 totaled some \$221 billion; foreign direct investment in the United States in the same year stood at \$102 billion.

One symbol of this age of economic interdependence is the multinational corporation. The conditions that produced the explosion in trade across national boundaries have led to a similar internationalization of industry. Thirty years ago, most American industrial firms conducted their operations top to bottom within the United States. Today, those same operations are often spread out across the globe, whether to produce components at the lowest price or to produce goods closer to potential markets. Today, virtually every line of trade and industry has been affected—and advanced—by the spread and growth of multinational enterprises.

In this environment of commercial and industrial expan-

sion, it is not surprising that the United States—and other nations—often find it necessary to apply their laws, regulations, and policies to activities abroad that have substantial and direct effects on their own economies, interests, and citizens. Needless to say, our assessment of our need to reach persons or property abroad often runs up against other nations' conceptions of their sovereignty and interests and, if not handled skillfully and sensitively, can escalate into legal and political disputes.

Our relations with our neighbor Canada provide the best illustration of the potential for trouble—which, in this case, I'm happy to say, is pretty well under control. Americans own a controlling interest in approximately thirty-five percent of Canadian industry. In 1982, Canadian exports to the United States constituted twenty percent of Canada's gross national product. Approximately seventy percent of Canada's oil and gas, thirty-seven percent of its mining, and forty-seven percent of its manufacturing is controlled from abroad. Speaking from this perspective, Canadian Ambassador Alan Gotlieb has characterized our attempts to exercise jurisdiction over persons or entities in Canada as calling into question "the ability of a national government to impose its laws and policies—that is, to govern—within its national boundaries."

Just after I was confirmed as Secretary of State, I traveled to Ottawa for two-day talks with my Canadian counterpart, External Affairs Minister Allan MacEachen. After our talks, we announced our intention to meet at least four times each year to discuss bilateral and multilateral issues. We have already met seven times, and issues of extraterritoriality have invariably been at the top of our list. These issues range from banking and taxation to export controls and antitrust regulations.

Canada is not our only ally concerned about these issues. In the past year we have received more than twenty-five formal diplomatic demarches on the subject from many of our closest allies and trading partners. One of their major concerns is the unitary tax, now in use in twelve American states. In my tenure at the State Department, few issues have provoked so broad and intense a reaction from foreign nations. Fourteen countries submitted a joint diplomatic communication to the Department of State over this issue.

These countries—the ten members of the European Community plus Japan, Canada, Switzerland, and Australia, repre-

senting eighty-four percent of total foreign direct investment in the United States (that's \$85 billion)—had three complaints. They complained about the administrative burden of compliance and about the potential for double taxation. And they warned that we must anticipate adoption of unitary taxation by developing nations who are heavily in debt and looking desparately for new sources of revenue. As the world's largest foreign direct investor, the United States will be a big loser if the practice becomes widespread. Developing nations, I might add, would be even bigger losers in the long run, since they would scare away investors.

Although on a technical level it can be debated whether unitary taxation really involves "extraterritoriality," it is perceived that way on a political level. Thus I am pleased to see that the Unitary Tax Working Group of federal, state, and business representatives—established at the President's direction—has reached a consensus in favor of limiting unitary taxation to the "water's edge." Despite problems yet to be overcome, we think substantial progress has been made toward finding a practical solution.

III. NATIONAL SECURITY AND FOREIGN POLICY CONFLICTS

As controversial as these conflicts over trade and financial issues can be, the potential for sharp controversy is even greater when the disputes involve major foreign policy concerns. As the largest free nation, the United States must use the full range of tools at its disposal to meet its responsibility for preserving peace and defending freedom.

You all remember the case of the pipeline sanctions. When martial law was imposed in Poland in 1981, President Reagan applied economic sanctions to show that "business as usual" could not continue with those who oppress the Polish people. We prohibited exports of oil and gas equipment and technology to the Soviet Union by firms within the United States and by foreign firms using American-made components or U.S. technology. Eventually we also prohibited exports of wholly foreign-made commodities by subsidiaries of U.S. firms abroad. This caused a major dispute between us and our trading partners, who complained of the extraterritorial reach of the sanctions and the retroactive interruption of contracts already signed.

Our Export Administration Act, which is now up for renewal, authorizes the government to impose controls on exports of equipment or technology on grounds of either national security or foreign policy. That authority extends not only to entities within the United States but to any entity, wherever located, that is subject to U.S. jurisdiction. We consider this to include foreign subsidiaries of U.S. firms, although such authority has rarely been exercised. The act also provides authority for controls on reexports and for controls on the export abroad of foreign products using U.S. components or technology.

Thanks to the allied consensus on the need to keep militarily useful technology from falling into the hands of our adversaries, implementation of so-called "national security" controls has not generally created problems over extraterritoriality. Each allied government enforces similar controls, and policies are kept in harmony through the Coordinating Committee for Multilateral Security Export Controls or COCOM. It doesn't make sense to spend billions of dollars on defense but at the same time help our adversary build up the very military machine that we are spending the billions to defend against.

When it comes to use of export controls to impose sanctions on foreign policy grounds, which we resort to very sparingly, no such consensus exists. Our efforts under the Export Administration Act to compel U.S. firms outside the United States to adhere to our foreign policy controls have stirred up new controversy. This is in part because some of our allies do not share our belief in the efficacy of economic sanctions, in part because of differing strategic perspectives, and in part because their domestic economic interests would have been more adversely affected than ours.

In our current effort to extend and amend the Export Administration Act, we have given careful consideration to some of the provisions that made the pipeline sanctions so controversial. Specifically, the Administration supports clarifying the criteria for controls on so-called "foreign policy" grounds, taking account of the principle of sanctity of contracts in this area. At the same time, resolution of the pipeline dispute has demonstrated the benefits of a cooperative allied approach to economic relations with the Soviet bloc.

When I was in private business, I was concerned about the practice of using foreign trade as a tactical instrument of foreign

policy. I called it “light-switch diplomacy”—the attempt to turn trade on and off as a foreign policy device. The problem is two-fold. First, the United States is no longer in such a dominant position in world trade that our unilaterally imposed sanctions have as powerful a political effect as is intended. Moreover, America’s reliability as a supplier is eroded; other countries simply change suppliers or design U.S. components out of the goods they manufacture. The U.S. economy suffers unless our main trading partners go along with us. Foreign aircraft manufacturers, for example, are already avoiding U.S. made high-technology navigational devices for fear that some day new U.S. export controls might be imposed, preventing sales or drying up supplies of parts.

Now that I am Secretary of State, I continue to have the same concerns. But I know, too, that there are cases beyond the strict legal definition of “national security” that pose a serious challenge to our broader security and other foreign relations interests. In these cases, economic and commercial interests cannot be the sole concern of policy. Dealing with Libya and Iran is an example; and we must be able to prevent U.S. commerce from being the source of chemicals used unlawfully in regional conflicts.

For these kinds of cases, it seems to me imperative for the President to have discretionary authority to use national security and foreign policy controls on a selective basis. Although such controls can have painful side effects, the alternatives available for responding to threatening international developments can sometimes have even higher costs. We have thought a lot about the proper balance and have tried to build such a balance into the President’s proposal for amending the Export Administration Act. This approach merits congressional support.

But it is clear that problems will remain. As the world economy grows more interdependent, as the machinery of business regulation grows more complex, as the Soviet Union steps up its drive to acquire advanced technology that it cannot produce itself, the opportunity for differences is bound to grow. Any one of the major trading countries is likely, on some occasion in the future, to feel that its national interest or public policy cannot be served without an assertion of jurisdiction that leads to a disagreement with its partners. And, if the disputes get out of hand, they could do damage to this open system of trade and

investment and become an obstacle to further economic growth, as I have said. Disputes over extraterritoriality could become a bigger threat to our economic interests than the present concerns about tariffs, quotas, and exchange rates. On a political level, they can become a serious irritant in relations with our allies and thus even weaken the moral foundation of our common defense.

So extraterritoriality is not an esoteric, technical matter. It is high among my concerns as I go about the job of managing the foreign relations of the United States.

IV. THE NECESSITY FOR A SOLUTION

It is, in fact, a matter of some urgency. Increasingly, conflicts of jurisdiction are resulting in defensive and retaliatory actions on the part of some foreign governments.

A number of countries have enacted "blocking" statutes seeking to forbid individuals or companies from complying with U.S. law or regulation. In 1980, for example, Britain enacted the Protection of Trading Interests Act. This law empowers the British Government to order companies in Britain not to comply with foreign subpoenas and discovery orders, as well as foreign laws, regulations, or court orders that threaten to damage British trading interests. The act also authorizes a British company to retaliate against private treble-damage antitrust awards by filing a countersuit in British courts.

In addition, the prospect of application of our laws to off-shore conduct is beginning to result in new barriers to investment. Acquisitions and mergers have also been impeded, and foreign manufacturers are beginning to seek alternative sources of supply to replace U.S. sources that are considered unreliable.

- The threat of U.S. export controls has, indeed, inspired foreign purchasers to design around or circumvent the use of U.S. components in their products. An Italian firm, for example, uses General Electric rotors in turbines it manufactures for the Soviet pipeline project. Early this year, it notified GE that it wanted the license to manufacture the rotors in Italy or else it would manufacture them without GE approval by using technical knowledge developed over the years of using GE components.

- The unitary tax has made foreign companies think twice

about building plants in the United States. A few months ago, the president of Fujitsu was reported in the *Washington Post* as saying that his company is delaying plans to build a plant in California to see whether that state repeals its unitary tax law. Sony has stated that it decided to expand new U.S. investment here in South Carolina rather than California because of California's unitary tax. (South Carolina, I must say, has a remarkable record of attracting some \$3.5 billion in foreign investment in the last dozen years or so.)

- Speaking more broadly, we have had a number of suggestions from friends and allies in recent years that application of American law where it conflicts with their policies can only serve to damage adherence to an investment principle we have long cherished: national treatment for American-owned companies abroad.

These may be only the tip of the iceberg. The threat of extensive application of domestic law—be it U.S. or European law—to entities or persons abroad has the potential to harm the fabric of the global economic system. And disputes of this kind pose a danger of poisoning political cooperation among the democracies, whose solidarity and cohesion are the underpinning of the security, freedom, and prosperity of all of us. It is imperative, therefore, that we manage the problem of conflicts of jurisdiction.

V. THE SEARCH FOR SOLUTIONS

As we search for solutions, we can start by examining an analogy from our own history. As lawyers, you have much experience with dealing with conflicts of laws among the several states. And you remember that as this country grew from a collection of "free and independent states" under the Declaration of Independence to its status as a "more perfect union" under the Constitution, this growth was accompanied by a political struggle over the effort to centralize and strengthen national control over interstate commerce.

It's not news to the people of South Carolina that the growth of our country gave rise to a continuing tension between the sovereign states and the Federal Government. In the economic sphere, notwithstanding the centralizing clauses of the Constitution, conflicts of jurisdiction arose from the states' at-

tempt to regulate and tax the railroads in the late 1800's. America's railroads, indeed, were an early example of multijurisdictional enterprises. Their growth made the United States a truly "national" market for the first time. Understanding the importance of economic integration, the Supreme Court decided in several landmark cases, dealing with shipping and interstate commerce, that conflicts of jurisdiction among the several states could not stand in the way of national prosperity. Today, the United States can be viewed as the largest free-trade area in the world.

In the United States we have been fortunate that the friction generated by conflicts of jurisdiction has been eased by a strong federal system. In the international arena, differences among nations are not so easily resolved. As a result, what may first appear to be a clash of legal principles can quickly escalate into a major diplomatic incident. International law, instead of mitigating conflict, can become a battleground until the underlying dispute is eased by creative diplomacy. The need for such solutions is becoming more urgent as conflicts of jurisdiction multiply in our economically interdependent world.

The question we face, however, is not whether extraterritorial reach should be permissible but rather how and when it should be done. Thanks to the wonders of modern electronics, corporations and individuals can frustrate important national regulations and laws by transferring assets, data, and documents across oceans with a telephone call or the push of a computer button. In such a world, where transactions often involve parties in several nations, rigid territorial limits to jurisdiction are, in fact, not practicable.

Even some of the most eminent critics among our allies recognize this. Canadian Ambassador Gotlieb has stated: "It is clear that in our interdependent world a purely territorial approach to sovereignty—one that completely separates national jurisdictions—is not workable; some extraterritoriality is inevitable and, sometimes, even desirable."

Nevertheless, it is essential that the industrialized world find ways of containing or mitigating or resolving some of the problems. The United States cannot disclaim its authority to act where needed in defense of our national security, foreign policy, or law enforcement interests. However, we are prepared to do our part in finding cooperative solutions. We are prepared to be

responsive to the concerns of others. If our allies and trading partners join with us in the same spirit, we can make progress.

The first element of our approach is to strive to resolve the policy differences that underlie many of these conflicts of jurisdiction. The pipeline dispute, for example, was resolved through diplomacy: the United States lifted the sanctions while the industrial democracies began working out a new consensus on the important strategic issues of East-West trade. Harmonizing policies is not easy. Our allies are strong, self-confident, and independent minded; and they do not automatically agree with American prescriptions.

Even where policies are not totally congruent, it may be possible at least to bring them closer together in some areas, or to agree on some ground rules that allow us to meet our legitimate needs. Some examples include regulating competition, pursuing foreign insider trading in our securities markets, and protecting what we consider to be our sensitive technology. A good case in point is the cooperation we recently received from several foreign governments in intercepting sensitive computers that were being diverted to the Soviet Union.

Second, where policies do not mesh, countries should seek to abide by the principle of international comity: they should exercise their jurisdiction only after trying to take foreign interests into account, and they should be prepared to talk through potentially significant problems with friendly governments at the earliest practicable stage.

Sometimes, the answer may be a formal international agreement. We have tax treaties with thirty-five nations, for example, including all the major industrial countries. I have just returned from China, where the President signed a tax treaty that will enter into force after ratification. These have the effect of harmonizing national systems and fostering international commerce, and they usually establish procedures for enforcement cooperation.

Similarly, we and our partners have been expanding formal arrangements for mutual assistance in the law enforcement area. Three such formal treaties are already in force, three more have been signed and are awaiting ratification, and several more are under negotiation.

We are also discussing ways to develop further our informal arrangements of advance notice, consultation, and cooperation

with foreign governments where appropriate and feasible. Under OECD (Organization for Economic Cooperation and Development) guidelines regarding antitrust enforcement, in place since 1967, the United States has notified or consulted with foreign governments approximately 490 times regarding antitrust cases, including the well-known Uranium and Laker matters. With West Germany, Australia, and Canada, we have expanded these guidelines into bilateral agreements or arrangements.

We have cooperative procedures as well for some of the independent regulatory agencies. The Federal Trade Commission (FTC), for instance, participates in the antitrust notice and consultation program I mentioned earlier. And the Securities and Exchange Commission (SEC) has entered into a Memorandum of Understanding with Switzerland, through which we can obtain information in Switzerland that we need in investigating insider trading and other securities violations.

Third, we are working to improve coordination within the U.S. Government. Within the executive branch we are studying procedures through which other agencies inform and, if appropriate, consult with the Department of State when contemplating actions that may touch foreign sensitivities about conflicts of jurisdiction. The State Department has already played a constructive role in assisting, for example, the SEC, the FTC, and the Justice Department.

Fourth, we are considering the development of bilateral and multilateral mechanisms for prior notice, consultation, and cooperation with other governments. In the OECD, we are working out a set of general considerations and practical approaches for dealing with cases of conflicts of jurisdiction relating to multinational corporations. Discussions are taking place also in the U.N. framework with both developing and industrialized countries. We have had extensive bilateral consultations with Britain and Canada, and we are ready to consider such appropriate and mutually beneficial arrangements with other interested friendly countries.

Such measures will not end conflicts of jurisdiction, but they are an earnest of this country's determination to do what it can to avoid conflicts where we can and to minimize the harm that the unavoidable conflicts can do. The United States, for its part, will continue to maintain that it is entitled under international law to exercise its jurisdiction over conduct outside the

United States in certain situations. We will continue to preserve the statutory authority to do so. But we will exercise the authority with discretion and restraint, balancing all the important interests involved, American and foreign, immediate and long-term, economic and political.

VI. PROBLEM SOLVING

The essence of our approach is to reduce the problem from an issue of principle to a practice of problem solving. This is because, in the final analysis, there is a higher principle at stake: the political unity of the democratic nations. That unity, as I said earlier, is the key to our common security, freedom, and prosperity. The system of law that we and our allies so cherish and the free economic system that so nourishes us are under severe challenge from adversaries who would impose their own system by brute force. If the free nations do not stand solidly together on the fundamental issues, we all risk losing much that is precious—far more precious than the subject matter of any particular dispute.

To solve these problems, we need creative thinking on the part of the American legal community, businessmen and economists, government officials, foreign policy experts—and their counterparts abroad. I know that with imagination and dedication, we in the free world can surmount these obstacles. Too much is at stake for us to do otherwise.

