International Law: Private Law in United States Law

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Private Law in United States Law

This article discusses some aspects of the development of international economic law in the United States since the end of World War I and the impact it had on the development of international economic law generally, focusing specifically on the three areas in which U.S. law had the most significant impact on international economic law: international trade and investment, international taxation, and international antitrust measures. In general, in all three areas U.S. law had considerable influence on the development of international economic law in the twentieth century. However, the degree of influence in these and other areas varied depending on the degree to which other countries accepted the underlying principles of U.S. law.

International Trade and Investment Law.
International trade is the area in which the United States had the most obvious influence on the development of international economic law after World War II. Following the war, the United States was the dominant economic power, accounting for about 40 percent of world gross domestic product (GDP); eighteen of the top twenty multinational corporations in the world were American. Under these circumstances, and following the disastrous outcome of the tariffs imposed in the early 1930s, such as the Smoot-Hawley Tariff, which contributed to the Great Depression and the rise of fascism, the United States became committed to reducing tariffs worldwide and to the principle of comparative advantage (the idea that each country should specialize in the goods or services it is best at producing and import other goods and services from other countries). Even the U.S. labor unions favored free trade to encourage exports, since imports were not perceived as a significant threat until the 1970s. The United States thus had a major role in setting up the General Agreement on Tariffs and Trade (GATT), the first multilateral treaty for reducing trade barriers, in 1947 and in guiding it through successive rounds of negotiations among both developed and developing nations, culminating in the establishment of the current intergovernmental organization for trade matters, the World Trade Organization (WTO), in 1994. These negotiations succeeded in dramatically reducing average worldwide tariff rates on most imported goods from over 50 percent in 1947 to less than 10 percent in 1994, with the potential of further reductions in future rounds of negotiations.

The U.S. free-trade policy came under significant domestic pressure in the 1970s and 1980s following the oil crisis and the rise of Japanese and European multinationals. In the 1980s, for example, President Reagan imposed “voluntary” import quotas on Japanese car manufacturers, successfully inducing them to invest in manufacturing plants in the United States and enabling U.S. car manufacturers to learn Japanese methods of production.

Nevertheless, successive Republican and Democratic administrations continued to support free trade in principle through the 1980s and 1990s. In the Uruguay Round of trade negotiations that led to the establishment of the WTO, the United States achieved a major expansion of the scope of trade law by extending it to services (the General Agreement on Trade in Services, or GATS), intellectual property (Trade Related Intellectual Property, or TRIPs), and, to a limited extent, investment measures (Trade Related Investment Measures, or TRIMs). Those are all areas in which the United States has a significant comparative advantage. In addition, the United States was the main advocate of moving from the “diplomatic” consensus-based dispute-resolution mechanism of GATT to the more “legalistic” dispute-resolution mechanism of the WTO. In the WTO, a dispute is settled by a professional appellate body with expert judges, and only a unanimous decision by the members can overturn their decision, while in the GATT regime any member, including the losing party, could block implementation of an adverse decision.

The relative success of the United States in getting its position adopted in the trade area contrasts sharply with relative failure in the investment area. In the area of foreign direct investment (FDI), the United States has not been able to persuade other countries to follow its preference for relatively open investment policies in all sectors of the economy. The liberalization that occurred toward FDI from the 1980s was led by developing countries, not by the United States, and several American attempts to convince various international organizations to adopt a multilateral agreement on investment (MAI) have failed—even the Organisation for Economic Cooperation and Development (OECD), a group of like-minded developed countries, failed spectacularly in adopting an MAI in the 1990s. The basic problem is that foreign direct investment touches more areas in a country's internal affairs than trade, which is conducted primarily at the border. Investment is thus a more sensitive issue, and the United States has not been able to strike a generally acceptable balance between the rights and responsibilities of multinationals and of host countries. The best the United States could do in this area was lead the world in the direction of adopting bilateral investment treaties (BITs). These are by now ubiquitous (there are over 2,500 worldwide), follow similar models, and since they contain a most-favored-nation clause, have the potential of becoming de facto MAIs.
The United States has also played a key role in blurring the lines between trade and investment beyond the limited scope of TRIMs. The expansion of the GATT to services has meant that it covers significant parts of foreign direct investment, since many services (for example, hotels) cannot be delivered from a distance and require a presence in the host country. In addition, the focus in GATT has recently shifted from explicit tariffs to nontariff trade barriers like export subsidies and regulatory provisions (such as environmental and health and safety regulations), which also apply to FDI. The United States has been at the forefront of challenging these types of provisions—for example, in the beef-hormones case against the European Union, in which the United States successfully challenged the EU's ban on beef injected with bovine growth hormones—but has also now been on the receiving end of adverse WTO judgments—for example, in the tax–export subsidy case against the EU, in which the EU forced the United States to abandon its policy of subsidizing exporters via tax-law provisions. This blurring of the lines threatens to make trade rules as controversial as FDI rules. This can be seen if one considers regional trade agreements that incorporate investment provisions, of which the North American Free Trade Agreement (NAFTA) is a leading example. The NAFTA investor-state dispute-resolution provisions have been (unexpectedly) used to attack U.S. policies, by challenging regulations as equivalent to confiscation of investors’ property, and this has led to waning enthusiasm for such investor rights in the United States.

From a historical perspective, it is clear that the United States played a decisive role in favoring free trade in the post–World War II era, similar to the role of the British Empire in the nineteenth century. However, as the United States becomes less dominant in the global economy and as the lines between trade and investment continue to blur, it is questionable whether it can continue to maintain this posture in the face of increasing domestic pressures to adopt a more protectionist stance. Nevertheless, it is remarkable how successful the United States has been in persuading other developed countries to follow its lead in this area. Fundamentally, this is the result of three factors: an underlying agreement by policy elites in the developed world that free trade is the best policy; the relative openness of the United States itself to both imports and investment, and its perceived economic success; and the effective economic pressure the United States has been able to bring to bear as the dominant economic power.

International Tax Law.

The United States played a crucial role in the development of the current international tax regime, which dates back to the 1920s. After World War I, a debate emerged between capital-importing and capital-exporting countries over which should bear the responsibility of avoiding double taxation when both source (capital-importing) and residence (capital-exporting) countries had a right to tax the same item of income. The United Kingdom, for example, advocated pure residence-based taxation, with at best a deduction for taxes levied by the source country, whereas Italy (among others) supported taxation by the source country and an exemption by the residence country. The United States intervened decisively in 1918 by unilaterally adopting a foreign-tax credit, which maintained the primacy of source-country taxation while preserving the residual right of the residence country to tax if the source country does not. This move (led by the Yale economist and U.S. Treasury consultant T. S. Adams) was particularly significant since the United States was already the biggest capital exporter in the world. It reflected the concerns of the U.S. business community about double taxation and the reality that the source jurisdiction always gets the first chance to tax any income. Almost every country that taxes the foreign-source income of its residents (that is, the majority of countries in the world) has by now followed the United States in adopting the foreign-tax credit, even though many economists believe it is more rational to grant a deduction (rather than a credit) for foreign taxes, since a credit results in a direct transfer of revenue from the residence country to the source country.

Thereafter, the United States was instrumental in forging the 1920s compromise that active business income should be taxed primarily by the source country and passive investment income primarily by the residence country. This consensus, which was first embodied in the recommendation of a League of Nations committee of
experts chaired by Professor Edwin Seligman of Columbia, is the foundation for the current international tax regime and for over 2,500 bilateral tax treaties. The United States was also instrumental in setting the minimum threshold rule for source taxation of business income ("permanent establishment"), which provides that a country may not tax business income from sources within it unless the taxpayer operates from a fixed physical location (a "permanent establishment") in that country.

The United States was also responsible for the major innovation in international taxation in the post–World War II era, namely the extension of a country's jurisdiction to tax foreign corporations controlled by residents (controlled foreign corporations or CFCs). The first move in that direction had already been taken in the 1930s, when the United States began to tax foreign corporations earning mostly passive income that were controlled by five or fewer U.S. resident individuals (so-called incorporated pocketbooks). Then, in the 1960s, a similar regime was extended to subsidiaries of U.S. multinationals. By 2003, twenty-three other (mostly developed) countries, including Canada, Germany, the United Kingdom, France, and Japan, had followed the United States in adopting a CFC rule. This innovation has been quite unpopular with U.S. multinationals, who have claimed since the 1960s that it puts them at a competitive disadvantage vis-à-vis multinationals from other countries, but the success of the United States in persuading other OECD members to follow its lead has significantly weakened the force of such protests.

Yet another example of the United States’ influence in international taxation relates to transfer pricing, or the way in which the profits of multinationals are allocated among taxing jurisdictions. In general, each subsidiary corporation of a multinational corporation is treated as a separate taxpayer. As a result, a multinational corporation can shift profits from high-tax jurisdictions to low-tax jurisdictions by adjusting the prices ("transfer prices") paid by one company in the group for the goods or services provided by another. The United States, under the leadership of Stanley Surrey (a Harvard professor who served as the first assistant secretary of the Treasury for tax policy in the 1960s), was the pioneer in developing methods to adjust the transfer prices to the prices that would have been paid had the companies been unrelated to each other (the “arm’s-length standard”). The arm's-length standard and the methods adopted by the United States were then incorporated into highly influential transfer-pricing guidelines issued by the OECD in 1977. Subsequently, the United States realized that the methods developed by Surrey in the 1960s were not working, and in 1995 added two additional methods; these too were adopted by the OECD within weeks of their promulgation in the United States. As of the early twenty-first century, most developed and developing countries in the world follow the revised OECD guidelines, which are quite similar to the U.S. rules—similar, but not identical: one crucial U.S. rule relating to the allocation of income from intangibles, which is very favorable to the United States from a revenue perspective, was explicitly not followed by the OECD.

A final example of the way in which the United States has shaped the international tax regime is less beneficial from a perspective of enhancing global welfare. In 1984, in the face of a growing deficit financed mostly by foreign investors, the United States decided to abolish its withholding tax (i.e., tax withheld from payments to
foreigners) on interest paid to foreign investors. This “portfolio-interest exemption” has led to a classic “race to the bottom,” so that as of the early twenty-first century, almost no developed country is able to levy withholding tax on interest payments to foreigners. The problem is that because the interest can be routed through corporations in tax havens, it is not taxed by the residence country either, because tax havens offer bank secrecy and do not provide the necessary information to the residence jurisdiction. It is estimated that globally about $7 trillion of portfolio investments bears no tax burden as a result of this unfortunate U.S. decision. In 2003, the EU adopted a “savings directive” designed to ensure that payments of interest to EU residents from other EU countries are subject to tax, but the directive is conditioned on the ability to get the United States (as well as Switzerland) to cooperate, and it does not apply to interest paid from EU member countries to nonresidents.

These examples show that the United States has historically played a leadership role in shaping the international tax regime, generally for the better. The foreign-tax credit, CFC rules, and transfer-pricing rules are all important U.S. innovations that were copied by other countries. From the 1990s, however, the United States has tended to deviate more from the international consensus, for example in adopting rules (the “check the box” regulations adopted in 1997) that define what a corporation versus a partnership or branch is for U.S. tax purposes. These rules state that a U.S. taxpayer may choose whether a foreign entity is treated for U.S. tax purposes as a corporation, a partnership, or a branch, regardless of how the foreign country treats that entity for its own tax and nontax purposes. Not surprisingly, such innovations have led to considerable opportunities for tax arbitrage, that is, manipulating differences in the rules of two or more countries to achieve double nontaxation. For example, a U.S. limited liability company (LLC) that is owned by a Canadian parent can be treated for U.S. tax purposes as a branch, and payments by it to the parent as deductible interest that is exempt from U.S. withholding tax, while Canada may treat the same payments as dividends from a subsidiary corporation that are exempt from Canadian tax. The degree to which the United States can address this problem and the related problem of harmful competition among countries to attract investment will determine its continuing influence in the future.

Why has the United States been so influential? In part, because of its sheer size—that was certainly the decisive factor in the portfolio-interest example, because no country can afford to levy taxes on interest if the United States does not. Another example is the significant flow of investment from Europe to the United States after the 1981 Reagan tax cuts. But in most of the examples above, the United States has been able to persuade other countries that its chosen methods (the foreign-tax credit, CFC legislation, transfer-pricing rules) are needed for, on the one hand, levying some tax on cross-border transactions and, on the other, avoiding double taxation. It is the fundamental agreement on the goal of single taxation and on the 1920s compromise that enabled the United States to be so influential.

International Antitrust Law.

U.S. involvement in international antitrust law began inauspiciously when the Supreme Court (per Justice Holmes) held in American Banana Co. v. United Fruit Co., 213 U.S. 347 (1909), that the Sherman Antitrust Act did not apply even to egregious conduct (in that case, hiring troops to eliminate a competitor importing into the United States) when that conduct took place outside the territorial limits of the United States. This result could not last, and in 1945 Judge Learned Hand overturned it in United States v. Alcoa, 148 F.2d 416 (2d Cir.), which held that restraints on trade resulting from a contract entered into outside the United States with the intention of affecting imports inside the United States were illegal under the Sherman Act. (Judge Hand could ignore the Supreme Court precedent because the Second Circuit Court of Appeals was acting as court of last resort, since a recusal by three Supreme Court justices prevented the Court from mustering a quorum and thus from hearing the case on appeal.) Hand thus invented the “effects doctrine,” which has been quite influential (see, e.g., American Law Institute, Restatement of Foreign Relations Law of the U.S., 3d, sec. 402: “a state has jurisdiction to prescribe law with respect to… conduct outside its territory that has or is intended to have a substantial effect within its territory”) and was incorporated into the Sherman Act (as amended in 1982).
The extraterritorial application of U.S. law in the antitrust area has proven highly controversial, even though it was limited to “direct, substantial, and reasonably foreseeable effect[s]” (Sherman Act section 6a), and even though U.S. courts have tended to balance its application with the interests of the other country involved. One reason for the continuing debate about extraterritoriality in this area of law is that even though the Supreme Court has generally held that U.S. laws should not be applied extraterritorially unless Congress says otherwise (EEOC v. Arabian American Oil Co., 499 U.S. 244 [1991]), it has created a broad exception for antitrust law (Hartford Fire Insurance Co. v. California, 509 U.S. 764 [1993]). Moreover, in the Webb-Pomerene Act, the United States explicitly exempted its exporters from the antitrust laws. In addition, other countries have resented the ability of private U.S. parties to sue to enforce the antitrust laws and obtain treble damages. The United Kingdom, for example, passed legislation to retaliate against U.S. corporations—to the extent treble damages were awarded against British companies—to block collections of any such damages, and to “claw back” the extra two-thirds of the damage award.

This is not to say, however, that the U.S. approach has not been extremely influential. In particular, the EU has adopted the effects doctrine and has extended the reach of its antitrust laws (articles 81 and 82 [formerly 85 and 86] of the Treaty of Rome) to extraterritorial conduct. More broadly, articles 81 and 82 are counterparts to sections 1 and 2 of the Sherman Act, and that is no coincidence: for the better part of the twentieth century, U.S. antitrust law was the only actively enforced law in this area and thus set an important example for the EU. There is, in fact, a significant degree of convergence in this area, resulting primarily from U.S. influence.

Nevertheless, antitrust law remains an area in which the United States and other countries sometimes find agreement difficult, and this has tended to restrict the scope of U.S. influence in this field—especially in comparison with the trade and tax areas. This disagreement is due in part to the clash of national interests, but those exist in the tax and trade area as well. The basic reason for disagreement is that the United States and the EU have different approaches to the goals of antitrust law. In the United States, since at least the 1970s, the primary goal of antitrust law has been to enhance competition as it affects consumers, without regard to the effect on competitors (this was first established in FTC v. Brown Shoe Co., 384 U.S. 316, decided by the Supreme Court in 1966). In the EU, on the other hand, although article 81 of the Treaty of Rome focuses on consumer protection, article 82 focuses on “abuse of a dominant position” within the EU, which has been interpreted to include behavior that affects competitors. As a result, mergers that pass Federal Trade Commission (FTC) muster in the United States are sometimes blocked by the EU (e.g., the GE-Honeywell proposed merger) or at least have to be tested on different grounds (e.g., the Boeing–McDonnell Douglas merger). In 1991 and again in 1998, the United States and the EU entered into agreements designed to enhance cooperation in antitrust matters, but these agreements primarily address procedural issues and do not resolve situations in which the two parties disagree on fundamental aims. Moreover, these agreements do not apply to private claims under U.S. antitrust law.

Thus, in the antitrust field, there has been some U.S. influence on international economic law, especially in realizing that antitrust law must apply extraterritorially if it is to have any meaningful impact. But in comparison with U.S. influence in the areas of trade and taxation, this influence has been more limited because other countries do not completely agree with the basic orientation of U.S. antitrust law.

**Assessment.**

The United States was quite influential in shaping international economic law in the twentieth century. This influence was due in part to sheer U.S. importance in the world economy, especially in the post–World War II period. But it also resulted from the ability of the United States to persuade other countries to follow its lead and agree with its viewpoint on issues such as free trade and reducing tax barriers to investment. When the United States failed to persuade other countries that its approach is the correct one, as in the antitrust area, its influence was considerably more limited.
This contrast can also be seen if one compares two other areas of international law in which the United States has sought to establish a leadership position: anticorruption legislation and international sanctions. In the former, the United States was a pioneer, adopting legislation in 1977 (the Foreign Corrupt Practices Act) that penalized its multinationals for bribing foreign officials. This led U.S. multinationals to complain for a long time that the legislation put them at a competitive disadvantage with foreign multinationals who were permitted to bribe foreign officials (and in some cases were even granted a tax deduction for foreign bribes). Finally, in 1997, the United States was able to persuade the OECD to adopt recommendations and then a binding convention that incorporated the U.S. principles and applied them to all multinationals of OECD member countries (about 90 percent of all multinationals). This success is attributable to the effective lobbying of U.S. multinationals both in the United States and in other OECD member countries, as well as to the ability of the United States to persuade the other OECD members that condoning corruption in developing countries was not really in the best interests of either these countries or their multinationals. As long as the competitive-disadvantage issue was addressed by coordination through the OECD, countries proved quite amenable to U.S. influence.

On the other hand, the United States has long sought to lead the world in imposing sanctions against regimes it deems harmful. This practice was successful in periods when there was broad consensus about the need for sanctions (such as during World War II or in the 1950s). In other cases, however, the use of sanctions led to explicit rejection of the extraterritorial application of U.S. law to subsidiaries of U.S. multinationals. For example, both the French court in *Fruehauf Corp. v. Massardy*, Ct. App. Paris, 14e ch., Gazette du Palais 1965, 2, pan. Jurisp. 86, trans. in 5 ILM 476 (1966), and the Dutch court in *Compagnie Europeenne des Petroles v. Sensor Nederlands*, Dist. Ct. The Hague, 1982 Rechtspraak van de Week 167, 22 ILM 66 (1983), rejected U.S. attempts to prevent subsidiaries of U.S. corporations from dealing with China and the Soviet Union. From the 1980s, the United States has been unsuccessful in obtaining cooperation in sanctions against Cuba, Libya, Nicaragua, and Iran and only partially successful against Iraq. As a result, the United States has generally refrained from imposing effective sanctions (e.g., sanctions that apply to subsidiaries and not just U.S. parents) in situations where it has lacked international support, preferring symbolic gestures (like the anti-Cuba Helms-Burton Act, which imposes penalties that are routinely waived on foreign corporations doing business in Cuba) instead.

Another example in which U.S. influence is minimal is international bankruptcy law. There exists a general consensus (with few notable exceptions) in the U.S. academic community that it makes no sense to adjudicate bankruptcies of multinational enterprises in multiple forums. As is shown by several major bankruptcies (among them BCCI, Maxwell, and Olympia & York) in the early 1990s, the result is that each country seizes the assets located within it to pay local creditors, and payout ratios (how many cents per dollar of debt is paid to creditors) bear no relationship to the overall distribution or seniority of creditors worldwide. In practice, however, most countries (including the United States when it suits its interests) follow the territoriality rule and block universalist solutions (solutions that would assign the overall bankruptcy case to one forum for adjudication). Part of the explanation is self-interest, but this is not the key element, since countries do not know ahead of time whether they will be beneficiaries of a territorial regime over multiple bankruptcies. The underlying problem is that countries differ on the fundamental goals of bankruptcy law (the United States advocates rehabilitation of the debtor, whereas other countries prefer liquidation) and on priorities (many countries give priority status to wage claims by employees, who are general unsecured creditors under U.S. law). When a multinational bankruptcy case arises, countries tend to prefer to apply their own rules to the assets located in their territory and refuse to defer to a foreign forum for adjudicating the bankruptcy as a whole.

Thus, one conclusion that can be drawn is that U.S. influence on international economic law has depended crucially on the United States’ ability to get other countries to agree with the underlying goals of its policies. When such agreement was found, the U.S. approach was influential, even when there were competing national interests involved. When it was lacking, U.S. influence was more limited (or nonexistent).
Another lesson that can be learned is the unique influence of U.S. business on U.S. policy. In both the tax and the corruption areas, the key to U.S. policy has been to achieve the result sought by U.S. multinationals (the foreign-tax credit and multilateralization of the Foreign Corrupt Practices Act). This is an unlikely outcome in countries in which governments tend to be more hostile to business interests. The explanation lies in part in the U.S. practice of personnel moving from business to government service and back. But it also reflects more broadly held U.S. attitudes toward business, which tend to be more favorable than, for example, attitudes in European countries.

**Bibliography**

**general**


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