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PREFACE

This is the sixth issue of the *Journal of International Business and Law* (JIBL), a joint effort by the students of the Law School and the Zarb School of Business of Hofstra University. As in the past years, the student editors and staff worked tirelessly on this edition to successfully publish yet another issue of JIBL.

JIBL continues to serve as a vehicle to disseminate the research findings of students, faculty and alumni in the areas of international business, international trade, transactional law, and other related interdisciplinary fields. As globalization and its effects on business and law continues, there is a need for wide ranging scholarly debate and critical thinking on a broad range of topics that are crucial to both practitioners and academicians. This thinking is reflected in the articles that are published in this issue. By combining research in these two fields, JIBL hopes to bridge the gap between law and business in international corporate and entrepreneurial activities.

This issue contains nine articles covering a wide range of topics from globalization and its impact to anti corruption initiatives. Five of the articles were written by students of the Zarb School of Business and the Law School. The issue also includes articles by our alumni and practitioners in the field of international business. Reflecting the broad scope of the Journal, the sixth issue features an eclectic collection of articles that cover such topics as migration and trade policies, comparison of mergers and acquisitions across countries, health related issues of expatriates working in countries with poor health care systems, and the success of hedge funds.

For future issues, JIBL welcomes manuscripts on various international topics including the legal aspects of international business, corporate social responsibility, effects of outsourcing, global warming and its impact on businesses, emerging economies and their impact on international trade, exchange rate fluctuations and their impact on financial markets, and the cross-border issues that global companies need to address.

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We hope you find the journal useful. We encourage and seek your active participation and patronage in this endeavor.

James P. Neelankavil Ph.D.,
Professor of Marketing and International Business
Faculty Advisor

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GLOBALIZATION: HEALTH CHALLENGES FOR MULTINATIONAL CORPORATIONS

*Dr. Yann Meunier, M.D.**

INTRODUCTION

Increase in global activity and the ever-intense global competitive environment imply that international companies operating in overseas markets are compelled to pursue any competitive advantage that they can gain. Among the key advantages they seek is a well-trained workforce that can develop and execute their strategies. The management of human resource or human capital has been shown essential to their success. Part of the human resource management is the management of expatriates[♦] who are relied upon to implement global strategic action plans. Their deployment is warranted for fulfilling corporate goals.

Sending expatriates to manage overseas operations is an expensive proposition for international companies. The cost of expatriate failure to all of them amounts up to \$2 billions annually (Copeland L., Griggs L., 1985). A single aborted mission costs on average \$1 million (Shannonhouse R., 1996). Globally, multi national companies (MNCs) pay about \$75 billions a year on long-term international assignments (Sheridan W.R., 1998; and Van Pelt P., Wolniansky N., 1990). These costs include many aspects of placing expatriates in overseas operations. International companies spend considerable amount of time, effort and funds in selecting and training expatriates (Zeira Y., Banai M., 1984; Borstoff P., Field , Harris S.G., 1997; and Konopaske R., Werner S., 2005). Additional costs are incurred in addressing overseas challenges

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[♦] Expatriates are people residing in places other than their native country

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(adjustment and acclimatization to a new environment) for these employees (Harvey M.G., 1998; and Birdseye M.G., Hill J.S., 1995), and for career management and staff retention (Black J.S., Gregersen H.B., Mendenhall M., Stroh L.K., 1999; Tung R.L., 1981; and Tung R.L., 1987).

LITERATURE REVIEW

It is alleged that the costs of maintaining an expatriate could be two to three times as much as placing a comparable staff/manager in the home office (Black J.S., Gregersen H.B., 1999). In spite of this expenditure, more than 80% of international companies make use of expatriates (Black J.S., Gregersen H.B., 1999) because they play an important role in many essential and sensitive positions. Based on extensive research (Harzing A., 2001; Larson, 2004; and Hocking, Brown, Harzing 2004), the principle reasons for placing expatriates can be defined as follows:

- To start up new operations
- To maintain corporate control
- To fill a skill gap in a foreign business operation
- To transfer management expertise and corporate culture
- To protect intellectual property rights
- To develop leadership

The need for expatriates to perform the above activities remains high. At the same time, there are difficulties in recruiting them, which include family concerns (Tharenou, 2003) and relocation uncertainties. The main reason is one does not know what will happen on their return from an overseas assignment (Tyler K., 2006). Moreover, the success of expatriates in their foreign postings is not great. The attrition rate averages 21% compared to only 10% among the general population (HR Focus, 2006). If one considers the number of all managers sent abroad who returned early (10 to 40%) and the number of expatriates who leave the company, it becomes clear that a very significant fraction of all expatriates sent abroad are in reality non-productive.

To resolve the high failure rates of expatriate placements, programs have been suggested or implemented. They address various aspects of expatriation, such as: (a) Terrorism (Harvey M.G., 1993), (b) Cross-cultural and psychological issues (Jansens M., Brett J.M., Smith F.J., 1995; Ali A.J., 2003; and Shaffer M.A., Harrison D.A., 1998), and (c), Repatriation (Hurn B., 1999; and Larazova M., Caligiuri P., 2001). Expatriation failure itself has been examined and assessed by various authors (Harzing A., 1995; Wederspahn G.M., 1992). According to Kealy D.J. and Protheroe D.R. (1996), nearly 40% of Americans return earlier than planned.

The many reasons forwarded for the high failure rate among expatriates include difficulty in adjusting to a foreign country, family concerns,

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and anxiety over uncertain new environments (Black J.S., Gregersen H.B., 1999; and Tyler K., 2006). It appears that family matters are very high on the list of those who did not complete their foreign assignment. Some of the major concerns associated with family issues are health and health-related topics.

Certain health dimensions of expatriation have been analyzed and/or reported in the literature. For example, research studies have dealt with the distribution and magnitude of diseases in the world (Navaro V., 2000; Gentilini M., 1995; and Meunier Y., 1980). Similarly, researchers have investigated the effects of travel and established the principles and practice of travel medicine including precautions to be taken before traveling to a tropical country, e.g., the imperativeness of immunization before a trip (Zuckerman A., Zuckerman J.N., 2002; and Meunier Y., 1984). Other areas of research on the posting of expatriates include the influence of climate on health (Meunier Y., 2006), diseases transmitted by animals (Meunier Y., 2003), risk factors for expatriates (Memish, Ziad A., 2002; and Bonneux L., Van der Stuyft P., Taelman H., Cornet P., Goilav C., van der Groen G., Piot P., 1988) and screening of tropical diseases for expatriates returning from the tropics (Libman M.D., MacLean J.D., Gyorkos T.W., 1993).

Not only the financial but also the human toll of maladjustment can be dire. While they have sophisticated financial, marketing and operational plans for their overseas ventures, organizations too often ignore, under-estimate or misunderstand human dynamics and needs in certain specialized and crucial medical and health-related areas. This paper attempts to address some of the critical health issues of expatriation that may contribute to the high failure rate among expatriates.

METHODOLOGY

This research is based on hundreds of cases accumulated over the many years of the author's practice overseas. Below are six case studies that he was privy to and the conclusions that he drew from his expatriate physician background. Indeed, the case studies presented represent a microcosm of the overall problem faced by expatriates and could be used to correct some of the existing conditions in the area of expatriate placement. Due to the nature of the situations and to maintain confidentiality and privacy, individuals and their company names have been identified through codes.

Spousal psychological maladjustment

Mr. K.M. was the regional General Manager for a U.S. M.N.C. His wife, suffering from depression, was under the care of a local psychiatrist. She could not adapt to the loneliness and shallowness of her expatriate life and eventually had to return to the states with her husband, causing a major and

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expensive disruption to his company because of bad timing. For unforeseen reasons related to her condition, their move occurred right before the launching of a major new product, which consequently flopped. Psychological screening is rarely performed in an expatriate prior to overseas assignments. It is almost never done in spouses and children (Anderson B.A., 2005). This tool should be used to detect assignments potentially at risk, create support structures and avoid failure.

Ignorance of immunization international policies loopholes

Mr. S.A. was the regional Marketing Manager for a French M.N.C. who had attended a weekend seminar in Africa. I saw him for the first and last time in a coma due to yellow fever in the emergency department of a Paris hospital. He had not been immunized against the disease because it was not required coming from a non-endemic country. His demise sent shock waves throughout his company and caused unexpected and significant expenses. International immunization regulations are made to protect countries over individuals, as can be seen in the Centers for Disease Control website. Therefore, pitfalls exist and they are often unknown to non-specialist doctors.

Ignorance about tropical diseases

Mr. J.B. was a plant manager on a construction site in Asia. He contracted cerebral malaria and was unable to work for weeks. This happened because he had been recommended the wrong drug for prevention against local parasites. The financial impact of his disease was tremendous. In his absence, construction slowed down unexpectedly and his company had to pay heavy late penalties. Malaria prophylaxis is the most controversial preventive medicine issue for expatriates and travelers. The rationale of corporate medical departments sometimes lacks coherence in this regard. Moreover, doctors have to frequently update their knowledge on this topic (World Health Organization, 2006), (WHO website).

Ignorance about infectious diseases

National policy

Mr. D.C. was a regional Chief Financial Officer for a Swiss M.N.C. He became HIV positive in a country where upon such circumstances, working permits are cancelled and repatriation to the country of origin immediate. He lost his job, his wife divorced him and his children had to come back to the U.S., wasting one year of studies. His company had to incur many costly bills (including hotel stays, transportation and moves for him, his successor and their respective families). His sudden departure caused major disturbances in the

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corporate operation.

Information

Mr. E.R. was the General Manager of a Belgian M.N.C. when an epidemic occurred in the region where he was working. A spontaneous but unfounded exodus amongst his expatriate employees took him by surprise and stymied his company. HIV is a major concern for single expatriates. Legislation varies from country to country and can be quite drastic for some. Corporate preventive medicine messages should be stressed accordingly. HIV testing requirements are known prior to entry (e.g., on the State Department website). Local HIV-related legal idiosyncrasies are mostly discovered by employees after reaching their country of destination. However, in the author's experience this delay can be avoided. Prompt scientific information dissemination is paramount during epidemics (Gronvall G.K., Waldhorn R.E., Henderson D.A., 2006). Unfortunately, it is also a time when systems and protocols become more vulnerable and breakdown.

Ignorance about local medical care standards

Mr. W.P. was a high executive in a German M.N.C. He broke his leg while playing soccer on a wet field. He was adequately operated in a local hospital but follow-up was careless and his limb did not heal properly. He was left with a permanent limp making him unfit for work in the country where he had been transferred. Substantial costs ensued. Companies largely rely on outside vendors (e.g., the "Comite d'Informations Medicales" website) to provide them with the description of local medical conditions. Control of their data is rarely done. In the author's opinion, independent evaluations are warranted.

Lack of emergency structures

Mrs. X.M., Ms E.G. and Ms P.L., all executives in a U.S. M.N.C., were gang raped in a national park near the capital city of a nation at 10:00am on a Sunday. They became professionally inactive for many subsequent weeks. Because their corporation had no plans to deal with such crises and solutions were improvised, the credibility and trust in the leadership greatly and rapidly eroded across the whole organization. Emergency structures are hard to put in place and costly in developing countries. These are the main reasons why they can hardly be found in corporate milieus and related medical services are expensively outsourced (e.g., see the International S.O.S. website). In fact, emergency companies offer limited resources in some specialty areas. Corporate plans can palliate this.

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DISCUSSION

The cases described above have at least one common trait: Their untoward outcomes could have been prevented at the corporate level. After each one of them, the author has drawn conclusions and proposed action plans to pro-actively handle similar issues in the future. For the most part and to this date, they have been ignored by the H.R. and/or corporate Medical Departments of the prestigious institutions involved. Like many others, they continue to address such challenges defensively while conversely investing heavily in other areas of their overseas business strategy elaboration and implementation. In Table 1 below, the author has identified six systemic and systematic deficiencies in corporate international health care services.

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Table 1
Six Systemic and Systematic Deficiencies in Corporate International Health Care Services

1. ABSENCE OF GLOBAL PROGRAMS Each medical department works independently despite a wide array of common issues such as: (a) Tropical and infectious diseases prevention (particularly, malaria and dengue), (b) Immunization (particularly, yellow fever), (c) Emergencies (particularly, medevacs*), (d) Screening for employees, spouses and children before overseas assignments (particularly, psychological), etc Negative impacts: For example, malaria prevention: Redundancy, doubt in patients' minds, doctor's possible loss of credibility, time wasted in explaining discrepancies, expensive phone bills, sometimes false sense of security if a drug is no longer active against a local parasite unknowingly to its user, etc
2. ABSENCE OF COMMON REFERENCES FOR CORPORATE CLINICS OVERSEAS Each doctor uses his/her own set of references (for example: CDC**, WHO***, or others) Negative impacts: Same as above
3. ABSENCE OF PROTOCOLS, PROCEDURES AND POLICIES OVERSEAS This includes a large number of issues such as: (a) The avian flu, (b) Kidnappings, (c) Rapes, (d) PTSD**** and psychological support, (e) List of doctors, clinics and hospitals of reference, (f) CME***** programs for local staff, (g) Medevacs, (h) Logistics, (i) Public health programs, etc Negative impacts: High cost for reacting to situations already established, total uncertainty that the ad hoc solutions found are the best possible, stress and sometimes panic, enormous amount of time spent on solving emergency issues at the expense of core business, bad image with employees, bad press and bad reputation in the countries of operation, inability to find answers rapidly and reliably when a catastrophe strikes, . . .
4. ABSENCE OF A COMPUTERIZED AND CENTRALIZED MEDICAL FILE FOR EACH EMPLOYEE Negative impacts: Impossibility to gather all the medical data rapidly in case of an emergency, high cost for repeating blood tests and exams, employee time wasted on unnecessary or redundant procedures, vital risk if, for example, allergies are triggered by drugs/other factors or medications discontinued due to absence of information, etc.
5. STRUGGLE IN DEALING WITH TROPICAL DISEASES Because of corporate medical staff poor knowledge, absence or inadequacy of specialists of reference Negative impacts: Inappropriate treatments given with serious and sometimes life-threatening consequences, having to face recurrent similar problems, etc
6. ABSENCE OF A CORPORATE PHYSICIAN OF REFERENCE He/she should be available 24/7 for reference, advice, counseling, information, etc Negative impacts: Time wasted, stress, delay in starting a treatment or taking action to address a health problem. This delay can be life threatening
<i>Medical Evacuations, ** Centers for Disease Control and Prevention, ***World Health Organization, **** Post Traumatic Stress Disorder, ***** Continuing Medical Education</i>

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RECOMMENDATIONS

Based on the analysis of these and many other cases and after identifying the common traits, the following steps are recommended to improve the expatriate failure rates. Are companies currently in a position to answer the questions included in Tables 2 and 3 below?

Table 2
Can Your Company Answer These Structured and Systematic Questions?

- | | |
|-----|---|
| 1. | IS OUR CORPORATE MEDICAL DEPARTMENT LEADING OUR OVERSEAS CLINICS? |
| 2. | ARE ALL OUR EMPLOYEE MEDICAL FILES COMPUTERIZED AND CENTRALIZED? |
| 3. | DO WE HAVE A GLOBAL HEALTH INSURANCE NETWORK? |
| 4. | DO WE HAVE GLOBAL EMERGENCY SUPPORT SYSTEMS AND NETWORKS? |
| 5. | DO WE HAVE PREVENTIVE MEDICAL PROGRAMS OVERSEAS? |
| 6. | DO WE KNOW HOW TO CREATE AND IMPLEMENT PUBLIC HEALTH PROGRAMS IN DEVELOPING COUNTRIES? |
| 7. | DO WE KNOW THE LOCAL IMMIGRATION LAWS REGARDING COMMUNICABLE DISEASES IN EACH COUNTRY? |
| 8. | DO WE KNOW THE RISKS OF CONTRACTING INFECTIOUS AND PARASITIC DISEASES IN EACH COUNTRY? |
| 9. | DO OUR EMPLOYEES AND CORPORATE LEADERS HAVE CONFIDENCE IN THE LOCAL HEALTH STRUCTURES OF THE DEVELOPING COUNTRIES WHERE WE OPERATE? IF WE DO, HOW OFTEN DO WE UPDATE THE RELATED INFORMATION? |
| 10. | ARE WE READY FOR THE AVIAN FLU? IF WE ARE, DO WE KNOW THE POTENTIAL PITFALLS OF OUR PLANS AND HOW TO AVOID THEM? |

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Table 3

Can Your Company Answer These Process, Policy and Procedure Questions?

<i>Medical</i> • Do we have any pre-expatriation, testing and counseling programs? If we do, how effective are they? • Do we have local and corporate plans to deal with special issues, for example: Post Traumatic Stress Disorder, malaria, depression, HIV/AIDS? • Do we have an immunization program going beyond legal requirements and protecting our employees efficiently? • Do we have global medical evacuation policies? • Do we have control over our employees' hospital stays overseas?
<i>Psychological</i> • What is our plan when an employee dies overseas (for the corporation, corpse and family of the deceased)? • Do we have any couple and employee screening programs before overseas assignments (to identify individual risk and provide support)?
<i>Social</i> • Do we have female/male employee programs to deal with rape? . • Do we know the social sex risks in the countries where we operate? • How will we face a terrorist attack on our installations? • What is the best way to handle civil servant corruption? • Does our plan solve or create more problems? • Do we know how to handle employee kidnapping overseas?

The author believes that to tackle these types of problems efficiently, companies need the following:

- Reliable, cost-effective structures, systems, procedures, policies and processes, tailored to each country and providing peace of mind that the corporation is pro-actively preventing them or in a position to confidently respond
- A cost-effective medical department that is anticipatory, reliable and productive (for example, providing practical training/development programs to prepare executives and their families prior to leaving for an overseas assignment). It should:
 - a) Enhance its quantitative and qualitative output while reducing costs (for example, by improving the medical insurance coverage)
 - b) Control and decrease the number of hospital stays overseas (for example, by hiring experienced physicians competent in specialized areas)
 - c) Decrease the number of medical evacuations (for example, by

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increasing the reliability of local care through choosing appropriate referrals)

- d) Increase the scope and effectiveness of preventive medicine programs (for example, regarding malaria, dengue, AIDS, STDs, depression, alcoholism, etc)
- e) Decrease bureaucracy (for example, by computerizing and centralizing all medical files), etc.

Below, in Table 4, is a sample of a plan the author suggests for dealing with overseas kidnappings:

Table 4
Plan For Dealing with Overseas Kidnapping

Pre	• Have a list of all the countries where they are most likely, very likely and likely to occur • Have companies of referral to manage this kind of situation (and negotiate with the kidnappers, for example) • Have a protocol in place to take care of families, relatives and co-workers • Have a PTSD protocol in place for each country for: - The victim(s) of the kidnapping - Those who were involved in the victim(s) rescue - Co-workers • Have a protocol in place to deal with the kidnapped people as soon as they are freed or their bodies recovered (for example: Repatriation of corpses). In particular, logistics and legal aspects • Have a point person at the local embassy/consulate • Make sure that the company has an insurance covering all aspects of the situation • Have a logistic plan to evacuate the kidnapped people • Have a bank protocol and procedure ready if a ransom must be paid as part of the strategy to free the hostages
Per	• From the beginning, create a Crisis Management Team (including specialists such as, negotiator, international law enforcement advisor, insurance representative, corporate executive leading the case, etc) • Have communication lines open 24/7 • Be informed continuously on the kidnapped people status • Keep the families informed appropriately • Provide psychological support to the families • Provide psychological support to the co-workers
Post	• Have the kidnapped people medically checked-up • Provide psychological support (and psychiatric help, if needed) to the kidnapped people • Provide psychological support (and psychiatric help, if needed) to the families of the kidnapped people • Provide psychological support (and psychiatric help, if needed) to the co-workers of the kidnapped people • Have a plan to re-integrate the kidnapped people professionally

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CONCLUSION

Globalization is a reality for many multinational corporations. The safety and well being of their employees overseas deserve evolving structures and systems with policies, processes and procedures that enable them to face their medical and health-related local challenges successfully. The impact of a state of the art and wide-ranging medical department on corporate bottom line would be significant but the main obstacle to the creation of such an entity remains ignorance. Particularly in this field, what corporations don't know costs them dearly internally and externally. In this intense communication age it also reflects poorly on them and damages their image, notably among stockholders. Consequently, reviewing their medical structures at the corporate level and overseas with a new frame of mind may be wise.

No matter how dramatic and diverse the presented cases may be, this study is based on a personal experience. Further works are needed, especially to quantify the impact of the author's recommendations. This paper is also a stark risk reminder to some multinational corporations arguably just a virus away from being forced out of business. They are advised to start reviewing their Human Resources/Public Relations/Community Relations health and health-related activities with a different mindset.

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MIGRATION AND TRADE POLICIES: SYMMETRY OR PARADOX?

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I. INTRODUCTION

Other than national security and international terrorism, few issues appear to have occupied the attention of the public and of policy makers to a larger extent than migration, in particular irregular migration (*migration irreguliere*) and to a smaller extent, international commerce and globalization.¹ Heightened concern about these issues (aside from the customary concerns about intensely local matters such as school education and medical care) may be observed both in the liberal democracies of Western Europe and the United States ("U.S."), as well as in other parts of the world, including Asia and Africa. Indeed, election results in the U.S. in 2008 are likely to be molded to a substantial extent by the issue of migration. In Europe, political parties with strong positions on immigration and asylum have led to the emergence of a "radical right" and such parties in France, Denmark, Austria and Germany among others, have reported strong electoral gains.²

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¹ See World Public Opinions: Program on International Policy Attitudes, at www.worldpublicopinion.org; Ipsos Group for the U.K., <http://www.ipsosmori.com/polls/2003/migration.shtml>; Migration Watch, www.migrationwatchuk.org; Pew Research Center and National Public Radio, <http://www.npr.org/templates/story/story.php?storyId=5312922>.

² *Profile, Jean-Marie Le Pen*, BBC NEWS, April 23, 2002, at <http://news.bbc.co.uk/2/hi/europe/1943193.stm>. In France, the National Front Party of Jean-Marie Le Pen captured about 17 percent of the presidential vote in early 2002. *Id.* While in Austria, the far-right Freedom Party of Jitrg Haider gained seats in the Austrian coalition government shortly before that. *Austria and the Haider Factor: Special Report*, BBC NEWS, May 4, 2000, at <http://news.bbc.co.uk/2/hi/europe/628521.stm>. Similar results are reported for the anti-immigration Danish People's Party ("DPP") with respect to seats in the Danish Parliament (the *Folketing*) and the National Democratic Party ("NDP") (successor party to the *Deutsche Reichspartei*) in Germany. Roland Nelles and Gabor Steingart, *Rise of German Right-Wing Party Evokes Ghosts of Past*, SPIEGEL ONLINE INT'L, Jan. 31, 2005, at <http://www.spiegel.de/international/spiegel/0,1518,339604,00.html>. For more detailed discussion, see TERRI GIVENS, *VOTING RADICAL RIGHT IN WESTERN EUROPE* (Cambridge: Cambridge University Press) (2005) and SIMON GREEN, *THE POLITICS OF EXCLUSION: INSTITUTIONS AND IMMIGRATION POLICY IN CONTEMPORARY GERMANY* (Manchester University Press) (2004).

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Although “globalization,” in particular “corporate globalization,” has preoccupied the public to a large extent, free trade has had a somewhat lower profile than migration in most countries. In the U.S., trade issues remain of concern to specific sectors and groups that perceive an economic threat to themselves but, perhaps owing to its more ubiquitous nature, not since the days of NAFTA (North America Free Trade Agreement) in 1993-94 has the American populace focused to a large extent on free trade pacts.³ Moreover, trade and migration are not popularly viewed in the U.S. as being intimately related.⁴ In Europe however, at least for policy-makers, trade and migration are not viewed dichotomously. In particular, with respect to accession *vel non* to the European Union treaty, which in principle assures free mobility of both goods and persons (in addition to the other two “freedoms” involving movement of services and of capital).⁵

Concern over the undesirable linkage between trade and migration, though expected to be temporary, is the precise reason why the core members of the European Union have delayed the full freedom of labor rights for new members such as Bulgaria and Romania. The latter countries joined the Union on January 1, 2007, but will not have full free movement of labor privileges for a five year period (i.e. until 2012). Thus, while the original core European

³ NAFTA became effective on January 1, 1994. The larger Central American Free Trade Agreement (CAFTA-DR), which includes five Central American nations, the Dominican Republic and the U.S., has delayed its original final implementation date. *Central American Free Trade Agreement Misses Implementation Date*, GLOBAL EXCHANGE, <http://www.globalexchange.org/campaigns/cafta/>. The even more ambitious Free Trade Area of the Americas (FTAA) Agreement also appears stalled for now. *U.S. Seeks Trade and Investment Agreement with Panama - With FTAA Stalled, U.S. Engages in NAFTA Extension Piece by Piece*, COMMON DREAMS PROGRESSIVE NEWSWIRE, April 26, 2004, at http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/Section_Index.html.

⁴ During the debates leading to the ratification of NAFTA, some public officials and commentators had discussed the linkage between the trade pact and its consequences in mostly favorable terms, i.e., that the enactment of NAFTA would likely stem migration flows to the U.S. from Mexico. See Honorable Gene McNary, U.S. Comm'r for the INS, *Moving Goods and People in International Commerce*, Duke University (Feb. 6, 1992) in 2 DUKE J. COMP. & INT'L L. 247, 247 (1992). (“I feel more than a bit confident in acknowledging that, if immigration is not formally on the table, someone at the table will sooner or later realize as a practical matter that moving goods and services in international commerce involves moving people who trade in these goods and services.”). Other commentators, who may have proven more accurate, believed that NAFTA would exacerbate migration from Mexico to the U.S. in the short run, i.e., that there would likely exist a “migration hump.” See PHILIP MARTIN, *NAFTA AND MEXICO-U.S. MIGRATION* (2005), http://giannini.ucop.edu/Mex_USMigration.pdf.

⁵ See Treaty of Amsterdam Amending the Treaty of Rome, OJ 1997 C340/173, Art. 3.1(c). See Roger Goebel, *The European Union in Transition: The Treaty office in Effect; Enlargement in Sight: A Constitution in Doubt*, 27 FORDHAM INT. L.J. 455 (2004) (discussing the various amendments to the original European Community Treaties and associated protocols).

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Union members (West Germany, France, Italy, Belgium, Luxembourg and The Netherlands) pursued both free trade and free migration among each other, trade and migration policies have been dichotomized for many recent entrants into the Union for the present.⁶

What is the relationship between international migration and trade? Is liberalized trade likely to create or diminish incentives for additional migration? In the former case, trade and migration may be said to be complements and in the latter case, substitutes. If increased trade diminishes the incentives to migrate, then the present objectives of most developed nations of fostering free trade while restricting inbound migration could well be accomplished by the use of trade policy alone. Have policy makers and governments acted as though trade and migration policies were really different sides of the same economic coin? Are governments in more democratic societies more likely to be pro-immigration and pro-trade or conversely compared with less liberal democracies? Are the preferences (to the extent that meaningful franchise exists) of voters between trade and migration symmetrical, i.e. does being pro-trade normally imply that the voter in question is also likely to be pro-migration? What has been the impact of interest groups or coalitions of voters on articulated trade and migration policies historically? These are some of the several questions addressed in this multi-disciplinary article.

It will be observed that over the last two centuries, trade and migration policies have never been simultaneously liberal. One century ago, the policy mix was marked by relatively restrictive tariffs and a liberal migration regime. Shortly after the end of the Second World War, most advanced countries underwent a radical policy switch to one characterized by the opposite configuration of a liberalized trading order increasing restrictive migration policies. Simultaneous free trade and international labor mobility have, in fact, never existed over the past two hundred years, although there are periods during which labor and capital mobility have coexisted.

In what follows, the relationship between trade and migration policies will be examined, both on the basis of received doctrine in a number of disciplines and as actually implemented in most advanced countries. Work currently available in a number of fields, notably, law, economics, political science, public choice and to some extent, sociology and international relations are utilized. Broad interdisciplinary work of this type is still very much the exception and some of the analysis and conclusions should be regarded, at

⁶ See for example the release by the German Federal Foreign Office mentioning transitional periods for certain freedoms for the newest entrants to the European Union, Romania and Bulgaria on January 1, 2007 at <http://www.huliq.com/4162/bulgaria-and-romania-new-member-states-of-the-european-union>.

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present, as being tentative.

If there is a firm conclusion that may be reached it is this: All too often, authors in various disciplines, including law, appear to have unreservedly accepted the conclusions and

Implications of naïve (meaning of the vintage variety) economic frameworks that predict that trade and migration are interchangeable phenomena, in other words, countries can either trade goods or persons and the consequences are very similar. In fact though, trade and migration are quite different even with respect to purely economic implications and profoundly distinguishable in their non-economic, socio-political causes and consequences and there may not be any necessary close linkage between them. In this respect, the chorus of hand-wringing by a number of authors, notably in the law, regarding the “missed opportunities” for migration reform that should have been grafted on to the NAFTA accords is misplaced.⁷

Because of the scope and breadth of the present work, fuller details and exposition of some of the analysis must be left to a much longer paper. Where possible, the article attempts to simplify and abstract from unnecessary complexity in order to appeal to readers across a broad spectrum of interests and disciplines.

II. LAW

Unlike some areas such as Constitutional Law, Commercial Law and Criminal Law, or the Law of Evidence, legal doctrine by itself has no autonomous content and implications for social policy, either with respect to

⁷ See, Melinda McGehee, *Using Immigration as Protectionist Mechanism While Promoting Free Trade*, 8 L & BUS. REV. AM. 667 (2002); Alan Nelson, *NAFTA: Immigration Issues Must be Addressed*, 27 U.C. DAVIS L. REV. 987 (1994); James Smith, *NAFTA and Human Rights: A Necessary Linkage*, 27 U.C. DAVIS L. REV. 793 (1994); Dolores Acevedo & Thomas Espenshade, *Implications of a North America Free Trade Agreement for Mexican Migration into the United States*, 18 POPULATION & DEV. REV. 729, 730-31 (1992) (observing, “[i]n absence of protectionism, trade among countries with different factor endowments is a substitute for migration. In other words, if countries with an abundance of labor can specialize in the production of labor-intensive goods, there need not be labor migration to more developed countries.”). In a well-cited paper Kevin Johnson observes that the dichotomy between trade and movement of people in the NAFTA is a “false separation” since “labor migration and capital flow are related to international trade ... [and that] [i]n the absence of protectionism, trade among countries with different factor endowments is a substitute for migration”) (emphasis in original). Kevin Johnson, *Free Trade and Open Borders: NAFTA and Mexican Immigration to the United States*, 27 U.C. DAVIS L. REV. 937, 965 (1994); see also Howard Chang, *Liberalized Immigration and Free Trade: Economic Welfare and Optimal Immigration Policy*, 145 U. PA. L. REV. 1147 (1997); Howard Chang, *Migration as International Trade*, 12 U.C.L.A. J. INT’L L & FOREIGN AFF. 371 (1998-99).

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international trade or international migration (of persons or of capital).⁸ Virtually every independent nation has a body of law relating to external trade and migration, both “on the books” (as it is written) and as practiced or actually enforced.⁹ As alluded to above, public debates have often centered around perceived deficiencies of the legal regime, particularly, as enforced. For instance, current immigration debates in the U.S. have focused on the some 12 million or so undocumented aliens (irregular migrants) currently residing in the U.S.¹⁰ While such persons are subject to deportation and while U.S. employers employing any such persons are subject to civil and criminal sanctions, the overwhelming practical reality is that no such enforcement occurs in practice for a number of reasons not immediately relevant.¹¹

The motivation and content of both external trade and migration policies is derived from, and is dependent upon, received doctrine in *other* disciplines, notably economics, political science, public choice and other areas.

A. The Trading Regime

Trade law, both at the multilateral level and as domestically implemented, in the post-Keynesian, post-World War II period of “re-globalization” has been reformed in virtually every developed country, and to an increasing extent in other countries as well, by the twin principles of superiority of free trade coupled with “fair” trade. Free trade economists won

⁸ Authors such as Posner have questioned the autonomous existence of law as a separate discipline in general. See generally Richard Posner, *The Decline of Law as an Autonomous Discipline 1962-1987*, 100 HARV. L. REV. 767 (1987); RICHARD POSNER, *FRONTIERS OF LEGAL THEORY*, Harvard U. Press (2004).

⁹ In some cases, particularly in colonial times, nations existed, but were not permitted by the colonial rulers to establish their own trade or migration policies, for example, the case of India under the British Raj. See generally David Clingingsmith and Jeffrey Williamson, *India's De-Industrialization Under British Rule: New Ideas, New Evidence* (NBER Working Paper No. 10586, June 2004).

¹⁰ This figure appears to have been commonly accepted being as accurate for the U.S. for late 2005. See Jeffrey Passel, *The Size and Characteristics of the Unauthorized Migrant Population in the U.S.* (Pew Hispanic Center 2006), at <http://pewhispanic.org/reports/report.php?ReportID=61>; Michael Hoefer et al., *Estimates of the Unauthorized Immigrant Population Residing in the United States: January 2005* (Department of Homeland Security Report, Office of Immigration Statistics Policy Directorate, August 2006), http://www.dhs.gov/xlibrary/assets/statistics/publications/ILL_PE_2005.pdf. Figures such as these are subject to rapid obsolescence as some one million additional irregular migrants are estimated to enter the U.S. each year, net of those apprehended at the border.

¹¹ Readers may consult the work of populists such as Patrick Buchanan. See, e.g., PATRICK BUCHANAN, *STATE OF EMERGENCY: THE THIRD WORLD INVASION AND THE CONQUEST OF AMERICA* (Tomas Dunne Books 2006). More academic work along these lines includes work by the well-known Harvard sociologist, Samuel P. Huntington. SAMUEL P. HUNTINGTON, *WHO ARE WE? THE CHALLENGES OF AMERICA'S NATIONAL IDENTITY* (Simon & Schuster 2005).

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the day during establishment of a new world trading order and monetary system, following cessation of hostilities after the Second World War.¹² This was not always the case; in earlier times, economic and social policy was guided by the mistaken notion of “mercantilism” (roughly meaning that exports are “good” and imports are “bad”).¹³ Of course, the fallacy of composition exerts its inexorable influence here as well, for one country’s exports are another’s imports. In fact, the calamitous Depression of the 1930s in the U.S. and other industrialized nations was preceded by sharp tariff increases by the U.S. followed by retaliatory tariff measures by other countries, coupled with an equally misguided monetary contraction in the U.S.¹⁴

Even in more recent times, during the long Cold War and mistrust of American-style capitalism, several developing countries attempted to purposefully close their markets to external influences, pursuing “import substitution” rather than “export promotion”.¹⁵ The success of the export-oriented economies such as South Korea, Singapore and the other “Asian Tigers” in achieving rapid economic growth coalesced with the Reagan-Thatcher free market liberal revolution of the 1980s. Even India, long known for its regressive tariffs, began a period of rapid re-opening to international

¹² The decision to establish the International Monetary Fund and the World Bank was taken at the Bretton Woods Conference held in New Hampshire in December 1944, <http://www.ibiblio.org/pha/policy/1944/440722a.html>. By that time, the imminent defeat of Germany was apparent to world leaders. The Soviet Union did not enter the International Monetary Fund until 1991 (as Russia). See Daniel P. Erikson, *Bridging the Gap: IMF and World Bank Membership for Socialist Countries* (Inter-American Dialogue, ASCE 2003), http://www.thedialogue.org/publications/programs/haiti/bridging_erikson.pdf. The proposed International Trade Organization never came into being primarily owing to U.S. resistance surrendering American hegemony to a world body. However, a negotiating forum for trade issues, the General Agreement on Trade and Tariffs (GATT) was established in 1947. GATT was succeeded by the World Trade Organization (WTO) in 1995. See http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm. There has never existed comparable world migration organization or even a negotiating forum, despite the fact that most developed countries face common problems of unwanted unskilled migration coupled with a growing scarcity of needed “knowledge workers”.

¹³ See Laura LeHaye, *Mercantilism*, in THE CONCISE ENCYCLOPEDIA OF ECONOMICS, (The Library of Economics and Liberty 2002), at <http://www.econlib.org/library/enc/Mercantilism.html>.

¹⁴ See generally MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, *A MONETARY HISTORY OF THE UNITED STATES, 1867-1960* (Princeton Univ. Press 1963).

¹⁵ In some respects, political independence was confused with economic isolation or autarky. See Diet Rothermund, *AN ECONOMIC HISTORY OF INDIA FROM PRE-COLONIAL TIME TO 1991* 30-60 (Routledge 1993). Thus emerged the “*dependencia*” models of Latin American economists such as Raúl Prebisch, which were grounded upon abhorrence of foreign investment and imports. See ALAN TAYLOR, *LATIN AMERICA AND FOREIGN CAPITAL IN THE TWENTIETH CENTURY: ECONOMICS, POLITICS AND INSTITUTIONAL CHANGE* (NBER Working Paper No. 7394, Oct. 1999) (discussing some of the pertinent theories, especially the “*Dependencia*” model)

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trade and foreign investment.¹⁶

The globally accepted preference for free trade has been articulated in legal terms by international treaties and conventions, notably the GATT/WTO accords, and by regional arrangements such as the Treaty of Rome (later the European Union treaty) and NAFTA.¹⁷ In fact, the proliferation of regional trading pacts may, in the view of some authors, seriously undermine the future relevance of multilateral accords such as the GATT/WTO.¹⁸ The legislative preference for free trade, through progressive lowering of tariffs, is discreetly contained in Article XXIX of the WTO Agreement, authorizing periodic tariff reductions (or concessions) and implemented through successive multilateral

¹⁶ See *A Survey of the World Economy: The New Titans*, THE ECONOMIST, Sept. 16, 2006, available at 2006 WLNR 15982733.

¹⁷ See 19 U.S.C. § 3311 (Approval and entry into force of the North American Free Trade Agreement (hereinafter "NAFTA")); see also http://www.wto.org/english/docs_e/legal_e/htm (World Trade Organization website providing digital versions of The Uruguay Round Agreements, Marrakesh Declaration of 15 April 1994, Agreement Establishing the World Trade Organization, GATT 1947, and other international agreements pertaining to transnational trade). North American Free Trade Agreement, Dec. 17, 1992, 32 I.L.M. 289; General Agreement on Tariffs and Trade 1994, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, 1867 U.N.T.S. 187, 33 I.L.M. 1153 [hereinafter GATT 1994], the original GATT Agreement and U.S. legislation implementing the accord be found at General Agreement on Tariffs and Trade, Oct. 30, 1947, 55 U.N.T.S. 187 (hereafter GATT), http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm. GATT 1994 simply absorbs the 1947 GATT Agreement with the amendments agreed to until that time. GATT 1994 was then merged into the WTO accord of 1995. For ease of exposition, I shall refer as needed, to the article numbers in GATT 1994. The European Union Treaty (hereinafter "EU Treaty") was formally adopted in 1992 and amended the original instruments such as the Treaty of Rome; Maastricht Treaty on the European Union, Sept. 21, 1994, 31 I.L.M. 247. See Goebel, *supra* note 5 (The European Community (or "EC"), originally designated as the European Economic Community, was created by the Treaty of Rome, 298 U.N.T.S. 11 (signed March 25, 1957; effective January 1, 1958). The current consolidated text of the EC Treaty as amended appears in O.J. C 325/33 (Dec. 12, 2002)). See also A CITATION MANUAL FOR EUROPEAN COMMUNITY MATERIALS (6th ed.), 23 FORDHAM INT'L L.J. 935 (2000).

¹⁸ See generally, JAGDISH BHAGWATI, THE WORLD TRADING SYSTEM AT RISK (Princeton University Press 1991); JAGDISH BHAGWATI, FREE TRADE TODAY (Princeton University Press 2001). Bilateral and plurilateral accords to which the U.S. is a party are listed at the website of the United States Trade Representative (USTR), at www.ustr.gov/Trade_Agreements/Bilateral/Section_Index.html. Space considerations preclude extended discussion, however, for the trading partners themselves, the benefit of bilateral/regional accord is that each country is able to extract an immediate *quid pro quo* from its partners, in exchange for trade concessions, which is necessarily prohibited under the Unconditional Most Favored Nation (MFN) Clause of the GATT/WTO accords. See also GATT 1994, *supra* note 17, at art 1.1. Formation of regional trade accords is expressly authorized under GATT/WTO. See GATT 1994, *supra* note 17, at Art. XXIX.

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Rounds such as the completed Uruguay Round and the ongoing Doha Round.¹⁹ Meanwhile, regional accords such as NAFTA and the EU Treaty contain their own detailed tariff reduction and implementation schedules.

“Fair” trade rules are intended to preserve the confidence of trade system participants in the superiority of free trade, unencumbered and undistorted by market imperfections or “carve outs” that may be engineered by one or more trading partners.²⁰ Without such confidence in the “fairness” of the system, the voluntary nature of multilateral or bilateral trading regimes would quickly evaporate. Thus, both GATT/WTO agreements and the NAFTA and EU accords contain rules meant to permit derogation from free trade under certain circumstances. Such rules are generally described as “safeguard measures” and encompass Anti-dumping and Countervailing Duty measures, functioning to counter predatory pricing in export markets, various Emergency or Escape Clause measures used even in the absence of predation, but intended instead to limit the disruption caused by an unforeseen surge in imports.²¹ Likewise, exports are regulated in the trade accords through the familiar proscription on export subsidies which would distort free market forces and hence be “unfair.”²²

As observed earlier, international trade law has no autonomous co-independent theoretical basis of its own, and the content of trading rules is necessarily by other disciplines.²³ I shall turn to some of these disciplines in

¹⁹ The current Doha Round began in late 2001. The Uruguay Round extended over 1986-94. See Gary Hufbauer and Jeffrey Schott, *The Doha Round after Hong Kong*, POLICY BRIEF PB06-2 (Institute for International Economics, Washington D.C.) at <http://www.iie.com/publications/pb/pb06-2.pdf>. A simple timeline of the various GATT/WTO Rounds of negotiation is at the WTO website at http://www.wto.org/english/thewto_e/minist_e/min98_e/slide_e/slide_list.htm.

²⁰ Some very recent work suggests that many of today's advanced countries may have substituted non-tariff barriers to replace tariff reductions. See Daniel Y. Kono, *Optimal Obfuscation: Democracy and Trade Policy Transparency*, 100 AM. POL. SCI. REV. 369 (2006).

²¹ The GATT/WTO rules are contained in the Emergency Action and Anti-dumping and Countervailing Duties articles. GATT 1994, *supra* note 17, at arts. VI, XIX. For additional discussion and U.S. legislation implementing specific sections of the GATT accords, see generally Daniel K. Tarullo, *Beyond Normalcy in the Regulation of International Trade*, 100 HARV. L. REV. 546 (1987).

²² Export subsidy proscriptions are contained in Article XVI of the GATT/WTO accords. GATT 1994, *supra* note 17, at art XVI. Legislation in the U.S. (and in other countries) also contains a plethora of usually opaque export classifications and regulations which may be scattered in different sections of the United States Code. See, e.g., Export Administration Act, 50 App. U.S.C. § 2403 (1979) (containing some of U.S. export control regulations pertaining to export license classifications). Other controls and regulations are scattered elsewhere. See, e.g., Peter Lichtenbaum, *Coping with U.S. Export Controls*, 872 PLI/COMM 345 (2004).

²³ Foreign affairs practice or international relations with other countries affect trade policy to a

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what follows.

B. Migration Rules and Regimes

In sharp contrast to the world trading order, there is no international migration regime or world migration body, other than a few conventions dealing with certain specific areas such as stateless persons, refugee status, human trafficking and a few others.²⁴ Instead, immigration and nationality policies are creatures of domestic legislation, the exception being isolated labor mobility accords, such as those between certain Scandinavian countries, Australia and New Zealand, and the still incompletely-implemented Schengen Agreements (pertaining to a common border policy) in the European Union.²⁵ Denmark and the United Kingdom for example, have still not acceded to the common border rules of the Schengen Agreement and the new periphery members of the Union (such as Bulgaria and Romania) are not expected to have access to labor markets of the inner core countries until at least 2012, much less to the common border accords of the Schengen Agreements. Domestic rules in each country, often a product of historical, geographical and cultural factors, determine the permissible types and amounts of permanent and temporary migration (relating to quotas and ceilings), nationality and citizenship rules (pertaining to acquisition or forfeiture of unitary or dual citizenship), refugee and asylum policies (rules dealing with classification or *refoulement*, etc), along

significant degree. For example, trade sanctions are predicated upon foreign policy considerations, not on economic grounds. For example, the decades long trade embargo of Cuba by the U.S. is grounded in U.S. displeasure with the Castro regime. Trade sanctions against Iran are discussed in Jeffrey Schott, *Economic Sanctions, Oil, and Iran* (Testimony before Congress on July 25, 2006) at <http://www.iie.com/publications/papers/paper.cfm?ResearchID=649>.

²⁴ See, e.g. Convention Relating to the Status of Stateless Persons, *adopted on* Sept. 9, 1954, 360 U.N.T.S. 117 (*entered into force* June 6, 1960), http://www.unhchr.ch/html/menu3/b/o_c_sp.htm; Convention Relating to the Status of Refugees, *adopted on* July 28, 1951, 189 U.N.T.S. 150 (*entered into force* Apr. 22, 1954), http://www.unhchr.ch/html/menu3/b/o_c_ref.htm; Protocol to Prevent, Suppress and Punish Trafficking in Persons Especially Women and Children, supplementing the United Nations Convention Against Transnational Organized Crime, *adopted on* Nov. 30, 2000, G.A. Res. 25, annex II, U.N. GAOR, 55th Sess., Supp. No. 49, at 60, U.N. Doc. A/45/49 (Vol. I) (2001) (*entered into force* Dec. 25, 2003), <http://www.ohchr.org/english/law/protocoltraff.htm>.

²⁵ See, e.g., The Trans-Tasman Travel Agreement, at <http://www.mfat.govt.nz/Foreign-Relations/Australia/0-trans-tasman-travel.php>; see also Belgium-France-Federal Republic of Germany-Luxembourg-Netherlands: Schengen Agreement on the Gradual Abolition of Checks at Their Common Borders and the Convention Applying the Agreement, Agreement done at Schengen, June 14, 1985; Convention done at Schengen, June 19, 1990, 30 I.L.M. 68 (1991) and Treaty of Amsterdam amending the Treaty on European Union, 1997 O.J. (C 340) 1, 141, <http://www.europarl.europa.eu/topics/treaty/pdf/amst-en.pdf> (modifying the Schengen Agreement and integrating it into the framework of the Treaty on European Union).

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with other attributes of migration.²⁶

Unlike trading rules, migration rules are not squarely grounded in global economic considerations; if they were, and as demonstrated by a number of studies including a recent comprehensive report by the World Bank, free international mobility of persons would have been more prevalent and reflected in the official policies of states.²⁷ Instead, migration and citizenship rules are firmly rooted in considerations of history, demography (population pressures), political science (considerations of state sovereignty over defined areas including empire-building) and sociology (assimilative and cultural concerns).²⁸ There is also little doubt that parochial and sector-specific protectionist concerns have also played a large part in the "capture" of enacted immigration

²⁶ See, e.g., The Immigration and Nationality Act of 1952 §§ 201-204, 208, 310-320, 322, 324-344, 346-347, 349, 351, 356-357, 8 U.S.C §§ 1151-1154, 1158, 1421-1431, 1433, 1435-1455, 1457-1458, 1481, 1483, 1488-1489 (2000) (quotas are dealt with in I.N.A. §§ 201-204, nationality in §§ 310-357, while asylum and refugee status are covered in § 208).

²⁷ See THE WORLD BANK, GLOBAL ECONOMIC PROSPECTS 2006: ECONOMIC IMPLICATIONS OF REMITTANCES AND MIGRATION (World Bank Publications 2005), http://www-wds.worldbank.org/servlet/WDSCContentServer/WDSP/IB/2005/11/14/000112742_20051114174928/Rendered/PDF/343200GEP02006.pdf (listing the potential gains from international migration (based upon a large scale simulation model) and suggesting a conclusion, from the simulation results (which might well be underestimated), indicating that the potential worldwide gains from unimpeded migration are quite large, with larger benefits accruing to lowincome countries.). See also Bob Hamilton and John Whalley, *Efficiency and Distributional Implications of Global Restrictions on Labor Mobility*, 14 J. DEV. ECON. 61 (1984) (suggesting similar results from more free international labor mobility); Jonathon W. Moses and Bjørn Letnes, *The Economic Costs To International Labor Restrictions: Revisiting The Empirical Discussion*, 32 WORLD DEV. 1609 (2004); and Howard F. Chang, *The Economic Impact of International Labor Migration: Recent Estimates and Policy Implications*, 16 TEMP. POL. & CIV. RTS. L. REV. (forthcoming 2007).

²⁸ See Graziella Bertocchi & Chiara Strazzi, CITIZENSHIP LAWS AND INTERNATIONAL MIGRATION IN HISTORICAL PERSPECTIVE (Fondazione Eni Enrico Mattei, Working Paper No. 71.2005, 2005), available at <http://ideas.repec.org/p/fem/femwpa/2005.71.html> (follow "download info" hyperlink; then follow "download the selected file" hyperlink) (providing an excellent theoretical and empirical examination of the origin and evolution of citizenship rules in various nations). See also T. ALEXANDER ALEINIKOFF AND DOUGLAS KLUSMEYER, CITIZENSHIP POLICIES FOR AN AGE OF MIGRATION (Carnegie Endowment for International Peace 2002) (providing more legal perspectives on national citizenship). Assimilative and cultural concerns over continued immigration, even into the U.S., is hardly a new phenomenon. The literacy test requirement enacted in 1917 over President Wilson's veto was intended to curb migration from Southern and Eastern Europe. The "inferiority" of the Mediterranean races was in fact, assumed by the Dillingham Commission of 1910 that issued a 42-volume report. The Dillingham Commission report and other scholars warned repeatedly against the acceptance of "beaten members of beaten breeds." See MALDWYN A. JONES, AMERICAN IMMIGRATION (2nd ed. 1992); JOHN HIGHAM, STRANGERS IN THE LAND: PATTERNS OF AMERICAN NATIVISM, 1860-1925, (2nd ed. 1998) (explaining that social and scientific Darwinism was already in full flower in the United States at that time).

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policies, both with respect to lawful and irregular migration.²⁹ Concerns over possible loss of jobs or wage erosion or imposition of fiscal burdens due to social transfers to arriving migrants have always loomed large in the cost-benefit ratio of migration for certain regions or sectors, at least in enfranchised liberal democracies.³⁰ This theme is discussed in greater detail in a later Section where it is observed that more autocratic regimes are likely to be more liberal with respect to immigration, precisely because such regimes are less responsive to the preferences of average citizens or median voters.

III. ECONOMIC CONSIDERATIONS

While international trade and migration are separate sub-fields among scholars in economics (international economics and labor economics respectively), theoretical constructs developed by trade theorists several decades ago are fully capable of generating testable hypotheses about the effects of trade liberalization upon incentives to migrate and conversely. Typical work in trade analysis has not however, proceeded along these lines, focusing instead on the predicted patterns of trade (i.e. which countries export which goods) and on the effects of free trade upon prices of goods, returns to inputs or factors of production such as labor, capital and land and on the aggregate distribution of income and welfare.³¹ However, the interrelationship between trade and

²⁹ For instance, the end of the *Bracero* program in the U.S. (which permitted Mexican farm labor to lawfully work on a temporary rotating basis in the U.S.) in 1964 may be largely attributable to political pressure exerted by powerful farm labor interests in the U.S.. See GARY C. HUFBAUER & JEFFREY J. SCHOTT, *NAFTA REVISITED: ACHIEVEMENTS AND CHALLENGES* (Institute for International Economics 2005). More than a century ago, the Chinese Exclusion Acts of the 1880s were a direct result of numerous complaints by U.S. business interests especially in the West over these foreign workers who "worked too hard". In more recent times, the ceiling on H-1B "specialty occupation" visas was temporarily raised in response to the expressed need of U.S. business for high-tech workers. See *H-1B visa a Bit Player in Immigration Debate*, May 26, 2006, at <http://www.itbusinessedge.com/item/?ci=16808>. A myriad of pending immigration bills too numerous to review here (and including Senate Bill S 2611 originally passed in May 2006) would also allocate a much larger number of temporary worker visas for certain skilled workers.

³⁰ The fiscal burdens associated with inbound migration are unevenly distributed across the various states in the U.S. and the tax burdens involved in such costs are directly reflected in voters' attitudes toward migration. For example, voters in states with relatively generous welfare systems and high state taxes are markedly more restrictionist in their views regarding further migration than voters in states where a meager welfare net does not impose a substantial cost of upon natives when new migrants arrive. See GORDON H. HANSON, *WHY DOES IMMIGRATION DIVIDE AMERICA? PUBLIC FINANCE AND OPPOSITION TO OPEN BORDERS* (Institute for International Economics 2005).

³¹ The genesis of the modern Heckscher-Ohlin theory of trade may be dated to a paper originally published in Swedish by Eli Heckscher in 1919 and translated into English some thirty years later. Heckscher's student, Bertil Ohlin (recipient of the 1977 Nobel Prize in economics) explicated the framework further. Refinements by Samuelson and Stolper in 1941, T.M. Rybczynski in 1955 and

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migration can readily be deduced from elementary models of trade, notably the Heckscher-Ohlin framework, which has been the standard workhorse of trade analysts for a number of decades.³² On the other hand, it is the work of labor economists that deals primarily with causes and effects of migration, both internally within a country and internationally, but most of this literature has no direct implications for patterns or consequences of international trade in goods and services.

A. Trade Frameworks

This sub-section demonstrates that the standard workhorse trade model generates a strong testable conclusion regarding trade and international migration, namely that trade in goods is a strong substitute for migration of persons. A nation may elect either route; either import goods and services or import the people whose labor is embodied in the goods (i.e. allow migration). Either policy will have the same equalizing effect upon wages and returns to capital in the importing and exporting countries. Thus, free trade alone will dampen the incentives to migrate internationally.³³ If true, these results are particularly attractive to policy makers. For example, the implication is that a free trade agreement such as the NAFTA would allow both the United States and Mexico to reap the well-known benefits of geographical specialization and at the same time, reduce, if not eliminate further migration from Mexico to the United States. There would be no need for additional immigration-restricting measures such as construction of a border fence or enhanced interior enforcement.

Reality however, is much more complex and the strong substitute relationship between trade and migration has not manifested itself, either in reality or in the policy stance actually adopted by governments over the last two hundred years.³⁴ While the vintage trade framework can be refined or extended

Ronald Jones in 1965 among others followed. See T.M. Rybczynski, *Factor Endowments and Relative Prices*, 22 *ECONOMICA* 336 (1955); Wolfgang F. Stopler & Paul A. Samuelson, *Protection and Real Wages*, 9 *REV. ECON. STUD.* 58 (1941); and Ronald W. Jones, *The Structure of Simple General Equilibrium Models*, 73 *J. POL. ECON.* 557 (1965). The interested reader may refer to any standard text in international economics for further details, for example, PAUL R. KRUGMAN AND MAURICE OBSTFELD, *INTERNATIONAL ECONOMICS: THEORY AND POLICY* (6th ed. 2002).

³² Rybczynski, *supra* note 31; Stopler & Samuelson, *supra* note 31; Jones, *supra* note 31.

³³ A corollary implication of this stark framework is that persons in both countries are fully symmetric in their preferences toward trade and migration. Depending upon their relative skill level, they are either both pro-trade and pro-migration or opposed to both. See discussion *infra* Part III.B.

³⁴ A hundred years ago, as noted above, most developed countries, especially those in the New World, followed relatively restrictive trade policies coupled with a liberal migration policy stance. Starting in the early twentieth century, the policy mix has reversed itself with the trading regime being liberal, while migration controls continue to be tightened. See TIMOTHY J. HATTON &

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to produce much more complex relationships between trade and migration, unfortunately, much of this more modern literature appears to have escaped writers in fields other than economics, particularly, international trade. Many authors writing in law-related journals and indeed many public officials have continued to assume that trade and migration are tied together as substitute, alternative policies.³⁵

The Vintage Framework

The demonstration of the stark implication of the vintage trade model regarding the patterns of trade and the trade-migration link is straightforward.³⁶ The standard Heckscher-Ohlin framework finds its most comfortable home in a highly stylized world in which there are only two countries, rich and poor (or North and South), only two inputs in the production process in each country, each of which is capable of producing two goods, but at different relative costs and prices.³⁷ For reasons of history, geography or natural accident, countries are assumed to be differentially endowed with these inputs and all differences in cost-price structures of the two goods are directly attributable to the relative endowments of the two inputs/factors in the two countries. Perfect competition and constant returns to scale exist in all markets.³⁸ These assumptions may appear highly restrictive; however, many can be relaxed without loss of generality in the results. Although, it is typical to assume that the two inputs in the productive process are labor and capital, instead the paradigm of unskilled and skilled labor will be utilized. If desired, the reader may assume that capital is simply “congealed” or embedded skilled labor (such as “knowledge workers”). The rich country is rich precisely because it is better endowed with skilled labor relative to unskilled labor, compared with the poor country. Because of the existence of competitive markets, wages of skilled labor relative to unskilled labor will be lower in the rich country compared with the poor country in the absence of trade. This is a natural consequence of the relative abundance of skilled labor in the rich country. Accordingly, the rich country has a comparative advantage in producing goods that intensively utilize skilled labor in the production process. If free trade, or some trade, is now allowed, the rich

JEFFREY G. WILLIAMSON, A DUAL POLICY PARADOX: WHY HAVE TRADE AND MIGRATION POLICIES ALWAYS DIFFERED IN LABOR-SCARCE ECONOMIES? (NBER Discussion Paper No. 2145, 2006).

³⁵ See, e.g., *supra* text accompanying note 5.

³⁶ There are several alternative methods to present the framework. The one utilized is particularly simplified for expositional purposes. Standard textbooks usually rely upon more formalistic structures. See, e.g., KRUGMAN & OBSTFELD, *supra* note 31.

³⁷ See KRUGMAN & OBSTFELD, *supra* note 31.

³⁸ *Id.*

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country will export goods that are intensive in the use of skilled labor in the production process since it can produce such goods at a lower price than its trading partner.

What occurs as trade continues? As the rich country expands production of goods intensive in the use of skilled labor, given a finite supply of skilled labor and capacity and capital constraints, skilled labor gradually becomes more expensive in the rich country, with the opposite phenomenon occurring in the poor country, which would be expected to export goods intensive in the use of unskilled labor.³⁹ On both counts, differentials between relative wages of skilled to unskilled labor in the rich country narrow with free trade. This implication of course, is the quintessential reason why unskilled labor in rich countries would generally tend to oppose free trade. An alternative way of phrasing this is that protection, the opposite of free trade, benefits the scarce factor, which is unskilled labor in the rich country.⁴⁰ It should come as no surprise therefore, that groups such as the AFL-CIO, which generally represent unskilled or moderately skilled workers, have remained strident in their opposition to trade pacts such as NAFTA or CAFTA-DR.⁴¹

Although not normally presented as such, the standard workhorse model also implies symmetric conclusions regarding migration of persons, instead of trade in goods and services. If the migration policies of rich countries were to permit unimpeded and inexpensive migration of persons across countries, the relative wages of unskilled labor in the rich country, when compared with the poor country, would prove to be a magnet and such labor would migrate *en masse* from the poor to the rich country. The result would be identical to that observed for free trade in goods. Relative wages of skilled to unskilled labor in the two countries would tend to converge. Hence, a *symétrie élégante* emerges in this elementary framework. International trade and migration are indeed complete substitutes, with regard to their effects upon relative wages in the two countries. Free trade alone erodes the incentives to migrate and free labor mobility alone would eliminate the basis for mutually profitable trade.⁴²

³⁹ These are standard propositions in elementary trade theory. See KRUGMAN & OBSTFELD, *supra* note 31.

⁴⁰ This result – protection benefits the scarce factor – is termed the Samuelson-Stopler theorem. See Stopler & Samuelson, *supra* note 31.

⁴¹ See, e.g., *Labor Movement Declaration Concerning the United States-Central America Free Trade Agreement*, San Jose, Costa Rica, Nov. 18, 2002, at http://www.aflcio.org/issues/jobseconomy/globaleconomy/battle/cafta_declaration.cfm.

⁴² It is also easily observed that the loser from migration would be unskilled labor in the rich country which was initially scarce. Hence, unskilled labor in the rich country would be expected to oppose both free trade and liberal migration policies (with the opposite implications for skilled labor

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The fact that liberalized trade and migration are strong substitutes in their ultimate effects upon wages of skilled and unskilled labor has immediate, practical implications for policymakers. Free trade will certainly diminish the incentives for cross-country migration, but at the cost of eroding the relative wage advantage of skilled labor in rich countries. Immigration restrictions in the presence of free trade are not likely to protect domestic wages in the rich country, other than temporarily. This policy mix – free trade and closed or semi-closed borders is the policy stance currently adopted in all advanced countries.⁴³ If the assumptions of the vintage framework are accurate, there is only one way to fully protect domestic labor in rich countries and it is not economically nor politically palatable. Both trade and migration policies would need to be simultaneously restricted. Such is the inexorable logic of the strong substitute relationship implied by the standard trade framework.

More Modern Trade Structures

While the standard trade framework described above has proven to be useful in explaining observed reality, its stark assumptions of full information and perfect competition in all markets (in addition to the existence of only two inputs) have led theorists to pursue several more realistic extensions. While a detailed exposition of such extensions is not of immediate relevance to the present paper, it is important to observe that in most cases, more complex and realistic structures undermine, and can reverse, the strict substitutability trade-migration link noted above. It is quite possible therefore, for trade flows to be complementary to migration flows, i.e. increased trade in goods and services may, in fact, generate incentives for additional migration flows. In such cases, policy makers desiring liberalized trade but reduced migration (as is the case in most advanced nations) would necessarily have to deploy a judicious combination of trade and migration policies. One policy by itself will not do, even in theory.

One common extension of the standard framework involves the recognition of “specific factors,” i.e. the fact that certain inputs are specific to certain sectors or industries and are not easily transferable across sectors. This may be because of the existence of specialized capital equipment or specifically

in the rich country). Whether or not the preferences of workers are reflected in actual government policies is dependent upon the degree of voter enfranchisement and engagement in the political process.

⁴³ Immigration Trends and policies in advanced countries are documented in various reports of the Organization for Economic Cooperation and Development (OECD, Paris). *See generally*, INTERNATIONAL MIGRATION OUTLOOK 2006 (OECD, Paris 2006) and OECD FACTBOOK 2007 (OECD, Paris 2007).

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acquired skills.⁴⁴ Specificity of inputs may be limited to certain inputs, for example, fixed capital or unskilled/moderately-skilled labor, while highly skilled labor may be highly mobile, even across national boundaries. This would be the case for example, of “knowledge workers” who have migrated in increasingly large numbers from poorer to richer countries.⁴⁵

In frameworks such as those involving specific factors or where there are substantial departures from perfect competition, such as increasing returns to scale and/or monopolistic competition, a rich series of results may emerge.⁴⁶ Most of these are beyond the scope of the present article; however, it is quite possible for trade liberalization to lead to widened wage disparities and hence, to increased migration, legal or otherwise. Similarly, non-competitive structures such as increasing returns to scale could lead to accentuation of differences between countries and the emergence of “core-periphery” structures. Trade liberalization in this context will almost certainly lead to increased migration of skilled labor to the “core” country.⁴⁷

It is noteworthy that “core-periphery” or agglomeration frameworks generate or are consistent with “network effects” in an economic sense. Network effects, albeit of the socio-cultural type, are often crucial to sociological and anthropological explanations of migration patterns.⁴⁸

⁴⁴ One would not expect heavy machinery used in say, coal mining to be easily adaptable to the manufacture of memory chips, nor that coal miners could readily be usefully employed in software design. The seminal work in this area is Ronald Jones, *A Three-Factor Model in Theory, Trade and History*, in TRADE, BALANCE OF PAYMENTS AND GROWTH, (Jagdish Bhagwati ed., 1971). See also Anthony Venables & Victor Norman, *International Trade, Factor Mobility and Trade Costs*, 101 ECON. J. 1488 (1995). The existence of “adjustment costs” is the basis for trade adjustment programs in some countries. The current U.S. statute is the Trade Adjustment and Reform Act of 2002, Pub. L. No. 107-210, 116 stat. 933 (2002) (codified in scattered sections of 19 U.S.C. 26 (2002)). Information on the numbers of petitions for relief filed and those approved is maintained by the U.S. Department of Labor, *Trade Act Petitions*, <http://www.doleta.gov/tradeact/trade-data>.

⁴⁵ The latter phenomenon is the subject of much recent attention in literature on the “brain drain.” See Simon Commander et al., *The Brain Drain, Curse or Boon: A Survey of the Literature*, in CHALLENGES TO GLOBALIZATION: ANALYZING THE ECONOMICS 235 (Robert Baldwin & L. Alan Winters eds., (Univ. Chicago Press 2004)); see also PHILIP MARTIN ET AL., *MANAGING LABOR MIGRATION IN THE TWENTY FIRST CENTURY* (Yale Univ. Press 2005).

⁴⁶ A few of the classic references incorporate imperfect competition or increasing returns to scale. See e.g., PAUL KRUGMAN, *GEOGRAPHY AND TRADE* (MIT Press 1991); ELHANAN HELPMAN & PAUL KRUGMAN, *MARKET STRUCTURE AND FOREIGN TRADE: INCREASING RETURNS, IMPERFECT COMPETITION AND THE INTERNATIONAL ECONOMY* (MIT Press 1987); JAMES MARKUSEN, *MULTINATIONAL FIRMS AND THE THEORY OF INTERNATIONAL TRADE* (MIT Press 2002).

⁴⁷ See KRUGMAN, *GEOGRAPHY AND TRADE*, *supra* note 46; HELPMAN & KRUGMAN, *supra* note 46; MARKUSEN, *supra* note 46.

⁴⁸ See, e.g., NANCY FONER, REUBEN RUMBAUT & STEVEN GOLD, *IMMIGRATION RESEARCH FOR A NEW CENTURY: MULTIDISCIPLINARY PERSPECTIVES* (Russell Sage Foundation, 2003); GLOBAL

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Contrary to what may be all too commonly assumed by non-specialists, trade theory does not unequivocally pin down the direction of the trade-migration relationship. It is immediately apparent however, that the nature and direction of the link could not be more relevant to policy makers, for an incautiously chosen combination might render impotent both trade and migration policies. Empirical analysis alone can shed further light on the nature of the trade-migration relationship and these are discussed in the next Section.

Empirical Results

As indicated above, the trade-migration policy mix adopted by most developed countries underwent a major shift in the early twentieth century, from one of restrictive tariffs and liberal migration to liberalized trade and restrictive migration. Countries in the Old World generally adopted free trade policies before the New World, and New World countries, being the early recipients of inbound migration, imposed immigration restrictions prior to Old World countries.⁴⁹ Within the group of Old World and New World countries, there was considerable variation in the time of adoption of liberal or illiberal policies.⁵⁰ These facts would suggest the tailor-made possibility of empirical analysis. Surprisingly and unfortunately though, there has been very little in the way of empirical testing of the nature of the trade-migration relationship. An important exception is the work of the economic historian Jeffrey Williamson and his colleagues and in what follows, the empirical regularities observed by these authors is examined.⁵¹ An important caveat is that the work of Williamson, et al., is limited primarily to historical evidence for periods preceding the mid-twentieth century. Extension of this type of work to encompass the rest of the twentieth century still awaits further scholarly endeavor.

In an often-cited paper, Collins, et al., have performed both time-series and cross-section panel data tests to attempt to determine the nature and

NETWORKS, LINKED CITIES (Saskia Saasen ed., Routledge 2001); MANUEL CASTELLS, THE RISE OF THE NETWORK SOCIETY (2d ed. Blackwell 2000); DOUGLAS MASSEY & J. EDWARD TAYLOR, PROSPECTS AND POLICIES IN A GLOBAL MARKET (Oxford U. Press 2004).

⁴⁹ See HATTON AND WILLIAMSON, *supra* note 34.

⁵⁰ See generally TIMOTHY HATTON & JEFFREY WILLIAMSON, THE AGE OF MASS MIGRATION: CAUSES AND ECONOMIC IMPACT (Oxford Univ. Press 1998).

⁵¹ The key references are WILLIAM COLLINS ET AL., WERE TRADE AND FACTOR MOBILITY SUBSTITUTES IN HISTORY? (NBER Working Paper No. 6059, 1997); JEFFREY WILLIAMSON, WINNERS AND LOSERS OVER TWO CENTURIES OF GLOBALIZATION (NBER Working Paper No. 9161, 2002); ASHLEY TIMMER & JEFFREY WILLIAMSON, RACISM, XENOPHOBIA OR MARKETS: THE POLITICAL ECONOMY OF IMMIGRATION POLICY PRIOR TO THE THIRTIES (NBER Working Paper No. 5867, 1996).

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direction of the trade-migration link over the period 1870-1936, with the data set being truncated to exclude the war years of 1914-1918.⁵² Countries included in the empirical tests include New World labor receiving countries such as the U.S., Canada and Australia and the dominant industrialized countries of the time, of which the United Kingdom was the unquestioned leader.⁵³ Regressions of real absolute trade flows (i.e. exports plus imports) on a number of explanatory variables including gross migration, net capital flows, tariff revenue and a proxy for transportation costs fail to indicate that trade and migration flows are negatively related, which would be necessary if trade flows were truly a substitute for international migration.⁵⁴ If at all, the available evidence seems to support the hypothesis of a mild complementary relationship between trade and migration over the indicated period. In other words, increased trade flows were accompanied by increased migration to the New World.⁵⁵

Cross-section pooled regressions carried out for each decade separately over approximately the same period also fail to yield a negative association between trade flows (deflated by GDP) and net migration flows. There may be lurking statistical and econometric problems in the econometric procedure, such as correlation between some of the independent variables, for example, labor and capital flows. Nevertheless, the results are of interest in that even in a weak associational sense, there appears to be no support for the substitutability hypothesis between trade and migration flows. It may well be that omitted factors such as non-economic variables that may affect migration in particular (for instance, xenophobic or assimilative concerns) may need to be included in the empirical procedure to more fully explain the complex link between trade and migration. Work of this type remains unexplored territory at present.

Another possible perspective on the nature of a trade-migration link may be to inquire whether policy-makers acted as though they believed that trade and migration were substitutable. Timmer and Williamson have painstakingly examined the immigration policies of a number of New World countries (Argentina, Australia, Brazil, Canada and the United States) over long historical periods prior to the 1930s and have meticulously constructed measures of restrictiveness of such policies over the relevant periods.⁵⁶ Unfortunately, no such important work appears to have been performed in the post-WWII era. The immigration restrictiveness index is then regressed over various explanatory variables, including trade to GDP ratios, a host of

⁵² See COLLINS ET AL., *supra* note 51.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ See TIMMER & WILLIAMSON, *supra* note 51.

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macroeconomic variables, variables intended to capture the relative skills of immigrants versus natives, as well as some political variables, such as the degree of political participation.⁵⁷ The variable for relative skills of immigrants as compared to natives is intended to capture immigrant selectivity based upon “quality.”⁵⁸ For the most part, migration to the New World during this period was of unskilled labor which would be expected to increase income inequality in the New World in the same manner as would imports of goods that were produced primarily by unskilled labor.

While the interested reader is referred to the works cited above for more details, the significant point for present purposes is that the ratio of trade to GDP is statistically insignificant in explaining the progressive change in New World immigration policies over long periods. Policy makers did not act as though they regarded trade and migration policies as being interchangeable. If they had done so, then the relative position of domestic labor could well have been protected by restrictive immigration policy alone or by only restricting imports of unskilled labor intensive goods, but not both.

B. Labor Market Frameworks

Unlike the trade frameworks or analytical constructs discussed above, labor market scholars have focused primarily on the migration of persons and typically contain no direct implications for international trade policy. If trade policy cannot “explain” the migration stance because it appears to be unrelated to migration as discussed above, perhaps immigrant selectivity based upon labor market considerations, in addition to a host of other non-economic socio-political factors, might offer a more satisfactory explanation of migration policies as they evolved over long periods.

Early analysis of migration of persons dates to the pioneering work of Harris and Todaro in the context of internal migration (rural to urban).⁵⁹ In this

⁵⁷ *Id.* at Appendices. (The scores for the immigration policy index, which range from -5 to +5, for the U.S. are presented in Appendix B of the Timmer & Williamson Working Paper. For example, the index was set at a neutral 0 in 1868 when indenture contracts were repealed in the U.S. By 1907, the increase in head taxes on arriving immigrants and the establishment of financial tests for admission to the U.S. lowered the score to -2. The literacy test established in 1917 reduced it to -3.5, and finally to -5 with the establishment of permanent immigration quotas).

⁵⁸ See TIMMER & WILLIAMSON, *supra* note 51.

⁵⁹ John Harris & Michael Todaro, *Migration, Unemployment and Development: A Two-Sector Analysis*, 60 AMER. ECON. REV. 126 (1970). The rural-urban migration framework is intimately related to analytical constructs emphasizing “dual” or segmented labor markets, for instance an informal sector in which employment is casual and wages are low and a formal, urban sector. In an international context, temporary worker (“Gastarbeiter”) programs are based in part on the recognition that certain jobs can only be filled by immigrants and programs of this type often merely place the state’s imprimatur on what already exists. See MARTIN ET AL., *supra* note 45; See

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framework, rural-urban migration is determined by the present discounted value of the rural-urban wage differential, net of anticipated migration and re-settlement costs.⁶⁰ Straightforward extension of this framework to international migration implies that the expected supply of migrants is determined by the domestic-foreign wage differential (appropriately cumulated and discounted), net of migration and assimilation costs, taking into account the new possibility of deportation from the host country.⁶¹ In a framework of this type, the continued migration from Mexico to the U.S. or from Albania to Italy is likely to continue unabated for now, given the large wage differentials and labor pools in the relevant countries.⁶²

The “self-selection” hypothesis of Borjas is another proposed source of immigration based upon relative market skills of immigrants and natives that has gained considerable support in the literature.⁶³ In fact, the relative skills of migrants have long been the focus of attention in the U.S. and most countries.⁶⁴ The literacy test enacted in 1917 by the U.S. was intended primarily to curb immigration from Southern and Eastern Europe, whose emigrants were thought to be of lower “quality” than of previous immigrants from Western and Northern Europe.⁶⁵ While some 80 percent of the annual quota for immigrants into the U.S. is based upon family ties, the 20 percent or less reserved for employment-based immigration is allocated to categories known as “preferences”.⁶⁶ Unskilled labor is allocated in smaller quotas than skilled labor

also RICHARD FLORIDA, *CITIES AND THE CREATIVE CLASS* (Routledge 2004).

⁶⁰ Harris & Todaro, *supra* note 59.

⁶¹ For a short, but excellent paper along these lines, see Douglas S. Massey & Felipe Garcia Espana, *The Social Process of International Migration*, 237 *SCIENCE* 733 (1987).

⁶² Projections of the labor pool available from Mexico, in view of the expected rise in Mexican incomes and decline in Mexican fertility rates seem to suggest however, that within a decade and a half at most, the “pull” of much higher U.S. wage rates and the “push” factor of lack of suitable employment in Mexico should both curb unlawful migration to the U.S., with or without border fences. See, e.g., HUFBAUER & SCHOTT, *supra* note 29. For an excellent review of U.S.-Mexico integration, SEE PHILIP MARTIN, *ECONOMIC INTEGRATION AND MIGRATION: THE MEXICO-U. S. CASE* (Wider Discussion Paper No. 2003/35), at

<http://www.wider.unu.edu/publications/dps/dps2003/dp2003-35.pdf>. For Mexican population and migration forecasts, see DAVID A. BRAUER, *PROJECTIONS OF NET MIGRATION TO THE UNITED STATES*, CONG. BUDGET OFFICE PUB. NO. 2774 (2006), <http://www.cbo.gov/ftpdocs/72xx/doc7249/06-06-Immigration.pdf>.

⁶³ George J. Borjas, *Self Selection and the Earnings of Immigrants*, 77 *AM. ECON. REV.* 531 (1987).

⁶⁴ For a detailed discussion of various aspects of Mexican migration to the U.S., See GEORGE J. BORJAS, *MEXICAN IMMIGRATION TO THE UNITED STATES* (University of Chicago Press forthcoming 2007), <http://www.nber.org/books/mexico/index.html>.

⁶⁵ See JONES, *supra* note 28 at 222.

⁶⁶ Immigration and Naturalization Act § 203, 8 U.S.C. § 1153 (2006).

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and has much longer processing times.⁶⁷ In similar fashion, temporary visas allocated to unskilled labor are smaller and subject to much longer delays than those for skilled labor.⁶⁸

The “self-selection” hypothesis has clear implications for voter attitudes toward immigration in host countries and as discussed below, recent work on such attitudes appears to be consistent with the hypothesis.⁶⁹ The hypothesis predicts that international migration is closely related to two factors, the relative skills of migrants versus natives and the extant degrees of inequality in income distributions in the sending and receiving countries. Thus, there will be negative self-selection of migrants, meaning that low skilled workers would prefer to emigrate, into destination countries with more egalitarian income distributions than to those countries with highly skewed income distributions. Since migrants moving into countries with a more unequal income distribution tend to be higher skilled (i.e. positively selected) than those migrating to egalitarian host societies, it follows that skilled natives, who face competitive pressures from the inflow of skilled migrants, would tend to be more anti-immigrant than those in more equal societies.

Skill levels are highly correlated with educational attainment so that better educated natives in more unequal societies, such as the U.S., would be expected to oppose migration more so than well-educated natives in more egalitarian societies, such as those in Northern Europe.⁷⁰ Whether or not these predictions are currently borne out is an empirical matter addressed below in the Section on public choice.

⁶⁷ *Id.*

⁶⁸ See Department of State, Visa Bulletin Vol. VIII, No. 102 (Feb. 2007), http://travel.state.gov/visa/frvi/bulletin/bulletin_3111.html. Visa categories are defined in Section 203 of the I.N.A., *supra* note 66. Time delays in processing various applications are not the I.N.A., but the Department of State Visa Bulletin provides an approximation of current delays.

⁶⁹ For further discussion, see *infra* Section V. The literature on the changing patterns of skills of immigrants is simply too vast to be reviewed here. See, e.g., George J. Borjas, *The Economics of Immigration*, 32 J. ECON. LITERATURE 1667 (1994). Some earlier literature had suggested that informational failures might lead to a disproportionately large number of unskilled workers entering host countries, since their potential employers may not be able to accurately gauge their true lack of skills. See, e.g., Eliakim Katz and Oded Stark, *Migration and Asymmetric Information: Comment*, 74 AM. ECON. REV. 533 (1987).

⁷⁰ Data in income inequality may be obtained from several sources. See generally BRANKO MILANOVIC, *WORLDS APART: MEASURING INTERNATIONAL AND GLOBAL INEQUALITY* (Princeton University Press 2005); JAMES B. DAVIES ET AL., *THE WORLD DISTRIBUTION OF HOUSEHOLD WEALTH* (UNU-WIDER 2006), <http://www.wider.unu.edu/research/2006-2007/2006-2007-1/wider-wdhw-launch-5-12-2006/wider-wdhw-report-5-12-2006.pdf>.

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C. The Continuing Paradox

In the Introduction of this paper, it was noted that today's labor-scarce advanced economies have apparently never simultaneously maintained both free trade and liberal migration policies, at least over the last two hundred years. Typical accounts though, of the last two centuries often refer to the first global century (roughly 1860-1914) as being the *belle époque* or the golden age of globalization, with trade, labor and capital all being freely internationally mobile.⁷¹ The second global century (approximately 1950-Present) is commonly regarded as being global with respect to rapid expansion in trade and cross-border capital flows, but not international labor flows.

Recent work indicates however, that the first global century was not so global after all, being characterized for the most part by restrictive tariffs coupled with relatively liberal international migration policies.⁷² By the end of the First World War, a major paradigm shift had occurred. Now, especially after 1950 free trade began to flourish along with international capital movements, to some extent, although the major boost to the latter occurred after the dismantling of remaining capital controls by advanced countries in the 1980s.⁷³ These observations suggest that, contrary to the classic trade model and contrary to what has been commonly assumed by non-specialists, trade and migration were never regarded as substitutes.

In the labor-scarce economies of the New World in Particular, an increase in tariffs would raise domestic wages and protect domestic labor, this being an elementary statement of the classic Samuelson-Stolper result. If trade and migration were in fact substitutes, then permitting unimpeded labor flows at the same time would certainly undo the protective effects of higher tariffs.

⁷¹ See MIGRATION: THE CONTROVERSIES AND THE EVIDENCE (R. Faini, Jaime de Melo and K. Zimmerman, eds., Cambridge University Press 1999). See HATTON & WILLIAMSON, *supra* note 34.

⁷² See JEFFREY G. WILLIAMSON, THE POLITICAL ECONOMY OF WORLD MASS MIGRATION: COMPARING TWO GLOBAL CENTURIES (American Enterprise Institute for Public Policy Research 2005); JEFFREY G. WILLIAMSON, GLOBALIZATION AND THE POOR PERIPHERY BEFORE 1950 (MIT Press 2006); NAT'L BUREAU OF ECON. RES. CONF. REP., GLOBALIZATION IN HISTORICAL PERSPECTIVE (M.D. Bordo, A.M. Taylor & J.G. Williamson, eds., U. Chicago Press 2005). Tariff rates in most of the New World (including the U.S.) during the first global century remained highly protective until 1914. In fact, as late as 1945, average tariffs on industrial goods in advanced countries stood at an astounding average of 40 percent. See HATTON & WILLIAMSON, *supra* note 34. The beginning of the free trade era or the *belle époque* was not, as is commonly assumed, the famous Cobden-Chevalier Treaty between Britain and France of 1860. See Gregory Bresiger, *Trade Trumps War: How Two Ancient Enemies Turned Away From Bloodshed. More Trade or More Forts?*, Mar. 6, 2000, <http://www.antiwar.com/orig/bresiger1.html>.

⁷³ Capital and exchange controls of each country are summarized in the *Annual Report on Exchange Arrangements and Exchange Restrictions*, International Monetary Fund (Sept. 9, 2002).

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Trade and migration were not substitutes, but instead, stood in a complementary relationship in the first global century. Precisely the same logic applies to show that in the second global century, characterized by free trade and migration restrictions, trade and migration could not have been substitutes. If they had been, free trade itself would have eroded the incentives to migrate and there would be no need for fiscally and politically costly restrictive migration policies. Finally, as noted previously, immigration policies in the New World remained mildly pro-liberal or at least neutral, until the First World War. After that, the immigration restrictiveness index, compiled by Timmer and Williamson, demonstrates a sharp restriction of migration policy between 1917 and 1930.⁷⁴ No such index is available for the years beyond 1930, but it would be a rare scholar indeed who would question that in the second global century (after 1950), migration policies tightened much further in all advanced countries and continue to do so.⁷⁵

But why did the policy mix in advanced countries undergo a complete reversal in the early twentieth century? While several economic, quasi-economic and non-economic explanations may be offered, it is easier to confront economic explanations with empirical evidence. Other explanations, such as demographic, ethnic or socio-cultural reasonings no doubt played and continue to play an important part. However, rigorous empirical verification or falsification of such hypotheses is not usually possible because of the lack of appropriate quantitative data.

Three principal reasons can be hypothesized for the turnaround in the trade-migration policy combination a century ago. First is an explanation grounded in immigrant skills or immigrant “quality.”⁷⁶ As the poverty constraint in Europe eased, poorer and less skilled persons were able to migrate to the New World, with the result that unskilled or semi-skilled native workers were increasingly threatened by the newcomers.⁷⁷ During the early period too,

⁷⁴ See TIMMER & WILLIAMSON, *supra* note 51.

⁷⁵ Lacking a formal immigration policy index after 1930, one may examine the results of reports by national governments to the United Nations as to whether the policy objective in their respective states was to restrict or liberalize further inbound migration. See U.N. Dept. of Econ. and Soc. Aff., *International Migration Report 2002*, <http://www.un.org/esa/population/publications/publications.htm> (follow “International Migration Report 2002” hyperlink).

⁷⁶ See HATTON & WILLIAMSON, *supra* note 34.

⁷⁷ Proxy immigrant quality by the ratio of per capita GDP in the sending versus receiving country. For the U.S., the index of immigrant quality had dropped close to 50 percent over the period 1870-1920. In more recent times, immigrant quality has deteriorated much faster, with the result that most migrants, especially from Mexico, can only compete with natives at much lower effective wage rates. HATTON & WILLIAMSON, *supra* note 34, at 10.

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tariff revenue formed an important part of total fiscal receipts of most New World governments since vast, sparsely populated tracts of land made efficient tax collection from other sources difficult.⁷⁸ In addition, migration did not threaten the national treasuries of most receiving states in the early period since very little existed in the form of an active social welfare state, characterized by a tax and transfer system, until well into the twentieth century.⁷⁹

But in the post-WWII period, if not before, all of these fundamentals had changed. Lower transport, information and search costs coupled with the establishment of networks meant that at least in absolute terms, large numbers of unskilled persons could emigrate to advanced countries. At the same time, the rise of the social welfare state necessitated large transfers to incoming migrants, especially at the state level, with corresponding tax implications.⁸⁰ None of these changes would mean much however, if governments could safely ignore most of their average citizens. This was not the case. Many advanced countries had transformed their political regimes from autocratic forms of government to relatively liberal, enfranchised democracies that *per force* catered, however imperfectly, to the median voter.⁸¹ Faced with wage competition from low-wage demand migrants, higher tax burdens to support social transfers to the latter and the existence of at least partially voter-sensitive governments, it is not at all surprising that states have turned sharply restrictionist with respect to migration policies in recent times.

IV. POLITICAL SCIENCE CONSIDERATIONS

Widespread existence of voter-responsive liberal democracies is still very much a recent creation. While countries such as the United States and Britain (despite being a nominal monarch) have long had liberal democratic traditions, this has not been the case for many advanced countries of today, and even less so for the newly-industrialized economies of Asia. A number of organizations, such as Freedom House, publish data or rankings on political and

⁷⁸ It is reported that Alexander Hamilton observed that customs duties were more important as a fiscal tool for purposes of revenue than as a means to encourage domestic production of manufactured goods. HATTON & WILLIAMSON, *supra* note 34, at 12.

⁷⁹ In the United States, the series of programs initiated between 1933-1937 during the "New Deal" may be regarded as the beginning of a much larger, activist state characterized by a tax and transfer system.

⁸⁰ Estimates for social transfers to migrants and the vies of voters with respect to these are discussed more. See HANSON, *supra* note 30 (providing estimates for social transfers to migrants and the vies of voters).

⁸¹ See STANLEY ENGERMAN & K. SOLOKOFF, THE EVOLUTION OF SUFFRAGE INSTITUTIONS IN THE NEW WORLD, (NBER Working Paper No. W 8512, 2001) (Recent account of the development of suffrage in the New World.)

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civic freedoms.⁸² However, a standard, but exhaustive, source of regime types for most countries of the world is the seminal work of Charles Boix.⁸³ Thus, while the inner core European countries such as France, Italy, Austria, West Germany and Denmark can date their liberal democratic regimes to the mid-1940s, other European states such as Greece have had a more checkered history, with an uninterrupted democratic regime dating only to 1974, with Spain and Portugal following some two or three years later. A large number of former Eastern bloc states such as Poland, Hungary, the Czech and Slovak republics, Bulgaria and Romania among others can only claim this title beginning in the early 1990s. In Asia, democratic regimes emerged in South Korea only in 1988, in the Philippines in 1986 and in Turkey 1983.⁸⁴

A potentially fascinating area is the relationship between regime type and migration and trade policies. Are liberal democratic states more likely to be pro-migration than autocratic states and what does the data indicate? And, in a similar vein, is trade protectionism more likely to be observed in autocratic states or in more broadly enfranchised democratic nations? Issues such as these have only recently begun to be examined in political science and the results thus far, appear surprisingly counterintuitive.⁸⁵

Consider first the relationship between democracy and regime type (i.e. democracy versus authoritarianism) and migration policy. For a number of reasons, it is quite likely that authoritarian regimes, particularly those of rich nations, would adopt more liberal migration policies than their democratic counterparts. The starting point is to observe that democracies are characterized by contested elections and their governments are more likely to adopt policies

⁸² See, e.g., <http://www.freedomhouse.org/template.cfm?page=1>.

⁸³ See CHARLES BOIX, *DEMOCRACY AND FREEDOM* (Cambridge U. Press). (Appendix 2.1 in this work contains an exhaustive list of countries by regime type, i.e., democratic, authoritarian, transitional, etc). The standard work on European political institutions in the early 19th century is Paul Bairoch, *European trade policies: 1815-1914*, in *THE CAMBRIDGE ECONOMIC HISTORY OF EUROPE*, VOLUME 8 (Peter Mathias and Sidney Pollard eds., Cambridge Univ. Press 1989).

⁸⁴ *Id.*

⁸⁵ There has been some previous work on the relationship between general economic policies and regime types, but it has not been particularized to trade and migration policies. See, e.g., RONALD WINTROBE, *THE POLITICAL ECONOMY OF DICTATORSHIP* (Cambridge Univ. Press 1998), ADAM PRZEWORSKI ET AL., *DEMOCRACY AND DEVELOPMENT* (Cambridge Univ. Press 2000); Casey B. Mulligan et al., *Do Democracies Have Different Public Policies than Nondemocracies?*, 18 J. ECON. PERSPECTIVES 1 (2004),

<http://cas.uchicago.edu/workshops/cpolit/papers/mulligan.pdf>, NIKOLA MIRILOVIC, *REGIME TYPE AND IMMIGRATION* (Univ. of Chicago Working Paper, 2005),

http://harrisschool.uchicago.edu/Academic/workshops/pol_econ_papers/mirilovic-immigration.pdf; KEVIN H. O'ROURKE & ALAN M. TAYLOR, *DEMOCRACY AND PROTECTIONISM* (NBER Working Paper No. 12250, 2006), <http://www.wcfia.harvard.edu/seminars/pegroup/ORourkeTaylor2006.pdf>.

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reflecting the preferences of the median voter. However, the median voter class in most countries, rich or not, is likely to consist only of moderately skilled labor with modest resources compared with the elite class of capital owners or the landed gentry. As a factual matter, while a few migrants moving into rich countries are highly skilled (who might well be viewed as capital owners), most migrants are low skilled and directly threaten the wage levels of the native median voter. In turn, the latter would be expected to pressure their elected governments to restrict immigration. This effect is absent in rich autocratic regimes in which meaningful franchise is limited, if existing at all, and in which the state's policies are geared to a small elite ruling class that does not depend upon labor income. Hence, there is little pressure on the government in autocratic states to restrict immigration to mollify the average citizen.

An additional important reason for the expected pro-immigration stance of autocracies compared with democratic regimes relates to the existence of the welfare state. Authoritarian regimes are expected to spend less on social transfers than their democratic counterparts, since there are few, if any needy constituents to satisfy.⁸⁶ The cost of arriving immigrants (in terms of required social transfers for medical care, food stamps etc) and the fiscal constraints upon immigration, therefore, can be easily avoided in authoritarian regimes. The growth of the modern welfare state in modern times coupled with an increase in the efficiency of tax collection machinery in recent times, explains in part, why migration policies in the second half of the twentieth century became markedly more restrictive than say, fifty years prior to that when there was no welfare state to any extent. Finally, the inexorable fiscal burden of today's aging democracies characterized by declining fertility rates is expected to compound the tax burden further for the working populace.⁸⁷ If anything, this factor may be expected to lead democratic governments to further restrict migration of persons likely to require social transfers, while encouraging migration of younger, but highly skilled workers.⁸⁸

Are these hypotheses empirically validated? Indices of civic and political freedom are readily available, as indicated previously. Additionally, it

⁸⁶ See, e.g., PRZEWORSKI ET AL, *supra* note 85 (Pointing out that this might be one reason why autocratic regimes are characterized by higher population growth rates than democratic regimes). Because the social welfare net is limited people need to provide for old age security by having larger families. Another theme relates to less legitimate reasons for autocratic governments to expand population and geographical boundaries, i.e. those that refer to concept such as *Lebensraum* (living space). Readers will recall this ominous term from the expansionist policies pursued by Nationalist Socialist Germany in areas to its east.

⁸⁷ For long run projections of populations in various countries, see, e.g., United Nations Population Information Network, at <http://www.un.org/esa/population/unpop.htm>.

⁸⁸ See generally MARTIN ET AL., *supra* note 45.

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is possible to code Boix's listing of regime types as a binary, dummy variable.⁸⁹ For the years until 1930, the Timmer-Williamson index of restrictiveness of immigration policy may also be utilized.⁹⁰ A possible, but imperfect proxy for the permissiveness of immigration policy following that time period could be the share of foreign labor in total domestic employment.⁹¹ Cross-section and panel data tests performed appear to corroborate the principal hypothesis to a surprising degree for the last quarter of the twentieth century, i.e. democratic regimes are more likely to pursue more restrictive immigration policies than their authoritarian counterparts.⁹² These results are also corroborated for the period prior to 1930 upon examination of the index of immigration restrictiveness constructed by Timmer and Williamson.⁹³ Thus, the reported index of immigration policy permissiveness for the major democracies is -0.16 over the period 1850-1930, while for dictatorships, immigration policy was far more liberal, with the index being 1.8.⁹⁴

Consider next the relationship between regime type and protectionism of trade policy. Scholarly endeavor in this area too is still very limited.⁹⁵ One focus of inquiry is to examine, in a causal sense, whether broadening the voter franchise leads to more liberal trade policies (i.e. lower tariffs).⁹⁶ Extending voter franchise creates more voters and in most countries, including developed nations, the median voter is primarily one with labor skills and does not derive income primarily from capital or from land ownership. Hence, the effect of democratization is largely determined by whether the average voter stands to

⁸⁹ See BOIX, *supra* note 83.

⁹⁰ See *supra* text accompanying note 51.

⁹¹ This proxy is imperfect since several Middle Eastern countries have a large proportion of resident foreign labor and are not generally regarded as being characterized by democratic institutions. This limitation can be avoided by limiting empirical testing to advanced Western nations.

⁹² See MIRILOVIC, *supra* note 85.

⁹³ See TIMMER & WILLIAMSON, *supra* note 51.

⁹⁴ See *supra* text accompanying note 31 (Britain, although a democracy, is an outlier during this period and pursued pro-immigration policies, due perhaps to the special needs of colonialism and empire-building).

⁹⁵ An exception is O'ROURKE & TAYLOR, *supra* note 85. See also Harry Bliss & Bruce Russett, *Democratic Trading Partners: The Liberal Connection, 1962-1989*, 60 J. POL. 1126, 1126-47 (1998); James D. Morrow et al., *The Political Determinants of International Trade: The Major Powers, 1907-1990*, 92 AMER. POL. SCI. REV. 649 (1998). For more literature on the topic of democracy and general economic performance, see, e.g., Dani Rodrik and Romain Wacziarg, *Do Democratic Transitions Produce Bad Economic Outcomes?*, 95 AMER. ECON. REV. 50 (2005); TORSTEN PERSSON, FORMS OF DEMOCRACY, POLICY AND ECONOMIC DEVELOPMENT (CEPR Discussion Paper No. 4938, 2005).

⁹⁶ The reverse question of whether encouraging free trade promotes democracy is of interest to foreign relations scholars and to observers of globalization.

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gain or lose from liberalized trade. While the benefits of free trade in terms of cheaper access to a wider variety of goods are ubiquitous and dispersed, its costs are more narrowly imposed upon workers whose livelihood may be threatened by foreign competition. The vintage trade framework discussed in previous sections is instructive in this regard. In that framework, it will be recalled, it is protection that benefits the scare factor or input. Thus, in advanced labor-scarce economies such as the United States or Canada, the average voter would lose from liberalized trade and extending democratic franchise would imply more pressure upon elected governments to satisfy constituents by restricting trade. By contrast, in the labor abundant economies of the Old World, land was scarce even in the late nineteenth and twentieth centuries and labor would have preferred free trade, while landed interests would have sought protection from trade. These observations are not without empirical support. As discussed earlier, the labor abundant economies of the Old World lowered their tariff rates much earlier than New World countries.⁹⁷ More sophisticated regression results for the period 1870-1914 for a data set including 35 countries also indicates that the extent of democratic franchise is a significant determinant of protectionism, once relative scarcities of land and labor in the relevant countries is taken into account.⁹⁸ Finally, when there is a third input, besides land or labor, such as capital, these effects are no longer as clear cut. Analysis of the effects of democratization upon trade policy in the context of a more complex framework has just begun and much remains to be done.

V. INTEREST GROUPS AND PUBLIC CHOICE

In Section III, it was discussed that in the standard Heckscher-Ohlin trade framework, trade and migration policies and their effects are characterized by an elegant symmetry. In Section IV, the relationship between types of regimes and the trade-migration policy stance was analyzed. In this Section, a more microscopic examination of the preferences of individual voters regarding trade and migration is utilized. Clearly, it is liberal democratic regimes that are expected to be responsive to voter preferences, rather than authoritarian regimes. Thus, the results discussed in this Section are primarily of relevance to liberal, democratic structures, whether rich or poor. Attitudes or preferences of median voters in such societies are translated by the governing regime, which must decide between pro- or anti- trade/migration policies.

Both trade and migration policies lead to identical effects upon returns to inputs, such as labor and land, the standard framework. Since rich countries

⁹⁷ See *supra* text accompanying note 72.

⁹⁸ See O'ROURKE & TAYLOR, *supra* note 85.

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are characterized by scarcity of unskilled labor (to use the paradigm utilized earlier), trade liberalization benefits the relatively abundant input, which is skilled labor in rich countries. Hence, skilled labor would be expected to be pro-trade in rich countries and conversely, it would be unskilled labor which would support trade liberalization in poor countries. Because open migration is a complete substitute for liberalized trade in the classic framework, as discussed earlier, skilled labor would also be liberal with respect to migration of unskilled labor into the rich country. In this case too, relative wages of skilled labor would increase following liberalization of migration policies. Hence, skilled workers are complete “globalists” in rich countries, preferring both liberalized trade and liberalized migration. Skilled labor in poor countries though, would display the precise opposite preferences. These properties with respect to attitudes of skilled and unskilled labor in the two countries are conveniently summarized in Table 1.

Table 1

	Rich Country	Poor Country
Skilled Labor	Pro-Trade Pro-Migration	Anti-Trade Anti-Migration
Unskilled Labor	Anti-Trade Anti-Migration	Pro-Trade Pro-Migration

Two observations regarding these simple results are in order. First, it may be easier for states in rich countries to garner support for general globalization (trade and migration) for the simple reason that skilled and richer workers would more easily be able to form coalitions and fund government platforms advocating globalization. This may result from the highly skilled being both better informed and educated and having access to more resources for political activism. On the other hand, in poor countries, liberal democracies attempting to promote globalization are likely to be opposed or blocked by powerful, well informed and wealthier voters who are decidedly opposed to globalization in every respect. It is no surprise then, that free trade agendas of the WTO are often reported to be obstructed or delayed by less developed countries rather than by the rich, industrialized nations.⁹⁹

Second, as in every theoretical construct, caveats are necessary and at least two are appropriate in this case. To the extent that migration from poor

⁹⁹ See, e.g., Jeffrey J. Schott, *Reviving the Doha Round*, INST. FOR INT'L ECON., May 2004, <http://www.iie.com/publications/papers/paper.cfm?ResearchID=207>; see also *The WTO under fire*, THE ECONOMIST, Sept. 18, 2003, <http://www.globalpolicy.org/soecon/bwi-wto/wto/2003/0918underfire.htm>.

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countries consists of skilled labor, in other words there is a “brain drain,” the results noted in the chart would be altered. For now, the emigration of skilled labor to rich countries would directly threaten skilled natives in the latter. A more complex setting would recognize that skilled workers in developed nations are likely to be selective in their migration preferences; unskilled labor migration, even that which may consist of unlawful migrants, may be encouraged or tolerated, while inbound migration of skilled labor would be disfavored. In addition, even without the complication of a possible “brain drain,” the classic framework is subject to several qualifications as noted earlier. In particular, factors such as market imperfections or increasing returns to scale might easily result in trade and migration being complements rather than substitutes and in fact, the empirical evidence cited earlier points to that conclusion.¹⁰⁰ If the strict substitutability relationship between trade and migration is undermined, so would the preference configurations listed in the summary chart above.

What does analysis of the empirical data demonstrate with respect to these propositions? Observe first that individual attitudes or preferences can only be gauged through responses to voter surveys or polls. At least three sets of cross country voter surveys have been utilized in the little empirical work that exists; those from the International Social Survey Programme, the World Values Survey and the European Social Survey.¹⁰¹

Preliminary empirical testing of voter attitudes toward immigration appears to be consistent with the classic trade framework, but the latter does not seem to capture all the determinants of voter attitudes.¹⁰² In general, the

¹⁰⁰ See *supra* text accompanying note 34.

¹⁰¹ For details regarding these international surveys, see www.issp.org; www.worldvaluessurvey.org; www.europeansocialsurvey.org

¹⁰² Consistency with the classic trade framework means that native voters' attitudes toward migration depend upon their skill levels relative to those of incoming migrants. See KEVIN H. O'ROURKE & RICHARD SINNOTT, THE DETERMINANTS OF INDIVIDUAL ATTITUDES TOWARD IMMIGRATION (Trinity College of Dublin Dept. of Econ., Paper No. 20042, 2001), http://www.tcd.ie/Economics/TEP/2004_papers/TEPNo2KOR24.pdf, ANNA MARIA MAYDA, WHO IS AGAINST IMMIGRATION? A CROSS-COUNTRY INVESTIGATION OF INDIVIDUAL ATTITUDES TOWARDS IMMIGRANTS (CEPR, Discussion Paper No. 5055, 2005), <http://www.georgetown.edu/faculty/amm223/revisedimmpolpref.pdf>; Jens Hainmueller & Michael J. Hiscox, *Educated Preferences: Explaining Attitudes Toward Immigration in Europe* (Kennedy School of Gov't, Harvard Univ. 2005), <http://www.people.fas.harvard.edu/~hiscox/EducatedPreferences.pdf>. Voter attitudes toward trade policy (protectionism in particular) have also been analyzed. See KEVIN H. O'ROURKE AND RICHARD SINNOTT, THE DETERMINANTS OF INDIVIDUAL TRADE POLICY PREFERENCES: INTERNATIONAL SURVEY EVIDENCE (Trinity College of Dublin, Dept. of Econ., Paper 200110, 2001), http://www.tcd.ie/Economics/TEP/2001_papers/TEPNo10K021.pdf; Kenneth F. Scheve &

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International Social Survey results seem to indicate that non-economic factors such as patriotism or chauvinism play a strong part in explaining voters' attitudes toward migration. Factors such as gender and religion may also have some impact.¹⁰³ For labor market participants, there appears to be qualified support for the classic framework; the high-skilled are less opposed to immigration than the unskilled. However, contrary to the results described in the chart, skilled labor everywhere (i.e. in both rich and poor countries) is more liberal with respect to migration than unskilled labor. In addition, as in the self-selection hypothesis, income inequality also plays a part.¹⁰⁴ When income distribution in the host country is highly skewed, there is positive selection of migrants (i.e. migrants have higher labor market skills) and skilled native labor in receiving countries turns anti-immigrant.

These results parallel those found for individual attitudes toward protectionist trade policy.¹⁰⁵ Again, nationalist sentiments play a large role in explaining attitudes toward protectionism and better skilled workers, especially those in rich countries who are likely to be pro-trade. Finally, there is surprisingly robust evidence of a gender gap in that women tend to be more protectionist everywhere as compared with men at equivalent skill levels.

The survey results reported above refer to cross-country data. Within a single country such as the U.S., there also appears to be a fairly wide disparity in attitudes toward immigration - particularly, illegal immigration - across the various states. How can this be explained in the face of a national or federal immigration policy? Models of trade such as the vintage trade framework discussed earlier are of no application to interstate variations in voters' attitudes toward immigration within a nation, and the equivalence between trade and migration as implied by earlier work in trade analysis and relied upon by many authors, is without relevance. In intriguing recent work, authors such as Hanson have begun to analyze varying attitudes toward migration across the several states of the U.S. in terms of three primary factors. First, migrant access to the state's welfare system (coupled with its tax burden), second, the existing proportion of migrants in the state's resident population and finally, labor

Matthew J. Slaughter, *What Determines Individual Trade-Policy Preferences?* 54 J. INT'L ECON. 267 (2001) Anna Maria Mayda & Dani Rodrik, *Why are Some People (and Countries) more Protectionist than Others?*, 49 EUR. ECON. REV. 1393 (2005).

¹⁰³ For a recent paper dealing with the impact of religious beliefs upon attitudes toward trade, see PATRICK LAM, RELIGION AND ATTITUDES TOWARD INTERNATIONAL TRADE: DOES RELIGIOUSITY INCREASE PROTECTIONISM? (Dept. of Gov't, Harvard Univ. Working Paper, 2006), <http://www.iq.harvard.edu/NewsEvents/Seminars-WShops/PEW/Fall06/Lam2006.pdf>.

¹⁰⁴ This result also finds support in European survey data. See Hainmueller & Hiscox, *supra*, note 102.

¹⁰⁵ See *supra* text accompanying note 102.

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market outcomes of increased migration.¹⁰⁶ Of these, the third factor is central to international trade models as well and has been discussed above. Specifically, the higher the skill and education levels of average workers in a state, the less likely it is that migration of unskilled labor could threaten natives' jobs and generate anti-immigration sentiment. The other two factors though, are not of relevance in standard trade analysis, which is conducted at a gross national level, but were touched upon in an earlier Section.

Space considerations preclude extended discussion; however, the following observations may be made: Data on attitudes of voters in different states in the U.S. for large samples is available from the National Election Studies project, covering 3400 observations over the 1990s.¹⁰⁷ There does not appear to be any such large scale studies for later periods. The statistical random sample of adults suggests that three factors affect public perceptions about additional migration; first, access to public assistance services coupled with the level of state taxes, second, the education level of respondents and third, the existing size of the state's immigrant population. Contrary to popular belief, residents of southern border states need not necessarily be more opposed to immigration than those in more distant states, such as New Jersey. In general, voters in states with a high proportion of existing migrants, high state taxes and generous state welfare systems are more likely to be opposed to additional migration, at least for respondents with equivalent education levels.¹⁰⁸

The effect of education in explaining variations in attitudes toward additional migration has been mentioned earlier and is relatively straightforward to rationalize. In general, education is a proxy for labor skills. The higher the level of education, and hence skills, of residents of a state's population, the less likely that unskilled labor migration could directly threaten natives' job security and conversely. States also vary a great deal by their degree of access to state welfare systems, with states such as Florida, Texas, North Carolina and Virginia being far less generous than others such as California, Maryland, New Jersey

¹⁰⁶ HANSON, *supra*, note 30.

¹⁰⁷ Virginia Sapiro et al., *National Election Studies Project* (Inter-University Consortium for Political Research, ICPSR Series 2536, CD Rom, Ann Arbor, 1998), www.chass.utoronto.ca/datalib/major/us_nes.htm.

¹⁰⁸ Access to state provided welfare became a more important factor after federal welfare for migrants was sharply curtailed in 1996. See Personal Responsibility and Work Opportunity Act of 1996, Pub. L. No. 104-193, § X, 110 Stat. 2105 (1996); Illegal Immigration Reform and Responsibility Act of 1996, Pub. L. No. 104-208, § X, 110 Stat. 3009-546 (1996) ("IIRIRA"). (Title V of the IIRIRA amends and re-incorporates the Personal Responsibility and Work Opportunity Act. The IIRIRA barred undocumented aliens from most means-tested public assistance programs and also limited access of legal immigrants to such benefits for a five year period. Following the federal initiative, several states restored many of the benefits through state-funded programs).

MIGRATION AND TRADE POLICIES

and New York.¹⁰⁹ At the same time, state tax burdens tend to be relatively high in California and some northeastern states such as New Jersey as compared with Texas and Florida. It would not be surprising therefore, that the direct fiscal impact of additional migrants on natives would be more acute in California than in Texas or Florida. These propositions appear to be corroborated by recent empirical studies.¹¹⁰

CONCLUSION

In this article, the relationship between trade and migration policies was analyzed on a number of levels and across several disciplines. Contrary to assumptions often made by writers and scholars, including those in the law, increased trade liberalization does not have predictable effects upon international migration, which is a far broader and more complex phenomenon. Nations should pursue independent policies with respect to international trade and migration, as the United States has already done. There need not be any hand-wringing over the “missed opportunities” for migration reform in the U.S. during trade accords such as the NAFTA because of any necessary linkage between trade and migration. It may be possible in the future, to combine elements of trade and migration analyses and construct a richer analytical structure than exists currently. As a policy matter, on the levels of both theory and practice, there appears to be no need, at this time, to inevitably wed trade and migration reforms.

¹⁰⁹ See Wendy Zimmerman and Karen C. Tumlin, *Patchwork Policies: State Assistance for Immigrants Under Welfare Reform*, Occasional Paper No. 24 (The Urban Institute, 1999).

¹¹⁰ GORDON H. HANSON ET AL., LOCAL PUBLIC FINANCE AND INDIVIDUAL PREFERENCES OVER GLOBALIZATION STRATEGIES (NBER Working Paper 11028, 2005), <http://irpshome.ucsd.edu/faculty/gohanson/HSSImm&PF1204.pdf>.

LATIN AMERICA, ITS EMERGING MARKETS AND THE GLOBAL ECONOMY – AN OVERVIEW

*Dr. Walter Molano**

INTRODUCTION

The global economy continues to roar ahead, enjoying some of the best conditions imaginable. A combination of balanced-economic growth and a high level of international liquidity created the ideal conditions for financial markets. In contrast to previous periods, when GDP growth was concentrated in a few population pockets, all of the major economic zones are enjoying greater levels of prosperity. The result is a broader consumer base, greater resiliency and less vulnerability to shocks. Surprisingly, we are in a period when the developing world is growing at a faster pace than the developed world. More internationals are deriving their earnings and revenue growth in developing countries, fueling greater levels of investment. Trade also continues to expand rapidly- -despite setbacks on the multinational and bilateral fronts. Changes in technologies and techniques are leading to amore productive and efficient global marketplace.

The massive increase in global liquidity is the force behind the economic momentum. It is no longer an issue of the large fiscal and current account deficits generated by the U.S. It is more the development of new financial instruments and derivatives that fueled an explosive growth in the global money supply. For example, the stock market of over-the-counter derivatives exploded four-fold this decade, reaching a total of \$453 trillion by the end of 2006. This is what produced the global credit boom. Mortgages and consumer loans are now abundant in Chile, India, Russia and South Africa.

THE CHANGING GLOBAL ECONOMIC SCENE

The realignment of the global order is occurring faster than anyone expected. Times have changed, it is no longer a world dominated by Europe, Japan, and the United States in terms of global business transactions and economic activity. Newer players with equally strong penchant for mega deals and world dominance are entering the global arena. Countries like Brazil, China

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and India are flexing their muscles and demanding to be recognized as world class economies. Brazil's economy is expected to grow more than 5% in 2007. The Brazilian government has relaxed some of its fiscal and monetary policies and at the same time increased its investments in public sector projects. Brazilian and Indian companies recently vied for a U.K. based steel maker.

The Chinese economy is on track for another year of double-digit growth. The Chinese economy grew 10.7% in 2006. China's trade surplus rose steadily, as it moved into higher value-added products. China recently displaced Japan in the number two slot for research and development (R&D) spending. China is clearly becoming a major element of global stability. China is the main source of development capital in Africa, displacing the IMF. (Indeed the multilateral lending agency, one of the vestiges of the old world order, has been left out of a job—and it may be forced to sell some of its assets to cover its operating expenses). China is the third largest exporter of manufactured goods after Germany and the U.S. China is also one of the most important importers of raw materials consuming a third of the world's steel, iron ore, coal, zinc, and tin. The Chinese consumer plays a pivotal role in the global marketplace. It is the third most important market for luxury goods, where it represents 12% of global luxury sales, behind Japan with 14% and the U.S. with 17%.

India is another country that is taking major steps towards being recognized as an economic power. India's economy is on a pace to grow at 9% in 2006, versus original estimates of 8.4%. Indian companies are aggressively seeking merger and acquisition (M&A) opportunities on a worldwide scale. For example, after its acquisition of Arcelor Steel company, by the Indian owned Mittal Steel Company, the renamed; ArcelorMittal became the world's number one steel company with 320,000 employees in more than 60 countries. Similarly, the aggressive acquisition of Corus by Tata & Co. a diversified Indian multinational, the purchase of a controlling stake in Telecom Italia by an Indian conglomerate, and the growing presence of its IT consultancy services is propelling India to new heights in the global economy.

EMERGING MARKETS OF LATIN AMERICA

According to the World Bank, Latin America's total GDP growth averaged 4.4% in 2005 and is expected to grow by 4.6% in 2006. In fact, Chile, Colombia, Peru, and Venezuela are projected to have a GDP growth rate of over 6% in 2007. In 2006, Latin America had the highest export revenues and volumes compared to other regions of the world. From uneven economic progress during the 70's and 80's, this region has had a complete turnaround and is one of the most vibrant regions of the world. With substantial foreign direct investments coupled with increased export activities, the Latin American region is experiencing an economic boon unheard of for this region. More

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importantly, the economic success is not just centered in one or two countries, but transcends across many of the countries in the region. Countries like Brazil, Chile, Mexico, Peru, and Venezuela through their export activities in items such as automobiles, aircraft, and oil are part of the global economy. A growing middleclass in the region demands imported goods and has the purchasing power to be selective in their choices.

Politically, the region is vulnerable, with leftist governments in Bolivia, Ecuador, and Venezuela and a tendency for radical policy shifts. The region started the year on a bad note, with President Chavez's decision to nationalize the electricity and telecommunication sectors. The announcement underscored the political risks associated with populist governments in the region.

Unfortunately, the events in Venezuela highlight the arbitrariness of political leadership in Latin America. The demise of political parties led to the rise of populists, who were more interested in holding on to power through a variety of headline-grabbing stunts and rhetoric. Unfortunately, the situation in Venezuela is spiraling out of control. The country's infrastructure is buckling and corruption is rampant.

The problems in Venezuela are spreading to other countries in the region. Ecuador and Bolivia are following the radical policies enacted by President Chavez. Argentina's President Kirchner often veers into extremities of populism, and Lula's (Brazil), as well as Alan Garcia's (Peru), ideological background means that such policies are a possibility. Even Chile's President Bachelet hails from the more leftist side of the political spectrum, and is prone to populist ideas.

One of the lessons to be learnt from the past for Latin America is how many of the developing countries were able to dig out of their economic struggles through some innovative privatization policies. But, things have changed and the policymakers are shifting away from some of the key policies that helped them attain economic success. Although privatizations were the norms for the past two decades, nationalizations are part and parcel of developing country policies. Ironically, they occur in countries that are experiencing large current account surpluses. Privatizations are capital account transactions used to plug holes in current account balance, but nationalizations are the opposite. The nationalization of the Argentina railroad and telecommunication systems, at the end of World War II, occurred when the government was flush with cash. Many countries nationalize their energy sectors, when the projects are fully operational—generating strong cash flows and requiring no additional investment. Governments are also lured by sectors that generate monopoly rents, such as electricity and telecommunications. They can produce large profits and provide excellent employment opportunities. Most

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developing countries including those in Latin America experienced large current account deficits during the past two decades and did not have the resources to nationalize anything. However, the commodity boom of the past five years changed everything, and many countries do not know what to do with the cash. That is why nationalizations could become vogue.

ECONOMIC PERFORMANCE OF SELECTED COUNTRIES IN LATIN
AMERICA

What follows are some key economic indicators for a select few countries to highlight the economic performance of these countries in the past five years. The countries that are discussed here include Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, and Venezuela. Some of the improvement in the economies of these countries may have been the result of involvement in the global economy.

ARGENTINA

Argentina is one of the few countries in the region that have not met the expectations of investors in terms of economic stability. In the past five years, its gross national income (GNI) per capita has declined from \$7,470 in 2000 to \$4,470 in 2005. The economy had a negative GDP growth rate of -1% in 2000, -4% in 2001 and -11% in 2002. Since then, it has had some strong showing with an average GDP growth rate of 9% for 2003 through and 2005. Argentina's long-term debt has also been on the rise. In 2000 it had long-term debt of 114 billion dollars and by 2005 this debt had risen to 127 billion dollars. In addition, Argentina has experienced double digit inflation and a decline in its FDI flows.

In spite of its poor start in 2000, a score of economic sectors are operating at full tilt, including agriculture, tourism, and construction. The retail sector is showing signs of increased activity with increases in electro-domestic sales, reflecting the improved purchasing power of Argentine households. Real wages soared 15% in 2005 and was 7% in 2006, allowing households to increase expenditures on discretionary items.

The strong level of economic activity is allowing the government to maintain fiscal discipline. The primary fiscal surplus in 2006 was 3.6% of GDP, and the operational fiscal surplus was 2.13% of GDP. Fiscal discipline, along with a tight monetary position, will allow the government to reign in the inflation rate to a range of 8% to 9%. Argentina's overall creditworthiness is also improving. Argentina's public sector debt dropped to 61.8% of GDP in

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2006, from a level of 71% of GDP the year before. The level of indebtedness should fall into the 50% range in 2007. Overall, Argentina's economic performance is mixed, but there are signs that it may recover during the next few years. Some of the key economic indicators for Argentina are presented in Table 1.

Table 1
Selected Economic Data for Argentina

<u>Variable</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Exports (% of GDP)	11	12	28	25	25	-
FDI (\$000,000,000)	10	2	2	2	4	-
GDP (\$000,000,000)	284	268	102	129	153	183
GDP growth rate (%)	-1	-4	-11	9	9	9
GNI/capita (\$)	7,470	7,010	4,050	3,670	3,670	4,470
Gross capital formation (% of GDP)	16	14	12	15	19	-
Imports (% of GDP)	12	10	13	14	18	-
Inflation (%)	1	-1	31	10	9	9
Long-term debt (\$000,000,000)	114	120	120	127	127	-
Merchandise trade (% of GDP)	18	17	34	33	37	37
Population (000,000)	36.9	37.3	38.6	38.0	38.4	38.7

Source: <http://devdata.worldbank.org/data-query> - February 28, 2007

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BOLIVIA

Bolivia's economy has coasted along with below average performance on most economic indicators. GDP growth rate which had averaged 2.5% during the first four years (2000 – 2003) has had a modest rate of growth of 4% in the last two years and is expected to maintain this rate through the year 2007. Merchandise trade as a percentage of GDP is also on the rise from 36% in 2000 to 52% in 2005. Gross national income per capita, inflation, and foreign direct investment flows have all remained steady through the past five years. It is expected that Bolivia's economy will probably continue in its present state for the foreseeable future. Some of the key economic indicators for Bolivia are presented in Table 2.

Table 2
Selected Economic Data for Bolivia

Variable	2000	2001	2002	2003	2004	2005
Exports (% of GDP)	18	20	22	25	31	-
FDI (\$000,000,000)	0.7	0.7	0.7	0.2	0.1	-
GDP (\$000,000,000)	8.4	8.1	7.9	8.0	8.7	9.3
GDP growth rate (%)	3	2	2	3	4	4
GNI/capita (\$)	1,000	960	930	920	960	1,010
Gross capital formation (% of GDP)	18	14	17	13	12	-
Imports (% of GDP)	27	25	28	26	27	-
Inflation (%)	5	2	3	6	7	5
Long-term debt (\$000,000,000)	5	4	4	5	6	-
Merchandise trade (% of GDP)	36	37	39	40	46	52
Population (000,000)	8.3	8.5	8.6	8.8	9.0	9.2

Source: <http://devdata.worldbank.org/data-query> - February 28, 2007

BRAZIL

Brazil's economy has also been sluggish in the past few years. Most of the economic indicators are showing a weakness in the economy, except for long-term debt which has decreased over the years from 210 billion dollars in 2000 to 171 billion dollars in 2004. GDP growth rate which had averaged 3.0% during the first six years (2000 – 2005) is expected have growth of 2.8% in 2006 and is projected to grow by 3.5% in 2007. Merchandise trade as a percentage of GDP is steadily on the rise from 19% in 2000 to 25% in 2005. Inflation, a perennial concern in Brazil has been on the rise from 8% in 2000 to 15% in 2005, but is projected to be around 7% in 2007. Foreign direct investment flows have steadily declined from a peak of 32 billion dollars in 2000 to 18 billion dollars in 2004. Gross national income per capita had a slight

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decline from \$3,590 in 2000 to 3,460 in 2005. Brazil's economy is expected to show sign of a mild recovery during the next few years. The lower interest rate at around 11.5% by the end of 2007 should boost economic activity. Brazil remains an investor's paradise as its exports continue roar ahead, with an expected trade surplus of more than \$40 billion in 2007 and international reserves of almost \$100 billion by year-end.

A continued rally in soft commodity prices and the expansion of the ethanol industry will boost embarkations. Brazil's debt to GDP ratio will fall below 40% by the end of 2007, putting it on track for an investment grade rating. Although Brazil may not be the most dynamic economy in asset class, it has a level of consistency and stability that is improving domestic conditions and assuring international investors. The size of the Brazilian economy was \$711 billion at the end of 2006, almost twice as big as it was at the start of President Lula's first term in office. Likewise, Brazil's unemployment rate was 9.5% at the end of 2006, versus 12.2% at the end of 2002. Some of the key economic indicators for Brazil are presented in Table 3.

Table 3
Selected Economic Data for Brazil

Variable	2000	2001	2002	2003	2004	2005
Exports (% of GDP)	11	13	15	16	18	23
FDI (\$000,000,000)	33	22	17	10	18	-
GDP (\$000,000,000)	601	508	461	506	604	794
GDP growth rate (%)	4	1	2	1	5	2
GNI/capita (\$)	3,590	3,040	2,790	2,680	3,000	3,460
Gross capital formation (% of GDP)	22	21	20	20	21	19
Imports (% of GDP)	12	14	13	13	13	15
Inflation (%)	8	7	10	15	8	7
Long-term debt (\$000,000,000)	210	194	189	184	172	-
Merchandise trade (% of GDP)	19	23	24	25	27	25
Population (000,000)	173.9	176.4	178.9	181.4	184.0	186.4

Source: <http://devdata.worldbank.org/data-query> - February 28, 2007

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CHILE

Chile's economy has performed relatively well compared to other countries in the region. Its GDP growth rate has averaged over 4% for the past six years and is estimated to be around 4.4% in 2006 and projected to be 5.5% in 2007. Gross national income per capita has risen from \$4,850 in 2000 to \$5,870 in 2005. Chile has received a steady flow of foreign direct investment over the past few years and is expected that this trend will continue for another few years. Inflation too has been under control and has averaged just over 5% between 2000 and 2005. In addition, merchandise trade as a percentage of GDP has been on the rise in recent years growing from 50% in 2000 to 63% in 2005. Chile is projected to be economically vibrant for the next few years.

Today, Chile is the picture of economic stability. It has a prosperous middle class, a moderate growth rate and price stability. However, it is no longer the dynamo it once was during the late 1980s and 1990s. The projected GDP growth rate of 5.5% in 2007 is rather lame, considering the boom in metal prices and the favorable international environment. The unemployment rate of 6.6% in 2006 was much better than the 8.8% that was recorded in 2005. Chile is one of the world leaders in signing free trade agreements, finalizing trade pacts with China, Colombia, India, Panama, and Peru. It is also consummating similar agreements with Brunei, Japan, New Zealand, and Singapore. Even with all these trade agreements, Chile continues to be principally, a copper producing country with less diversification given the appreciation of the currency. Some of the key economic indicators for Chile are presented in Table 4.

Table 4
Selected Economic Data for Chile

Variable	2000	2001	2002	2003	2004	2005
Exports (% of GDP)	32	33	34	37	41	42
FDI (\$000,000,000)	5	4	3	4	8	-
GDP (\$000,000,000)	76	69	67	74	95	115
GDP growth rate (%)	4	3	2	4	6	6
GNI/capita (\$)	4,850	4,610	4,330	4,320	4,930	5,870
Gross capital formation (% of GDP)	22	22	22	22	21	23
Imports (% of GDP)	30	32	32	32	32	34
Inflation (%)	5	4	4	6	7	5
Long-term debt (\$000,000,000)	31	33	35	35	36	-
Merchandise trade (% of GDP)	50	52	52	56	60	63
Population (000,000)	15.4	15.6	15.8	16.0	16.1	16.3

Source: <http://devdata.worldbank.org/data-query> - February 28, 2007

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COLOMBIA

Colombia's economy has shown some strength in the past few years. After a slow start, the GDP has been growing at a steady rate of nearly 5% in the last 3 years and is estimated that it will reach 6.0% in 2006. Inflation is also under control and is averaging just over 6%. Colombia's FDI flows are also on the rise from 2 billion dollars in 2000 to 3 billion dollars in 2004. Merchandise trade as a percentage of GDP is rising steadily from 29% in 2000 to 35% in 2005. Gross national income per capita and long-term debt of the country has remained almost at the same level over the last six years.

Colombia's economy is humming and private consumption is the main engine of growth. Consumer activity was so high in 2006 that a new shopping center was inaugurated every 23 days. Automobile sales have soared to record levels. Colombian exports rose 27% by the end of 2006 on the back of increasing oil and coal prices. Columbia's economy should continue its upward swing for a few more years. Some of the key economic indicators for Colombia are presented in Table 5.

Table 5
Selected Economic Data for Colombia

Variable	2000	2001	2002	2003	2004	2005
Exports (% of GDP)	22	20	19	21	22	21
FDI (\$000,000,000)	2	3	2	2	3	-
GDP (\$000,000,000)	84	82	81	79	97	122
GDP growth rate (%)	3	1	2	4	5	5
GNI/capita (\$)	2,060	1,930	1,840	1,840	2,010	2,290
Gross capital formation (% of GDP)	14	14	15	17	18	19
Imports (% of GDP)	19	21	21	22	21	21
Inflation (%)	12	6	6	8	6	6
Long-term debt (\$000,000,000)	31	33	30	33	32	-
Merchandise trade (% of GDP)	29	31	30	34	34	35
Population (000,000)	42.1	42.8	43.5	44.2	45.0	45.6

Source: <http://devdata.worldbank.org/data-query> - February 28, 2007

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ECUADOR

Ecuador's GDP is growing at a steady rate of 4% for the past few years and is estimated to reach 4.9% in 2006 and projected to be 4.0% in 2007. Foreign direct investments have averaged just over 1 billion dollars and inflation is under control in recent years averaging just under 7% in the last 2 years. Gross national income per capita is on the rise increasing from \$1,340 in 2000 to \$2,630 in 2005. Ecuador's merchandise trade as a percentage of GDP has averaged 50% over the past six years and its long-term debt is on the rise from 12.7 billion dollars in 2000 to 15 billion dollars in 2004. Overall the economic outlook for Ecuador is bright for the next few years. Some of the key economic indicators for Ecuador are presented in Table 6.

Table 6
Selected Economic Data for Ecuador

Variable	2000	2001	2002	2003	2004	2005
Exports (% of GDP)	37	26	23	23	24	-
FDI (\$000,000,000)	0.7	0.1	0.1	0.2	0.1	-
GDP (\$000,000,000)	16	21	25	29	33	36
GDP growth rate (%)	3	5	4	4	8	4
GNI/capita (\$)	1,340	1,380	1,560	1,930	2,360	2,630
Gross capital formation (% of GDP)	20	25	27	26	26	-
Imports (% of GDP)	31	31	31	27	26	-
Inflation (%)	-7	27	12	11	7	6
Long-term debt (\$000,000,000)	13	13	14	15	15	-
Merchandise trade (% of GDP)	54	47	46	45	47	54
Population (000,000)	12.3	12.5	12.7	12.9	13.0	13.2

Source: <http://devdata.worldbank.org/data-query> - February 28, 2007

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MEXICO

Mexico's GDP grew by 7% in 2000, but declined to 0% in 2001, 1% in 2002 and 1% in 2003. Since then, the economy has grown on an average of 4% and is projected to do the same in 2007. Gross national income per capita is on the rise increasing from \$5,110 in 2000 to \$7,310 in 2005. Mexico had 17 and 27 billion dollars in FDI flows during 2000 and 2001 respectively, but the FDI flows have declined in the past 3 years to around 15 billion dollars. Inflation is under control in recent years averaging just over 7% and is expected to continue at this rate.

Mexico's entry into NAFTA has not been all that beneficial for the country. The terms of the free trade agreement forced Mexico to focus on light manufacturing, a sectors where it enjoyed no comparative advantage—particularly on a global scale. As a result, Mexico's trade balance steadily eroded and is expected to reach a deficit of \$8.5 billion in 2007 from a surplus of \$6.5 billion a decade ago. Long-term debt and other economic indicators are all showing signs of maintaining a steady course for the Mexican economy for years to come. Some of the key economic indicators for Mexico are presented in Table 7.

Table 7
Selected Economic Data for Mexico

Variable	2000	2001	2002	2003	2004	2005
Exports (% of GDP)	31	28	27	28	30	30
FDI (\$000,000,000)	17	28	15	12	17	-
GDP (\$000,000,000)	581	622	649	639	683	768
GDP growth rate (%)	7	-0	1	1	4	3
GNI/capita (\$)	5,110	5,580	6,010	6,370	6,930	7,310
Gross capital formation (% of GDP)	24	21	21	21	22	22
Imports (% of GDP)	33	30	29	29	32	32
Inflation (%)	12	6	7	8	7	5
Long-term debt (\$000,000,000)	131	131	130	132	130	-
Merchandise trade (% of GDP)	60	54	52	54	58	58
Population (000,000)	98.0	99.0	100.0	101.0	102.0	103.0

Source: <http://devdata.worldbank.org/data-query> - February 28, 2007

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PERU

Peru's GDP grew by an average of 4% between 2000 and 2005, but is estimated to hit 7.2% in 2006 and projected to reach 6% in 2007. Inflation has remained under control averaging just over 3% for the past six years. Gross national income per capita is on the rise increasing from \$2,050 in 2000 to \$2,610 in 2005. Other economic indicators such as FDI flows, long-term debt and trade balances all remain steady for Peru.

The Peruvian economy may be the envy of some countries in the region. Export sectors such as silver and the Camisea gas fields were the most vibrant. Silver prices surged 68% last year boosting embarkations. Total exports rose 29% in 2006, a three-fold increase from the start of the decade. The strength of the Peruvian economy sparked has sparked a large increase in foreign direct investments, as well as the appreciation of the Peruvian Sol. In the long-run, Peru is expected to maintain its economic vitality and benefit from its rational economic policies. Some of the key economic indicators for Peru are presented in Table 8.

Table 8
Selected Economic Data for Peru

Variable	2000	2001	2002	2003	2004	2005
Exports (% of GDP)	16	16	16	18	21	25
FDI (\$000,000,000)	0.8	1	2	1	2	-
GDP (\$000,000,000)	53	54	57	61	69	78
GDP growth rate (%)	3	0	5	4	5	7
GNI/capita (\$)	2,050	1,970	2,020	2,150	2,360	2,610
Gross capital formation (% of GDP)	20	19	19	19	18	18
Imports (% of GDP)	18	18	17	18	18	19
Inflation (%)	4	1	1	2	6	3
Long-term debt (\$000,000,000)	24	24	26	27	29	-
Merchandise trade (% of GDP)	27	27	27	29	33	38
Population (000,000)	26.0	26.3	26.7	27.1	27.6	28.0

Source: <http://devdata.worldbank.org/data-query> - February 28, 2007

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VENEZUELA

Venezuela's GDP grew by 4% in 2000 and 3% in 2001, but had negative growth in 2002 and 2003 respectively (-9% and -8%). Since then, the economy has had robust growth of 18% in 2004 and 9% in 2005. It is estimated that Venezuela's economy will grow by 10% in 2006 and is projected to reach 7% in 2007. Gross national income per capita is on the rise increasing from \$4,100 in 2000 to \$4,810 in 2005. Peru's long-term debt has averaged around 30 billion dollars. Some disturbing trends in the economy are the double digit inflation rate that has remained around 30% and the FDI flows which have been declining steadily from around 5 billion dollars in 2000 to 1.5 billion dollars in 2004.

Venezuela is a country with immense wealth and with deep cultural ties to the U.S. In the long-run, Venezuela's economy is going to depend on the policy guidelines dictated by President Chavez. Some of the key economic indicators for Venezuela are presented in Table 9.

Table 9
Selected Economic Data for Venezuela

Variable	2000	2001	2002	2003	2004	2005
Exports (% of GDP)	30	23	30	34	36	-
FDI (\$000,000,000)	5	4	0.8	3	2	-
GDP (\$000,000,000)	117	123	93	83	110	139
GDP growth rate (%)	4	3	-9	-8	18	9
GNI/capita (\$)	4,100	4,580	3,970	3,470	4,030	4,810
Gross capital formation (% of GDP)	24	28	21	16	21	-
Imports (% of GDP)	18	19	18	17	20	-
Inflation (%)	29	8	33	35	31	29
Long-term debt (\$000,000,000)	34	31	29	30	31	-
Merchandise trade (% of GDP)	42	37	43	44	50	58
Population (000,000)	24.3	24.8	25.2	25.7	26.1	26.6

Source: <http://devdata.worldbank.org/data-query> - February 28, 2007

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CONCLUSION

This Latin American region has seen an emergence of economic power and is poised to be a major player in the global economy. Surging exports, control of inflation, and sound fiscal and monetary policies have helped countries in the region to enter the global economy. Many of the countries of the region have had steady growth rates and are experiencing renewed confidence in their economies from foreign investors. Countries such as Brazil, Bolivia, Chile, Colombia, Mexico, and Peru have had success in managing their economies and these economies should continue to perform well.

But the political situation in many countries including in Bolivia, Ecuador and Venezuela has shattered of foreign investors and may derail any potential economic gains. Due to some of the policy shifts observed among some of the countries in this region in recent months, investors are having second thoughts about Latin America and this can not be good for this region.

NIGERIAN ANTI-CORRUPTION INITIATIVES

*Ijeoma Opara**

INTRODUCTION

As the global world embarks on the fight against corruption, there is much need for a developing country like Nigeria to join the fight. Nigeria is a member of the Organization of Petroleum Exporting Countries (OPEC), but the oil revenues it receives has not translated into an improved economy because of corruption and other inefficiencies.¹ Corruption poses serious developmental challenges and undermines democracy and governance; it weakens governmental institutions and retards economic growth as it undermines foreign investments and siphons available resources needed to provide public services.² Consequently, the current global war against corruption was initiated to combat all forms of corrupt practices that have hindered the development of countries like Nigeria.

In 1977, the United States enacted the Foreign Corrupt Practices Act (FCPA) with the two primary functions of criminalizing bribery and eliminating the tax deductibility of bribery.³ Fearing that the law would disadvantage American companies when bidding for work abroad, the American government started pressuring other countries to follow suit.⁴ As a result of the mounting pressure, in 1996 the Inter-American Convention against Corruption was

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¹ See Ifiok Ibanga, *Valore International: The Economics of Privatizing and Deregulating the Nigerian Downstream Oil Sector*, available at, <http://www.florin.com/valore/ifiokibanga.html>.

² See The World Bank Group, Africa Region INFOBRIEFS: *Anti-Corruption initiatives in Sub-Saharan Africa*, No. 38, (Mar. 1999), available at, <http://www.worldbank.org/afr/findings/infobeng/infob38.htm>.

³ See Foreign Corrupt Practices Act of 1977, 15 U.S.C. § 78m, § 78dd-2, § 78ff (1994); See also Deborah Kelly, *Scandals, Laws Prompt Majors to Confront Corruption Issue*, INTERNATIONAL OIL DAILY, Sept. 24, 2003

⁴ Kelly, *supra* note 3.

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created and shortly thereafter, in 1997, the Organization for Economic Cooperation and Development (OECD) introduced the Convention on Combating Bribery of Foreign Public Officials in International Transactions (Anti-Bribery Convention) and it soon became the most widespread anti-corruption initiative to combat bribery.⁵

In 2002, the United Kingdom followed suit by introducing the Extractive Industries Transparency Initiatives (EITI).⁶ This initiative is an informational guideline aimed at increasing the transparency of payments and revenues by companies to governments in the extractive industries.⁷ It has provisions similar to the FCPA in the United States, including the characteristic of being a tough anti-bribery law, which no longer allows companies to make facilitating payments used to expedite routine business needs.⁸

Currently, almost every country, including Nigeria, has adopted some form of anti-corruption law.⁹ The fact that the anti-corruption organization, Transparency International (TI), has consistently ranked Nigeria as one of the top three most corrupt nations in the world on its Corruption Perception Index makes it clear that the Nigerian government had to take action against the corruption issue plaguing their country.¹⁰

The current initiatives undertaken by the Nigerian government to correct Nigeria's global image are the focus of this article. Part I addresses the history of corrupt practices in Nigeria, the types of corrupt practice prevalent in Nigeria and the current initiatives taken by the Nigerian government to eradicate corruption through a series of anti-corruption measures. Part II discusses other global multilateral anti-corruption laws that have helped with

⁵ *Id.*; Inter-American Convention Against Corruption, March 29, 1996, 39 I.L.M. 966, 986, available at <http://www.oas.org/juridico/english/treaties/b-58.html>. See Convention on Combating Bribery of Foreign Public Officials in International Transactions, November 21, 1997, 37 I. L. M. 1, www.oecd.org (follow "By Topic" hyperlink; then follow "corruption" hyperlink; then follow "OECD Convention/Texts" hyperlink).

⁶ See Report of the Extractive Industries Transparency Initiative London Conference, June 17, 2003, <http://www.dfid.gov.uk/news/files/eitireportconference17june03.asp>.

⁷ *Id.* (Extractive Industries are those industries that deal with oil and gas extractions).

⁸ See Lucinda A. Low et al., *The American Convention Against Corruption: A Comparison with the United States Foreign Corrupt Practices Act*, 38 VA. J. INT'L L. 243, 247-249 (1998).

⁹ Philip M. Nichols, *The Myth of Anti-Bribery Laws as Transnational Intrusion*, 33 CORNELL INT'L L. J. 627, 638 (2000); Okechukwu Oko, *Subverting the Scourge of Corruption in Nigeria: A Reform Prospectus*, 34 N.Y.U.J. INT'L L. & POL. 397, 639 (2002) (stating that "at one time, United States was the only country that controlled the corrupt activities of its residents outside its borders. Now, virtually all major trading countries and providers of cross-border direct investment regulate the actions of their residence and citizens in other countries.").

¹⁰ Oko, *supra* note 9; see also *Bangladesh Tops Bribery List*, INTERNATIONAL OIL DAILY, Oct. 7, 2003.

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the global fight against corruption. Part III looks to the sources of Nigeria's anti-corruption laws and how these laws are implemented in the current society. Part IV takes an in-depth look at the EITI and its impact on the Nigerian anti-corruption fight. Finally, this article concludes with an analysis of how far Nigeria has come in its effort to eradicate corruption, as well as an explanation of how far they have yet to go in order to conquer corruption.

I. HISTORY OF CORRUPT PRACTICES IN NIGERIA

Corruption is defined as "the abuse of public office for private gain."¹¹ While some countries differ in what they regard as corrupt practices, it is widely accepted that bribing a civil servant or public official is considered corruption.¹² Despite Nigeria's cultural and linguistic differences, its citizens almost unanimously agree that corruption has eaten into the fabric of their country, becoming so embedded in its national life, that it is accepted as a part of everyday life when doing business in or with Nigeria.¹³ Corruption in the global world has become a source of concern for most countries, including Nigeria.¹⁴ In a 2002 poll conducted by TI, more than 25,000 people out of 50,000 polled in 64 countries throughout the world said that they had paid a bribe in the last 12 months.¹⁵ Approximately half of all respondents also indicated that bribery affected business to a large extent.¹⁶ "Overall, one in 10 respondents to the survey . . . admitted that they or a member of their household ha[ve] paid a bribe in the past year."¹⁷ Corrupt practices in Nigeria have become so pervasive that between 1996 and 2002 Nigeria oscillated between the world's most corrupt and the fourth most corrupt nation with whom to do business.¹⁸ The giving and accepting of bribes is inculcated into the everyday operation of the country to such an extent that Nigerians argue it is part of the nation's culture. If you refuse to give bribes, you will likely hear from the person trying to take the bribe that "it is the culture", meaning that it is

¹¹ John D Sullivan, *Anti-Corruption Initiatives from a Business View Point*, Center for Int'l Private Enterprise (2001), www.cipe.org/pdf/publications/fs/initiatives.pdf

¹² *Id.*

¹³ The ICPC: Anti-corruption Crusade, February 21, 2003, Nigeria First: Official Website of the Office of Public Communications, http://www.nigerifirst.org/article_262.shtml.

¹⁴ John Brademas & Fritz Heimann, *Tackling International Corruption; No Longer Taboo*, S.C. Foreign Affairs, September 1998 – October 1998, at 17-22 (stating that "after years of being tolerated with a mixture of apathy, cynicism and denial, corruption is now becoming a target of serious international action").

¹⁵ *Cameroon Tops Bribery Poll*, INT'L OIL DAILY, Dec. 10, 2004.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ ICPC, *supra* note 13.

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culturally accepted to give and receive these bribes.¹⁹ Corruption is a sure path to the destruction of Nigeria. It not only affects the integrity of Nigeria in the global business world as a whole, but also the integrity of those countries with which Nigeria conducts business.²⁰

A. Types of Corruption

Corruption in Nigeria manifests itself in four major varieties, namely, occasional or opportunistic corruption, widespread corruption, systemic corruption, and finally, destructive corruption.²¹

Occasional or Opportunistic Corruption

Occasional or opportunistic corruption involves the art of paying bribes to gain unfair advantage or the art of abusing one's position by taking bribes to perform official duties one is otherwise obligated to perform by virtue of office.²² This type of corruption is so prevalent in Nigeria it is common knowledge that "greasing the palms" of public officers is expected before performance of the requested services begins. In other words, they expect some form of monetary compensation in order to perform their required function. In some situations, refusal to "grease the palm" of an official may lead to delays in obtaining the services sought.²³

Widespread Corruption

Widespread corruption is the situation in which the society as a whole endorses the taking of bribes as socially acceptable.²⁴ The presence of bribery in all facets of Nigerian industries has become so rampant that it is generally

¹⁹ After living in Nigeria for twenty-four years, it became apparent that whenever a service is requested from a public officer, it is implicitly and sometimes explicitly required to pay a bribe. As recent as July 2006, when I visited Nigeria, I saw a police officer receive a bribe from a person arrested for driving on the wrong side of traffic. When I complained to those standing around, I was promptly informed that it is the culture and was the accepted method of getting what you wanted from public officials.

²⁰ See Omar Aztar et al., *The Causes and Consequences of Corruption*, 573 ANNALS AM. ACAD. POL. & SOC. SCI. 42, 47 (2001).

²¹ ICPC website: Independent Corrupt Practices and other Related Offences Commission, Forms of corruption, <http://www.icpcnigeria.com>

²² *Id.*

²³ Cambridge International Dictionary of Idioms (2d ed. 1998), available at <http://idioms.thefreedictionary.com/grease+palm> (defining "greasing the palm" as 'to give money to someone in authority in order to persuade them to do something for you, especially something wrong' or 'to give someone money to persuade them to do what you want').

²⁴ ICPC website, *supra* note 21.

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recognized as means of obtaining any service.²⁵ In an attempt to defend these corrupt practices, Nigerians claim the “culture demands it.”²⁶

Systematic Corruption

Systematic corruption deals with situations where everyone in society – employees to employers, private citizens to office holders – attempts to reap personal gain.²⁷ This type of corruption leads to outright extortion of anyone requiring services before such services would be rendered. Systematic corruption most significantly affects the reputation of Nigeria among the international community because it impacts most on Nigerian international business transactions.

Destructive Corruption

Destructive corruption describes situations in which the rich seek to acquire more wealth, which translates into taking whatever steps necessary to grab a giant share.²⁸ This type of corruption is prevalent at the federal government level where top officials have access to the country’s financial resources. These resources are confiscated by the privileged few to the detriment of the majority who are wallowing in poverty.²⁹ Sometimes when contracts are awarded for officials to build infrastructures in a particular locality or state, they usurp the resources for their personal use, making it very difficult for the country to develop out of a poverty state.³⁰

These various forms of corruption not only stifle development, as resources are diverted to individual use, but also instill governance with inefficiency and increased costs.³¹

²⁵ John O’Shea, *Paying Aid to Corrupt Regimes No Use to Poor*, Irish Times, December 9, 2004, <http://www.globalpolicy.org/nations/launder/general/2004/1209aidcorrupt.htm>. (observing that corruption pervades all strata of the Nigerian society).

²⁶ See Oko, *supra* note 9 (stating that “the biggest challenges for Nigeria is not just punishing corrupt behavior, but also reversing the prevailing culture in which corruption is viewed as permissible, perhaps normal conduct.”).

²⁷ ICPC website, *supra* note 21.

²⁸ ICPC, *supra* note 13.

²⁹ *Id.* (stating “it manifests clearly in the rich seeking more wealth, while brazenly showing off extravagant life styles that can only provide discontent and violence”).

³⁰ See Nigeria Direct, *Nigeria: The Fight Against Corruption*, http://www.Nigeria.gov.ng/reforms_anticorruption.aspx (stating that “corruption has become so deep seated [sic] in the country that it had stunted growth in all sectors and has been the primary reason behind the country’s difficulties in developing fast”).

³¹ ICPC, *supra* note 13.

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B. Steps Necessary to End Corruption

The current President of Nigeria, Chief Olusegun Obasanjo, acknowledges, “there is need for anti-corruption initiatives.”³² These initiatives are necessitated by the level of corruption in Nigeria, which is known throughout the world. He agreed that until 1999, when he introduced Nigeria’s Corrupt Practices and Other Related Offences Act (CPROA), “the country had practically institutionalized corruption as the foundation of governance.”³³ The rise of corruption in Nigeria to unprecedented proportions led to the easy decay of societal institutions. He claimed this decay led to privatization of opportunities by the powerful, “intimidation of the judiciary, the subversion of due process, the manipulation of existing laws and regulations, the suffocation of civil society, and the containment of democratic values and institutions.”³⁴

The President, in this same address, traced the origin of corruption to the need for survival in a country where citizens are forced to devise extra-legal and informal means of survival.³⁵ He conceded that power has become nothing but a means of accumulation and subversion; as productive initiatives were abandoned, corruption was allowed to set in.³⁶ In fact, he claimed that at the root of this corruption quagmire was the virtual collapse of governance, erosion of accountability procedures, and the prevalence of bad leadership.³⁷

The address of the President demonstrated the urgent need for reforms and implementation of anti-corruption initiatives.³⁸ Nigerian corruption has eroded the public’s confidence in the country’s political and economic institutions, which in turn, has “promoted a culture of contempt for the rule of law and ultimately . . . a societal tolerance for a myriad of conducts previously considered abominable.”³⁹ The condemnation of corrupt practices is based on

³² President Olusegun Obasanjo, Nigeria: From Pond of Corruption to Island of Integrity, Lecture at the 10th Anniversary Celebration of Transparency International (November 7, 2003) <http://www.dawodu.com/obas35.htm>.

³³ *Id.*

³⁴ *Id.*

³⁵ Oko, *supra* note 9 at 416 (stating that “given the severe economic hardships, public servants often engage in corrupt practices not necessarily because of greed or avarice, but because they need extra money to meet their immediate needs”); see also Larry Diamond, *Nigeria’s Perennial Struggle Against Corruption: Prospects for the Third Republic*, 7 CORRUPTION REFORM 215, 224 (1993) (noting that many Nigerian Officials are corrupt not because of greed but for economic security).

³⁶ Obasanjo, *supra* note 32.

³⁷ *Id.*

³⁸ See Sullivan, *supra* note 11 (describing that corruption if left unchecked has a “corrosive effect on democracy and the general well being of a nation”).

³⁹ Obasanjo, *supra* note 32; see also Oko, *supra* note 9 at 413 n.60 (stating that where “corruption

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the belief that corrupt practices are inconsistent with the democratic values of good governance and the rule of law.⁴⁰ Nigerians knew they could not afford the social, political, or economic costs that systematic corruption had inflicted on their country.⁴¹ The failure to address the issue of corruption would amount to economic suicide.⁴² It became obvious that something had to be done to restore Nigeria to its former glory. The current government started by investigating what other countries had implemented to eradicate corruption, and followed suit by revisiting some of its own anti-corruption laws, promulgating new anti-corruption initiatives, and creating task forces to actualize those initiatives.⁴³

II. MULTILATERAL ANTI-CORRUPTION INITIATIVES BY INDUSTRIALIZED NATIONS

The first country to address the issue of corruption was the United States with the enactment of the FCPA of 1977.⁴⁴ The FCPA was enacted to halt the bribery of foreign officials and to restore public confidence in the integrity of the American business system.⁴⁵ The FCPA criminalized the

is tolerated on a grand scale, a culture of corruption emerges in which people feel justified in getting their piece of the action by illicit means”).

⁴⁰ See William J. Clinton, Statement by the President at the White House, Nov. 10, 1998, <http://www.usdoj.gov/criminal/fraud/fcpa/signing.htm> (noting that corruption not only undermines good governance and the rule of law but that “it is also contrary to basic principles of fair competition and harmful to efforts to promote economic development.”).

⁴¹ See Obasanjo, *supra* note 32 (stating that “reforms aimed at providing greater transparency and accountability of public institutions and government operations are urgently needed to redress our circumstances.”); See also Sullivan, *supra* note 11 (discussing that corruption is a waste of resources and without predictable economic environment, international business will be hindered).

⁴² See Nigeria Direct, *supra* note 30 (describing that TI ranking of Nigeria as among the five most corrupt nations of the world is an inglorious record that has stunted growth in all areas of endeavor in the country.).

⁴³ Oby Ezekwesili, *Ensuring Transparency in Nigeria's Oil and Gas Sector*, Alexander's Gas and Oil Connections, (Mar. 10, 2005) <http://www.gasandoil.com/goc/news/nta51048.htm> (“the Extractive Industry needed a major surgery for best practices to emerge. Hence a study was commissioned by the administration in 2000. The study revealed lapses in four broad segments namely Crude Output and Disposal; Funds Inflows; Funds Outflows; and Institutional Effectiveness. It therefore became imperative for the Administration to take decisive steps to institutionalize regular independent audits. As the Administration commenced arrangements to this end, some global dialogue was going on for mechanisms that improved transparency in the extractive sector”).

⁴⁴ FCPA, *supra* note 3.

⁴⁵ See Foreign Corrupt Practices Act: Anti-bribery Provisions, United States Department of Justice website, <http://www.usdoj.gov/criminal/fraud/fcpa/dojdocb.htm> (stating that “FCPA was passed to

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offering of bribes to foreign officials in exchange for their services.⁴⁶ The creation of this Act was necessitated by several publicized scandals involving bribery of foreign officials.⁴⁷ Investigations by the SEC in the mid-1970s “revealed that over 400 U.S. companies admitted making questionable or illegal payments in excess of \$300 million to foreign government officials, politicians, and political parties.”⁴⁸

The FCPA’s basic provisions makes it unlawful for a firm to offer, pay or promise to pay money or anything of value to any foreign official for the “purpose of obtaining or retaining business for or with, or directing business to, any person.”⁴⁹ In 1998, the U.S. Congress enacted the International Anti-Bribery and Fair Competition Act, which amended the original FCPA.⁵⁰ This new Act expanded the FCPA’s coverage in several important areas, including broadening the definition of “foreign officials” to incorporate officials of public international organizations like the United Nations, and also labeling as corrupt, payments made to obtain “any improper advantage.”⁵¹ In addition, the Act extended its reach to cover corrupt practices that occurred both within and outside the borders of the United States.⁵²

In the 1990’s other countries joined the U.S. in its fight against corruption by enacting their own laws aimed at combating corruption in international transactions.⁵³ As mentioned earlier, the OECD implemented the Anti-Bribery Convention in 1997, which, to date, has been ratified by 30 OECD member countries and implemented by six additional non-member countries.⁵⁴ It has captured “worldwide attention as the first global instrument to fight

restore public confidence in the business community after a series of bribery scandal tarnished corporate Americans image at home and abroad”).

⁴⁶ *Id.*

⁴⁷ See generally DONALD R. CRUVER, COMPLYING WITH THE FOREIGN CORRUPT PRACTICES ACT 3-5 (Section of Business Law American Bar Association 2d ed. 1999) (describing various bribery scheme that contributed to the enactment of the FCPA, including scandals involving Bell Helicopter, Exxon, General Tire & Rubber, Gulf Oil, and Lockheed Martin); see also Beverley Earle, *Bribery and Corruption in Eastern Europe, the Baltic States, and the Commonwealth of Independence States: What Is To Be Done?*, 33 CORNELL INT’L L. J. 483 (2000). (providing a sketch of the history behind the FCPA).

⁴⁸ FCPA: Anti-Bribery Provisions, *supra* note 45.

⁴⁹ *Id.*

⁵⁰ See 15 U.S.C. § 78dd-1.

⁵¹ See 15 U.S.C. § 78dd-1(f).

⁵² See 15 U.S.C. § 78dd-1(g); 15 U.S.C. § 78dd-2(i).

⁵³ ERNEST E. SMITH ET AL., INTERNATIONAL PETROLEUM TRANSACTIONS 84 (Rocky Mountain Mineral Law Foundation 2000).

⁵⁴ Convention on Combating Bribery, *supra* note 5; see also *The OECD Anti-Bribery Convention: How it works?*, (Feb. 6, 2006), <http://www.oecd.org/dataoecd/43/8/34107314.pdf>.

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corruption in cross-border business [transactions]”, and to that end it has made great headway.⁵⁵ The Anti-Bribery Convention requires advanced countries to pass laws similar to the FCPA.⁵⁶ Its most important aim and achievement is to promote high standards through the recommendations of its working group, which was implemented to “assess how effective each country’s anti-foreign bribery laws are in practice.”⁵⁷ The Anti-Bribery Convention has, thus far, contributed to leveling the competitive playing field for companies doing trans-border business.⁵⁸

When comparing it to other multilateral anti-bribery instruments, the Anti-Bribery Convention specifically targets foreign bribery, making it a crime to bribe foreign officials. It is a punishable offense for a public official or one of its signatories to bribe another public official in a developing country in order to obtain a public works contract.⁵⁹ The Anti-Bribery Convention does go “beyond ensuring that Parties outlaw bribery . . . it [also] ensures effective enforcement through systematic monitoring.”⁶⁰ It does so by mandating that the working group follow up on its signatories’ efforts to implement the standards established by the Anti-Bribery Convention.

The monitoring process utilized by the Anti-Bribery Convention is “based on a rigorous system of peer review . . . divided into two phases.”⁶¹ Phase 1 involves a comprehensive assessment of whether the country’s anti-bribery laws conform to the standards established by the OECD.⁶² Phase 2 involves “one week of intensive meetings in the examined country with key

⁵⁵ *OECD Anti-Bribery Convention: How it works?*, *supra* note 54 (outlining the success of the program since its inception).

⁵⁶ *Id.* (discussing the requirements of the OECD Convention).

⁵⁷ OECD Working Group on Bribery in International Business Transactions, www.oecd.org (follow “By Topic” hyperlink; then follow “Corruption” hyperlink; then follow “Working Group on Bribery” hyperlink) (describing that the working group is “composed of government experts from the 36 participating countries. It meets four to five times a year at the Paris Headquarters of the OECD to monitor compliance with the Convention.”); *OECD Anti-Bribery Convention: How it works?*, *supra* note 54.

⁵⁸ Sullivan, *supra* note 11 (The convention has created healthy competition because foreign companies are not afraid of being ousted because they are not willing to offer bribe to foreign officials in developing countries since the Convention does not allow bribery).

⁵⁹ Convention on Combating Bribery, *supra* note 5, at art. 1.

⁶⁰ *Id.* (describing the systematic monitoring process is done through the OECD Working Group on Bribery mandated by the OECD Convention. The Group is composed of government experts from participating countries and meets five times a year at the Headquarters of the OECD in Paris to monitor compliance with the Convention).

⁶¹ *Id.*

⁶² *Id.* (The Working Group has completed Phase 1 and as of Jan 2006 has completed Phase 2 for 27 of its member countries).

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actors from government, business, trade unions, and civil society to assess how effective that country's anti-bribery laws are in practice."⁶³ Both phases "culminate with reports of the working group's findings and recommendations for action to be taken . . . to improve compliance with the [Anti-Bribery] Convention."⁶⁴ The OECD has not only led the global fight against foreign bribery, but also provided the "framework for a united stand against corruption by the international community."⁶⁵

Following this series of anti-corruption moves, the United Kingdom developed their own anti-corruption initiatives. Prime Minister Tony Blair is at the forefront of the current war against bribery in the extractive industries. This is evident by the leading role Blair has taken in developing the Extractive Industries Transparency Initiatives (EITI), a voluntary disclosure code.⁶⁶ This initiative will allow for increased transparency of payments by companies to governments and government-linked entities, as well as transparency of revenues by those host country governments.⁶⁷ Revenues from the petroleum industry in the form of "taxes, royalties, signature bonuses, and other payments are an important engine for economic growth and social development in developing . . . countries."⁶⁸ However, lack of accountability and transparency in these revenues can exacerbate poor governance and lead to corruption, conflict, and abject poverty.⁶⁹ This is essentially what has happened in Nigeria,

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.* (describing that the reach of the Anti-Bribery Convention has truly become global as more countries become Parties to it and it reaches activities in different regions to help raise international norms. Through the commitment of its Parties, governments around the globe are taking significant steps to close the floodgates on corruption); see Sullivan, *supra* note 11 (describing that until the OECD governments agreed on this measure, many countries allowed their companies to pay bribes to foreign public officials in international business transactions. This led to the adoption of some form of convention or intergovernmental instrument to address corruption by the U.S., United Nation, European Union and council of Europe); See also Nancy Zucker Boswell, *New Tools to Fight Corruption*, ECONOMIC REFORM TODAY, No.2, 1998, http://www.cipe.org/publications/ert/e28/E28_02.pdf.

⁶⁶ *Launch of Extractive Industries Transparency Initiative (EITI)* website, DEPT. FOR INT'L DEV., http://www.dfid.gov.uk/news/files/eiti_website_launch.asp (stating "the EITI was launched by the U.K. Prime Minister Tony Blair at the World Summit on sustainable development in Johannesburg, South Africa on September 2, 2002." It is a voluntary initiative that aims to increase the transparency of natural resource revenues by developing standardized reporting requirements for companies and governments.).

⁶⁷ *Id.*

⁶⁸ Extractive Industries Transparency Initiative, Presentation to World Mines Ministries Forum (Mar 4-7, 2004), <http://www.wmmf.org/historical/2004/presentations/culverwell.pdf>.

⁶⁹ See *Fighting Corruption*, USAID Democracy & Governance, http://www.usaid.gov/our_work/democracy_and_governance/technical_areas/anti-

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a developing country rich in oil and gas resources.⁷⁰

Although Nigeria is known internationally as one of the most corrupt nations in the world, this is not due to its lack of laws proscribing corruption or its lack of anti-corruption initiatives.⁷¹ Rather, Nigeria's status is caused by the serious lack of accountability among government offices. This has allowed corruption to eat so deeply into the system of the country that considerable effort is now required to allow the country to escape the stronghold of corruption.⁷² Increasing transparency and knowledge of revenue will empower its citizens and institutions to hold the government accountable.⁷³ Open records will decrease mismanagement and diversion of funds, and in turn this will help developing countries like Nigeria attract foreign direct investment.⁷⁴

III. SOURCES OF NIGERIAN ANTI-CORRUPTION LAWS AND INITIATIVES

As previously mentioned, it is not a lack of laws that has led to the rampant corruption present in Nigeria.⁷⁵ There are several laws in the public sector proscribing corruption, including, most notably the Nigerian

corruption/index.html (noting that corruption poses a serious development challenge, undermines democracy, weakens government institution, siphons off resources needed for development thereby undermining economic growth, and generating economic distortion).

⁷⁰ Obasanjo, *supra* note 32 (describing the root of corruption in Nigeria is the erosion of accountability procedures, collapse of governance, prevalence of bad leadership and the erosion of public confidence in the country's political and economic institutions causing poverty that led citizens to devise ways of survival).

⁷¹ Oko, *supra* note 9 (describing that Nigeria, like most countries, has had and used laws and regulations to delineate boundaries of permissible conduct for public officials).

⁷² Nigeria Direct, *supra* note 30 (President Obasanjo after coming into power recognized the seriousness of the corruption problem in Nigeria and promised to make the fight against corruption in Nigeria top priority and he vowed to take decisive steps to confront this problem).

⁷³ Ezekwesili, *supra* note 43 (stating that "revenue transparency will act to increase accountability in both the executive and legislative branches of government at all levels (Federal, State, and local), reducing opportunities for corruption and the potential for waste of public funds."); see *Nigerian Government Steps up Anti-Corruption Drive*, PANAFRICAN NEWS AGENCY (PANA) DAILY NEWS WIRE, Oct. 5, 2000 (describing that as part of the steps taken to fight corruption, President Obasanjo instructed government offices to institute transparency programs aimed at curbing corruption by setting up transparency monitoring units.).

⁷⁴ Ezekwesili, *supra* note 43 (stating that "Lack of transparency is seen as a major obstacle to the creation of a favorable investment climate, better management of public resources and poverty reduction. Progress on the transparency front can be expected to attract increased finance and investment.").

⁷⁵ See *supra* Part III.

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Constitution.⁷⁶ The success of these laws, however, depends greatly on the level of enforcement given by police.⁷⁷ Just because the laws exist, does not necessarily mean they will be successful in eliminating corruption from the country.

The Nigerian Constitution of 1979 provides a code of conduct for public officers.⁷⁸ The code requires, among other things, that they publicly declare all assets at regular intervals to the Code of Conduct Bureau.⁷⁹ The Bureau itself was designed to monitor compliance with anti-corruption regulations in the code and refer those public officials not in compliance to the Code of Conduct Tribunal.⁸⁰ This tribunal, a quasi-judicial body, was established by the code of conduct to hear charges and impose penalties, including vacation of office, seizure of assets, and disqualification from office for violation of the code of conduct.⁸¹ In addition to the Nigerian Constitution there are other laws, regulations, and initiatives that have been enacted or implemented to fight corruption.⁸² As briefly mentioned earlier, the most sweeping law is the corrupt Practices and Other Related Offenses Act

⁷⁶ *Id.*; See Nuhu Ribadu, *Sanitizing Nigeria's Business Environment For Direct Foreign Investment*, Paper presented at Annual Patriots' Club of Nigeria Luncheon (Feb. 24, 2005), http://www.efccnigeria.org/index.php?option=com_docman&task=doc_download&gid=15&Itemid=78 (describing the efforts of the past government in promulgating the listed laws aimed at providing the legal framework to combat economic crimes. However, those efforts were strangled due to inadequate enabling laws and regulations or neglected for apparent lack of commitment on the part of the stakeholders to fight the menace. These laws include the Nigerian Criminal Code, Nigerian Constitution Schedule 5, Recovery of Public Property Act of 1984, Miscellaneous Offences Act of 1985, Banks and Other Financial Institutions Act of 1991, Foreign Exchange (Miscellaneous) Offences Act of 1995, The Money Laundering Act of 1995 (now repealed), Advance Fee Fraud and Related Offenses Act of 1995, Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act of 1996, and more recently The Corrupt Practices and Other related Offenses Act 1999).

⁷⁷ See Simeon Coldham, *Legal Responses to State Corruption in Commonwealth Africa*, 39 J. AFR. L. 115, 119 (notes that "[t]he use of the criminal law as a weapon in the fight against corruption . . . depends, of course, on all the actors in the criminal justice system (the police, the prosecution authorities, the courts) being both able and willing to play their roles effectively").

⁷⁸ CONSTITUTION, SCHEDULE 5 (1999) (Nigeria).

⁷⁹ *Id.* (this section also provides for the creation of the Code of Conduct Bureau itself).

⁸⁰ CONST. at Schedule 3(c) (Nigeria); CONST. at Schedule 5 at 18 (Nigeria).

⁸¹ See CONST. at Schedule 3(e) (Nigeria); CONST. at Schedule 5 at 15 (Nigeria).

⁸² See M. Adekunle Owoade, *The Military and the Criminal Law in Nigeria*, 33 J. AFRI. L. 135, 139-41 (1989) (describing all laws promulgated between 1966-1999 as being geared toward the fight against corruption but instability and political unrest led to their demise as they fall short of their intended goals. Those include: The Public officer's investigation of assets Decree No.5 of 1966, The Assets Investigation Panel created by Military head of state General Gowon Mohamed in 1975, The Corrupt Practices Decree No. 38 of 1978 (now repealed), The Recovery of Public Property (Special military Tribunals) Decree 1984(as amended)).

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(CPROA), enacted by the Nigerian Legislature on June 13, 2000.⁸³ Upon the return of Nigeria to a civilian government, President Obasanjo developed the idea for the CPROA, and although the bill was proposed in 1999, it did not pass until 2000 due to delays by the legislature.⁸⁴ Once enacted, it led to the inauguration of the Independent Corrupt Practice Commission (ICPC) on September 29, 2000.⁸⁵

The ICPC is the key agency for the war against corruption with the specific functions of preventive and investigative powers over corrupt practices, enforcement and prosecution powers against offenders, and educational and public awareness powers to educate the public about the overall evil of corruption and why it should be eliminated.⁸⁶ The CPROA was aimed at prohibiting corruption and prescribing punishment for those who violate its provisions.⁸⁷ It prohibits using bribery when bidding at auctions, for giving assistance, or using influence in the procurement of contracts.⁸⁸ It also prohibits soliciting or accepting advantages as an incentive or reward for giving assistance or in the promotion, execution and procurement of contacts.⁸⁹

In addition, the CPROA goes a step further by establishing a set of punishments for public officials who inflate the price of goods and services about prevailing market prices or professional standards.⁹⁰ It also makes it an offense to award or sign any contract without budget power, approval and cash backing.⁹¹ Among the nineteen specific offenses cited by the CPROA, the most important is the failure to report a bribery transaction.

In February of 2003, Nigeria passed the new Corrupt Practices and

⁸³ See Corrupt Practices and Other Related Offences Act, (2000) Act No. 5.

⁸⁴ See Obasanjo, *supra* note 32.

⁸⁵ Osita Agbn, *New Anti-Corruption Governments: The Challenge of Delivery* 9, Transparency International, Oct. 2004, http://www.transparency.org/content/download/4192/25973/file/Nigeria_long_Final.5_9_05.pdf, Corrupt Practices and Other Related Offences Act § 3(1). (allows for the creation of the Independent Corrupt Practices Commission).

⁸⁶ Corrupt Practices and Other Related Offences Act § 6.

⁸⁷ *Id.* at § 6(a) – (f) (setting out the functions of the Commission: to receive and investigate commission of offences and prosecution of offenders; to examine practices, systems and procedures of public bodies to direct and supervise them; to instruct, advise and assist government office or agency on ways to eliminate fraud and corruption; to advise heads of public bodies on changes that it deems fit to reduce the likelihood or incidences of bribery, corruption and related offences, to educate the public on or against bribery, corruption and related offences; and to enlist and foster public support in combating corruption).

⁸⁸ *Id.* at § 9.

⁸⁹ *Id.* at § 13, § 14-19.

⁹⁰ *Id.* at § 22(3); see Sullivan, *supra* note 11.

⁹¹ Corrupt Practices and Other Related Offences Act § 22-24, § 26-27.

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Other Related Offenses Act to “strengthen” the CPROA of 2000.⁹² However, the general belief is that this Act actually weakened the provisions of the 2000 Act because it purported to replace the Independent Corrupt Practices and Other Related Offenses Commission with an entity having lesser powers than granted under the 2000 Act.⁹³ Nevertheless, it is still geared towards the elimination of corrupt practices in Nigeria.

Other initiatives taken by Nigeria include its participation as a member of the Economic Community of West African States (ECOWAS). As a member of this community, Nigeria became party to the Attorney General and Justice Ministers’ Accra Declaration on Collaboration against corruption issued in 2001.⁹⁴ This collaboration was based on the need for all member States of ECOWAS to come together as a united body to fight against corruption.⁹⁵ Its purpose is to strengthen the mechanisms these States use to “prevent, suppress and eradicate corruption.”⁹⁶

In addition, Nigeria also joined in the development of the “inchoate sub-regional protocol on Corruption.”⁹⁷ As part of its continued commitment to the crusade against corruption, Nigeria is one of the leading continental powers behind the implementation of the New Action Plan for Africa Development (NEPAD).⁹⁸ This plan seeks to establish a platform for a new partnership

⁹² See Global Integrity, *An Investigative Report Tracking Corruption, Openness and Accountability in 25 Countries*, <http://www.globalintegrity.org/reports/2004/docs/2004/2004Nigeria.pdf> (stating “the National Assembly passed a bill replacing the ICPC with a less-powerful anti-corruption entity. Obasanjo subsequently vetoes the measure. The Assembly tries to override the veto in May, a move, which is, ruled illegal by the chief judge of the Federal High Court, who affirms the Corrupt Practices and Other Related Offenses Act of 2000”).

⁹³ *Id.*

⁹⁴ Transparency.org, Economic Community of West African States (ECOWAS): Protocol on the Fight against Corruption, http://www.transparency.org/global_priorities/international_conventions/regional_coverage/list/eco_was_protocol (last visited Apr. 22, 2007) (The ECOWAS protocol on the fight against corruption was adopted on Dec. 21, 2001).

⁹⁵ *Id.* (“The Economic Community of West African States (ECOWAS) is a regional organization of 15 West African nations formed in 1975 . . . the main objective for ECOWAS is the achievement of economic integration and shared development as a unified economic zone in West Africa. Later on, the scope was expanded to include socio-political interactions and mutual development in related spheres. The membership list includes the following countries [:] Benin, Burkina Faso, Cape Verde, Cote d’Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo.”)

⁹⁶ *Id.*

⁹⁷ ICPC, *supra* note 13 (“At the sub-regional level Nigeria was party to the ECOWAS attorneys general and justice Ministers’ Accra Declaration on Collaboration against corruption issued in 2001, in addition to joining in the development of the inchoate sub regional Protocol on Corruption”).

⁹⁸ *Id.* (seeks to “establish a platform for a new partnership between Africa [and the rest of the

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between Africa and the rest of the world in an effort to eradicate corruption.⁹⁹

In addition to ECOWAS and NEPAD, Nigeria also ratified the United Nation's Convention against Transnational Organized Crime in 2001.¹⁰⁰ It represents a major step forward in the fight against transnational organized crime and the recognition by U.N. member states that corruption is a growing problem, which can only be solved through close international cooperation.¹⁰¹ The convention is a legally binding instrument in which states that ratify it vow to take a series of measures against transnational organized crime.¹⁰² These measures include the "creation of domestic criminal offenses to combat the problem, and the adoption of new, sweeping frameworks for mutual legal assistance, extradition, law-enforcement cooperation, and technical assistance and training."¹⁰³ States who ratify the Convention will be able to rely on one another in "investigating, prosecuting and punishing crimes committed by organized criminal groups."¹⁰⁴ The Convention dealt with the overall fight against organized crime and some major specific activities in which transnational organized crime are commonly involved, such as "money laundering, corruption and the obstruction of investigations and prosecutions."¹⁰⁵

In December 2002, pursuant to its commitment to reduce corruption, Nigeria also established the Economic and Financial Crimes commission (EFCC) to investigate all financial crimes.¹⁰⁶ The EFCC established a Financial

world]" and one of its obligations is to set up "coordinated mechanisms to combat corruption effectively, as well as committing themselves to the return monies (proceeds) of such practices to Africa").

⁹⁹ *Id.*

¹⁰⁰ See The United Nations Convention Against Transnational Organized Crime, G.A. Res. 55/25, ¶ 2, U.N. Doc. A/RES/55/25 (Jan. 8, 2001); see also United Nations Office on Drugs and Crime, The United Nations Convention against Transnational Organized Crime and its Protocols, http://www.unodc.org/unodc/en/crime_cicp_convention.html (last visited Apr. 22, 2007) ("By its resolution 55/25 of November 15, 2000, the General Assembly adopted the United Nations Convention against Transnational Organized Crime. In accordance with Article 38, Annex 1 of the . . . resolution, the United Nations Convention against Transnational Organized Crime came into force on September 29, 2003).

¹⁰¹ U.N. Office on Drugs and Crime, *supra* note 100.

¹⁰² G.A. Res. 55/25, *supra* note 100, at art. 6 § (1)(a) – (b) (each state party shall take enumerated measures to combat corrupt practices).

¹⁰³ *Id.* at art. 16, 18, 27, 19.

¹⁰⁴ *Id.* at art. 18.

¹⁰⁵ *Id.* at art. 7-9, 23.

¹⁰⁶ See Economic and Financial Crimes Commission Establishment Act of 2002 (EFCCEA), Art. 5(1)(b). (describing that the powers of coordination and enforcement were vested in one body (the Commission), which had sweeping powers to enforce the Money Laundering Act of 2004, The Advance Fee Fraud and Other Related Offences Act (1995) The Failed Banks Act (1991) and any

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Intelligence Unit to strengthen its capacity for monitoring and enforcing laws against money laundering and other economic crimes.¹⁰⁷

In 2003, Nigeria also adopted the African Union Convention on the Prevention and Combating of Corruption, with the primary purpose of eliminating corruption in African Nations.¹⁰⁸ One of its main objectives is to promote and develop mechanisms required to prevent, detect, punish and eradicate corruption and related offenses in the public and private sectors.¹⁰⁹

Additionally, it aims to promote, facilitate and regulate cooperation among state parties to ensure effectiveness of its measures and actions and to establish the necessary conditions to foster transparency and accountability in the management of public affairs.¹¹⁰ The Convention covers corruption and related offenses associated with a public official's solicitation or acceptance of any benefit, gift or advantage in the performance of public duties; the diversion of public property for individual or personal use; and any illicit enrichment, or other related benefits received in the discharge of public affairs.¹¹¹ In light of these laws and commissions against corruption, it is easy to discern that corruption is not an accepted part of the Nigerian culture. Since corruption appears to be an accepted way of life, it is hard to believe it is outlawed in both private and public sectors.¹¹² The current trends of corruption in Nigeria have led to the subversion of the rule of law, the crippling of governance, and the downfall of the Nigerian economy, with Nigerian officials recognizing that desperate situations call for desperate measures.¹¹³ Therefore, the Nigerian government began investigating various ways to eradicate corruption through the implementation of several strategies aimed at combating corruption and restoring Nigeria's image in international communities, as discussed in the next section.

other law or regulation relating to economic and financial crimes including the Criminal Code).

¹⁰⁷ Press Release, White House, G8/Nigeria Partnership (June 10, 2004), <http://www.whitehouse.gov/news/releases/2004/06/20040610-34.html>.

¹⁰⁸ See African Union Convention on Preventing and Combating Corruption of 2003, Preamble, available at <http://www.africa-union.org/root/AU/Documents/Treaties/Text/Convention%20on%20Combating%20Corruption.pdf>.

¹⁰⁹ *Id.* at art. 2(1).

¹¹⁰ *Id.* at art. 2(2).

¹¹¹ *Id.* at art. 4(1)(a).

¹¹² *Id.*

¹¹³ Meaning that Nigeria desperately needs to implement measures that are aimed at eradicating corruption.

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IV. ELEMENTS OF ANTI-CORRUPTION INITIATIVES: CURRENT
INITIATIVES TAKEN BY THE NIGERIAN GOVERNMENT TO COMBAT
CORRUPTION

The Nigerian government has implemented several initiatives to combat corruption.¹¹⁴ These efforts include having more accountability in the public sector, enforcement of existing anti-corruption laws, establishment of a Public Procurement Commission, the publication of information and requirement of transparency in the petroleum industry, the requirement of transparency in the privatization and market liberalization processes, and finally, the requirement of transparency in the political process.¹¹⁵ Each initiative has its own policies and methods of enforcement, but when taken together should significantly impact, and hopefully reduce, the corruption problem.

A. More Accountability in the Public Sector

Since the public sector is known to have serious problems with corruption of public officials, emphasizing their accountability is a major step in the direction of reducing their corrupt practices. This initiative calls for new transparency, accountability, and zero-tolerance for corruption in Nigeria.¹¹⁶ To this end, the federal government created new institutions with specific authority to promote transparency in government budgets and financial operations.¹¹⁷ These measures will encourage open and competitive tender offers for government contracts.

The government also embarked on a massive anti-corruption campaign including public sector reforms that eliminate the opportunity for corruption and increased exposure of poor governance.¹¹⁸ Policies exposing corrupt practices have been adopted, in addition to implementing sanctions for such acts through an independent anti-corruption agency and an economic and financial crimes commission.¹¹⁹ It must be noted that these initiatives have not been met with overwhelming support by Nigerians as it is very difficult to create awareness in

¹¹⁴ Obasanjo, *supra* note 32 (including initiatives such as more accountability in the public sector, more transparency in the oil and gas sector, enforcement of existing laws, creation of the Due Process Mechanism, creation of the ECFF, etc).

¹¹⁵ Press Release, *supra* note 107.

¹¹⁶ See Obasanjo, *supra* note 32 (outlining these initiatives).

¹¹⁷ Ribadu, *supra* note 76 at p.3.

¹¹⁸ Obasanjo, *supra* note 32.

¹¹⁹ Ezekwesili, *supra* note 43.

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a country like Nigeria where corruption has become institutionalized.¹²⁰

B. Enforcement of Existing Anti-Corruption Laws

Although there are enough laws to address corrupt practices in Nigeria, these laws have consistently been ignored, left dormant, or not enforced at all. The current government has adopted specific policies intended to alter perceptions, attitudes and the ways in which public institutions in Nigeria work. Included in these policies is the creation of several commissions, aimed at increasing the enforcement of anti-corruption policies in the public sector.

As mentioned in an above Section, the CPROA of 2000 facilitated the creation of the ICPC, with its primary objective to deter corruption in the public sector.¹²¹ The ICPC is made up of a chairman and twelve members, two members each drawn from the country's six geopolitical zones.¹²² The Act specifically stated that the ICPC is an independent body, "not subject to the direction or control of any other person or authority."¹²³ Its members must fall into one of the following six categories, (1) a retired police officer not below the rank of Commissioner of Police, (2) a legal practitioner with ten years or experience or more, (3) a retired judge or a superior court of record, (4) a retired public servant not below the rank of director, (5) a woman, and (6) a youth between 21 and 30 years of age at the time of appointment.¹²⁴

The Act removes all litigation immunities for every citizen, including government officials of any rank, against whom complaints were lodged.¹²⁵ This provision of the SPROA established the law as an all-encompassing piece of legislation aimed at prohibiting corruption with far-reaching application to cases or actions, which were previously not regarded as criminal offenses.¹²⁶

The functions of the ICPC can be classified into three major groups, namely, prevention, enforcement, and education.¹²⁷ Under the preventive function, it has powers to examine the practices, systems and procedures of public entities.¹²⁸ It also has the power to review, direct, instruct and assist officers or governmental agencies in ways of eliminating or minimizing

¹²⁰ See Nigeria Direct, *supra* note 30.

¹²¹ Corrupt Practices and Other Related Offenses Act § 3(1).

¹²² *Id.* at § 3(3).

¹²³ *Id.* at § 3(14).

¹²⁴ *Id.* at § 3(3) (a)-(g).

¹²⁵ *Id.* at § 8-26.

¹²⁶ Corrupt Practices and Other Related Offenses Act § 8-9, §12-13, § 15-19.

¹²⁷ *Id.* at § 6(a)-(f).

¹²⁸ *Id.* at § 6(b).

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corruption by such officers or agencies.¹²⁹

Under its enforcement function, the ICPC has the power to investigate and prosecute cases of corruption and other related crimes.¹³⁰ It has the power to search, seize, arrest and summon all persons charged under the CPROA, including the power to enter buildings and premises to recover property acquired through corruption.¹³¹ It can search any person and has the power to gather any information, including privileged information, such as core attorney work product.¹³²

The education function gives the ICPC the authority and ability to educate and enlighten Nigerians on the effects of bribery and create public awareness on the need to eliminate all forms of corruption and other related crimes.¹³³ The citizens are encouraged to report corrupt practices and the ICPC promises to take prompt action once a report has been received.¹³⁴ The overall objective for the creation of the ICPC was to purge Nigeria of its corrupt mentality, and apprise the citizens of the risk involved in corrupt practices and the consequences the perpetrators of such practices will suffer.¹³⁵ The ICPC's success rate is not as high as it should be because efforts are met with significant distrust in the government's ability to fulfill its promises. As a result, Nigerians hesitate to report corrupt acts to the ICPC, however its creation is still a strong step towards the eradication of corrupt practices, and hopefully the trust of its citizens will improve.¹³⁶

¹²⁹ *Id.* at § 6(c).

¹³⁰ *Id.* at § 6(a).

¹³¹ *Id.* at § 28-29, § 36-38.

¹³² *Id.* at § 28, § 39.

¹³³ *Id.* at § 6(e).

¹³⁴ *Id.* at § 23.

¹³⁵ *Id.*

¹³⁶ See Dan Isaacs, BBC Nigeria, Analysis: Nigeria's Battle Against Corruption, <http://www.news.bbc.co.uk/2/hi/africa/2625305.stm>, (describing that one conviction in 3 years is not an impressive record. Nigeria is a federation of states with separation of powers between governments and this created a problem of enforcement for the Commission. The Nigerian Supreme Court in *Ogun State v. Federation*, 3 N.C.L.R. 166 (1982), held that "neither the President of the Federal Republic of Nigeria nor the National Assembly can unilaterally bring a state within the investigating or scrutinizing powers of the National Assembly; Although the Nigerian Supreme Court on a challenge of the constitutionality of the CPROA in *A.G. of Ondo State v. A.G. of Federal Government Of Nigeria (Fgn) & 35 Others (ors)* 6 S.C. (2002) (Pt.1) Page 1, held the Act constitutional, it held that Sections 26(3) (requiring prosecution of offenders and delivery of judgment with 90 days) is a usurpation of judicial powers, and Section 35 (allowing the commission to arrest and detain suspects indefinitely) is unconstitutional as it violates fundamental human rights; these facts coupled with the fact that the President appoints the Chairman and all members of the Commission contributed to the public distrust of the Commission and hence its slow success record).

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Another commission established was the Economic and Financial Crimes Commission (EFCC), created by an Act of the National Assembly, developed to tighten controls and enforce sanctions against fraud.¹³⁷ Some of its goals are to track financial crimes, money laundering and other economic misconducts that have created difficulties with the OECD Financial Action Task Force. The targeted fraudulent act is the widely known “419” scam, referring to the process of emailing fraudulent letters, asking for advance fees and promising shares of illicit activities.¹³⁸ This scam is named “419” because it is based on Section 419 of the Nigerian Criminal Code that makes it an offense to obtain money under false pretenses.¹³⁹ The popularity of this practice is rapidly declining as a direct result of the EFCC’s dedication to fighting these kinds of fraudulent operations.

The Nigerian government embarked on continuous reforms in their justice administration system and police force. These reforms range from an anti-corruption campaign to a provision of necessary equipment and recruitment, including more in-depth training of personnel.¹⁴⁰

C. Establishment of a Public Procurement Commission

The Nigerian government also created the Budget Monitoring and Price Intelligence Unit, also known as the Due Process Office, as part of a public procurement initiative, to commence contract award review, oversight, and a certification process.¹⁴¹ It is a mechanism that certifies, for public funding only, those projects that have “passes the test of proper project implementation packaging” and is in compliance with parameters established for open competitive bidding.¹⁴² Those certified projects must comply with the

¹³⁷ Economic and Financial Crimes commission Establishment Act, (2002) § 5(1)(b) (established to tackle financial and other related crimes).

¹³⁸ The 419 Coalition Website, <http://home.rica.net/alphae/419coal/index.htm>; *see also* “Nigeria and Corruption”, Nigeria-Planet.com, *available at* <http://www.nigeria-planet.com/Nigeria-and-Corruption.html> (stating that “the pervasiveness of 419 had made business prospecting a problem for genuine Nigerian businessmen who were being increasingly spurned by the international business community because of distrust brought about by advance fee fraud.”). *see also* Ribadu, *supra* Note 76 at 8. (commenting on the detrimental effects of corruption, describing that the advance fee fraud became the international image of Nigeria destroying the trust that the International community had and the credibility of both the government and individuals, and it discouraged genuine investors from coming into the country despite abundant opportunities therein).

¹³⁹ Criminal Code Act, (1990) Ch. 38, § 419 (Nigeria); *see generally* Criminal Code Act, (1990) Part 6, <http://www.nigeria-law.org/Criminal%20Code%20Act-Tables.htm>.

¹⁴⁰ *See* Obasanjo, *supra* note 32.

¹⁴¹ *Id.*, *see* ICPC, *supra* note 13.

¹⁴² Obasanjo, *supra* note 32 (describing that through the instrument of certification, value for money

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stringent requirements of the international competitive bid approach requiring openness in the government contract award process.¹⁴³ Since the implementation of the Due Process mechanism two years ago, the Nigerian government has saved over \$500 million through reductions in contract sums.¹⁴⁴ Accordingly, Nigeria is currently considering a bill to codify public procurement policies and to create a Public Procurement Commission with broad oversight authority on all Federal procurements.¹⁴⁵ The purpose of this commission would be to “streamline purchases, cut waste, eliminate duplication and bring sanity into business transactions.”¹⁴⁶ It will ensure that federal public procurements follow those standards set for public procurements.

D. More Transparency in the Oil and Gas Sector

As part of Nigeria’s responsibilities for joining the EITI, they began providing information about the oil and gas sector and implementing other methods to increase its transparency as well.¹⁴⁷ The current policy in Nigeria regarding the oil and gas sector is “publish-what-you-pay” and “publish-what-you-earn”.¹⁴⁸ The “Publish-What-You-Pay” Campaign is an NGO-led initiative pressing governments to require their oil and gas sector to disclose net payments including taxes royalties, fees and other transactions with the government and other public sectors for every country in which they operate or do business.¹⁴⁹ The initiative asks participants to acknowledge that transparency is crucial to effective financial management and accountability, and to recognize the need for a consistent and workable approach to disclosure

is once again returning as the fundamental premise for public expenditure and restores respect and public confidence in the contract awards process).

¹⁴³ Obasanjo, *supra* note 32; see Press Release, *supra* note 107 (describing that the procedure for government contract awards has been redesigned to conform with the standards of international competitive bidding, with emphasis on openness, competition and value for money).

¹⁴⁴ Obasanjo, *supra* Note 32; see Nuhu Ribadu, *supra* Note 76 (describing that the creation of the Due Process Office is one of the greatest efforts displayed by the President to bring accountability and transparency in public service and curbed abuse in awarding and discharging government contracts).

¹⁴⁵ Obasanjo, *supra* note 32.

¹⁴⁶ *Id.*

¹⁴⁷ See Ezekwesili, *supra* note 43 (noting that the government initiated transparency and accountability policies like the Ministry of Finance’s monthly publication of revenue allocation figures of all tiers of government, transparency of the budgetary processes and deregulation and liberalization of the petroleum sector).

¹⁴⁸ Obasanjo, *supra* note 32 (stating that “the position as of today is that Nigeria is resolutely committed to the “publish-what-you-pay” and “publish-what-you-earn” initiative).

¹⁴⁹ *Publish What You Pay*, <http://www.publishwhatyoupay.org/english/> (updated November 2006).

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of payments and revenues, especially in the petroleum industry.¹⁵⁰ Pursuant to this mandate, the administration will allow for a checks and balances approach by providing information about its actions, receipts and expenditures in the oil sector.¹⁵¹ Demonstrating a move in the right direction, the administration published budgets, records or revenue collection, and statutes and rules dealing with the oil and gas industry.¹⁵²

The government also encouraged the Nigerian National Petroleum Corporation (NNPC) and other oil companies doing business in Nigeria to make full disclosure of revenue and cost of operations. In order to remove public doubts about one-sided figures, this information is then cross-referenced with data published by the Nigerian government.¹⁵³ Additionally, the offices of Accountant General and Auditor General of the Federation were asked to improve transparency and thereby reduce corruption by publishing information related to revenues.¹⁵⁴

Furthermore, to boost transparency in producing countries the Nigerian Government will publish monthly details of oil and gas earnings.¹⁵⁵ This initiative is accomplished by “working with representatives from both the private and public sectors and the civil society through a National Stakeholders Working Group (NSWG).”¹⁵⁶ The NSWG has “engaged the U.S. Goldwyn International Strategies to help set the terms of reference and scope for an independent audit of Nigeria’s extractive industries.”¹⁵⁷ Goldwyn drafted a program of physical audits designed to provide a complete picture of the oil and gas industry that has been produced, lifted, lost, refined and exported between 1999 and 2004. The audits also provide a review of financial flows, showing who has paid how much money and to whom; and a process of auditing to cover

¹⁵⁰ *Id.*

¹⁵¹ Press Release, *supra* note 107 (showing that as part of the EITI policy, the Nigeria government has established an oil and gas Accounts Unit in the Federal Ministry of Finance for the purposes of forwarding accounting of expenditures and revenues in the oil and gas sectors).

¹⁵² *Id.* (describing that the government now reports revenue and costs received/incurred from/by the oil sector on a quarterly basis as of September 2004).

¹⁵³ Obasanjo, *supra* note 32; see also Christina Katsouris, *Nigeria Outlines Plan to Audit Oil Sector*, INTERNATIONAL OIL DAILY, April 21, 2005, <http://www.transparency.org/index.html>.

¹⁵⁴ Obasanjo, *supra* note 32.

¹⁵⁵ *Id.*

¹⁵⁶ Katsouris, *supra* note 153; see also Press Release, *supra* note 107 (stating that “a standing multi-stakeholders group of twenty-seven drawn from the private sector, civil society and public sector has been set up to implement transparency of revenue from oil, gas and solid minerals”).

¹⁵⁷ Katsouris, *supra* note 153; see also Press Release, National Stakeholders Working Group of NEITI, Nigerian Releases Results of Three Historic Audits of its Oil and Gas Sector (April 11-12, 2006), <http://www.neiti.org/pressrelease4-26-06.pdf> (demonstrating that Goldwyn International Strategies was the lead adviser to the working group under the audit initiative).

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capital expenditure proposals, checks and balances in the import of products, comparative analysis, benchmarking and recommendations for improvement.¹⁵⁸ As part of the transparency initiative, the Nigerian government selected the United Kingdom's Hart Group to conduct an audit of the country's oil activities over the past five years.¹⁵⁹ Following guidelines set by the EITI, "the audit will focus on the amount of oil produced, revenues received by the government and the administration of joint venture operations."¹⁶⁰ In addition, the audit assesses whether payments have been recorded in the Central Bank of Nigeria.¹⁶¹ It is said to be the most comprehensive energy sector transparency audit conducted in the world.¹⁶²

The assessment under the Nigerian EITI will be "three-tiered, including a physical audit of oil output, exports, and domestic consumption; a financial audit of payments made by oil companies and revenues received by the government; and a process audit looking at operations and procedures in terms of financial management and procurement relating to joint ventures."¹⁶³ In addition, it aims to review whether there are any discrepancies between the amount oil companies claim to have paid to the Nigerian government and what the government declares to have actually received.¹⁶⁴ Those reports will be broadly published and any discrepancies found from the audit will be investigated and corrected by the EITI.¹⁶⁵

The Nigerian Government has always zealously guarded the oil and gas industry, keeping revenue earned from that industry a closely guarded secret.¹⁶⁶ Additionally, the NNPC and joint venture partners, such as Exxon Mobil and ChevronTexaco, are generally unwilling to publish detailed accounts

¹⁵⁸ Press Release, *supra* note 157.

¹⁵⁹ Deborah Kelly, *Nigeria Hires Firm for Oil Sector Audit in Bid to Shake off Corruption Reputation*, INTERNATIONAL OIL DAILY, March 17, 2005, <http://www.transparency.org/index.html>.

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

¹⁶² Press Release, *supra* note 157 (stating that "the audits looked deeper into the conduct of government and industry practices in Nigeria than any country has ever attempted. The Nigerian example demonstrates that to create transparency in the energy sector it is essential to look beyond financial flows to how the State manages the energy sector itself. We have been honored to assist the NSWG in this groundbreaking enterprise").

¹⁶³ Kelly, *supra* note 159; see also Completed Audits and Reports: Financial audit <http://www.neiti.org/FARFinFinancial%20Flows.pdf>; Physical audit <http://www.neiti.org/FARPhysical%20Audit.pdf>; and Process audit <http://www.neiti.org/FARProcessMKtinGas.pdf>.

¹⁶⁴ Kelly, *supra* note 159.

¹⁶⁵ See Ezekwesili, *supra* note 43.

¹⁶⁶ Katsouris, *supra* note 153.

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of their Nigerian operational budget.¹⁶⁷ This secrecy has created a considerable amount of suspicion among Nigeria's citizens, who accuse consecutive governments and oil companies of diverting cash away from funds supposed to be used for public service and rebuilding the infrastructure.¹⁶⁸ This current situation led to the creation of systems for "monitoring and checking expenditures in every Ministry, including Nigeria's Department of Petroleum Resources, which regulates the oil sector."¹⁶⁹ Its development is hoped to increase the disclosure of earnings in this industry and thereby improve the public's opinion and confidence in the oil and gas sector.

E. Transparency in the Privatization and Market Liberalization Processes

In order to comply with the EITI Nigeria, with the assistance of the World Bank, implemented a process of increasing transparency in the privatization and liberalization of key economic sectors.¹⁷⁰ For example, the sale of government-held equity in cement, petroleum marketing and banking companies in 2000 and 2001 was for the first time in recent years, accomplished through "open, competitive bidding."¹⁷¹ Additionally, the Nigerian Government offices and private companies are working to increase transparency in advertising all advisory services procured, assets and shared bought and sold, and live televised auctions with national coverage for all divestiture transactions.¹⁷²

F. Political Transparency

A country cannot claim to be democratic if its political process is not transparent. Several initiatives are being implemented to ensure increased political transparency in Nigeria. There are ongoing local governmental reforms "designed to check indiscipline, waste, disorganization, inefficiency and corruption" at that level, along with a campaign to encourage adoption of federal reforms by various state governments.¹⁷³

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ Obasanjo, *supra* note 32.

¹⁷¹ *Id.*

¹⁷² *Id.* (noting that the televised auction of digital mobile licenses carried out with the assistance of UK in 2001 was the most transparent license auction in the world. The World Bank, USAID and DFID are also helping out with phase 2 & 3 of the privatization and market liberalization program).

¹⁷³ Obasanjo, *supra* note 32 (describing that the combined efforts of federal reforms, state level reforms, and reforms at the local government level will place Nigeria on a new pedestal that will transform the country from a pond of despair and corruption to an island of hope, growth and integrity. These reforms include: budget and fiscal transparency, public procurement legislation,

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Nigeria has also partnered with the G8 industrial nations to fight corruption in a “Compact to Promote Transparency and Combat Corruption.”¹⁷⁴ It acknowledges that “promoting transparency and integrity and fighting corruption require commitment and action on all sides.”¹⁷⁵ The Nigerian Government is employing several strategies as it pursues its goals in conjunction with the G8 members with a “spirit of partnership and mutual respect.”¹⁷⁶

The actions taken to enforce political transparency demonstrate that the Nigerian Government is aware that corruption is a significant problem for the country and that proactive steps need to be taken to combat this issue.

G. Extractive Industries Transparency Initiatives

Nigeria has embarked on a comprehensive national anti-corruption strategy, and in doing so, has made a pivotal step towards accelerating the rebuilding of the nation’s integrity systems.¹⁷⁷ These integrity systems include democracy good governance, economic development and growth of available resources.¹⁷⁸ The anti-corruption initiatives, created after agreeing to participate with EITI, are all part of a larger framework of structured reforms. These strategies include budget and fiscal transparency, public procurement legislation, the build-up of policy and administration anti-corruption institutions, and public service reform.¹⁷⁹ These transparency initiatives were

policy and administration, extractive industries transparency initiatives, anti-corruption institutions build-up, public service reform, transparency in open and competitive bid processes for government contracts, transparency in privatization and market liberalization processes, transparency in political processes, massive anti-corruption campaigns, information and transparency in government processes, reforms in the judiciary, legislature and ministries and government agencies).

¹⁷⁴ Press Release, *supra* note 107 (the G8 countries consists of –Canada, France, Germany, Italy, Japan, the Russian Federation, the UK and the USA. Together these countries take part in year-round conferences and policy research, and have a yearly summit to discuss their yearly work. These countries, while representing only 14% of the world’s population, account for almost 65% of the world’s economy).

¹⁷⁵ Obsanjo, *supra* note 32.

¹⁷⁶ *Id.*

¹⁷⁷ See Nigeria First – Features, 2003-2005: *The Journey So Far*, May 29, 2005, http://www.nigeriafirst.org/printer_4085.shtml; See also Ezekwesili, *supra* note 43 (stating that Nigeria’s decision not to be “perceived as the poster child for corruption” is “embodied in [the] rigorous commitment she has made to entrench the principals of transparency and accountability within the country and that those “comprehensive anti-corruption strategies” are beginning to deliver good governance goals for which they are intended).

¹⁷⁸ See USAID, Democracy and Governance: Anti Corruption Strategy, Washington D.C., Jan. 2005,

http://www.usaid.gov/our_work/democracy_and_governance/publications/pdfs/ac_strategy_final.pdf.

¹⁷⁹ Press Release, *supra* note 107.

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implemented to promote stability, accountability, efficiency, service delivery and a grassroots democracy.¹⁸⁰

Along with the initiatives and actions already undertaken by the Nigerian Government, there are additional measures recently announced to combat corruption.¹⁸¹ While this list is not all-inclusive, it demonstrates the proactive approach by the Nigerian Government to put an end to this serious problem plaguing the country. The measures include:

- a) sensitizing the selective stakeholders and requiring them to hold workshops;
- b) calling upon NGO's Civil Society, NNPC, Chevron, Shell and all companies to play their own role in this process by becoming more transparency in their dealings;
- c) issuing proposal requests to consultants to draft Tax Filings of Oil Revenue (TOR) in order to auditors to review annual accounts and tax filings of oil companies;
- d) proposing the auditing of government oil accounts including, NNPC and Central Bank of Nigeria accounts;
- e) implementing ways to disseminate the information regarding oil and gas revenue to the public;
- f) developing templates for reporting information about gas production, sales and revenues on a semi-annual basis, and developing templates for reporting on a semi-annual basis;
- g) providing semi-annual oil account reports to the public, posting it on the Economic Reform/NEEDS website, newspaper publications, and allowing Civil Society monitoring;
- h) establishing oil and gas accounts modeling an oversight unit in the Ministry of Finance;
- i) increasing EFCC officer strength to a 400 person staff;
- j) investigating resources and physical enabling environment;
- k) establishing a Financial Intelligence Unit;
- l) reviewing money laundering legislation to conform to Financial Action Task Force;
- m) launching communications campaign and database programs for combating the "419" scam;

¹⁸⁰ See Obasanjo, *supra* note 32 (identifying as imperative the need to restore the rule of law with social institutions firmly rooted in principles of equality, justice, peaceful co-existence, transparency, accountability and responsible leadership).

¹⁸¹ FEDERAL MINISTRY OF FINANCE, CORE ECONOMIC REFORM PROGRAM: FIGHTING CORRUPTION, IMPROVING TRANSPARENCY AND ACCOUNTABILITY (Sept 2003-2005), <http://www.fmf.gov.ng/detail.php?link=erp>.

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- n) establishing EFCC training school for capacity and specialized training of personnel;
- o) amending ICPC legislation to accelerate prosecution of convicted individuals and businesses and setting up an independent steering committee of civil society, private sector for oversight of ICPC conduct;
- p) drafting legal and judicial reform strategies appropriately aligned with implementation plans;
- q) extending the “due process” initiative to cover all governmental agencies not presently covered;
- r) publishing new procurement guidelines to government agencies and the public;
- s) setting up resident “due process” teams in all Federal Ministries and Agencies to complement departmental tender boards and federal tender boards;
- t) organizing stakeholders’ workshops on review of procurement policies and bills;
- u) issuing and making public an Auditor General’s report.¹⁸²

CONCLUSION: NIGERIA – FROM PONDS OF CORRUPTION ON THE ROAD TO SUCCESS

Nigeria has made a host of reforms and put into place a host of measures designed to help fight the war against corruption. The former Chairman and founder of the TI group, Dr. Peter Eigen, acknowledged that Nigeria has truly embraced the need to eradicate corruption.¹⁸³ He recognized that Nigeria is one of the first nations to go a step further than the EITI by requiring not only that all data regarding revenue from petroleum industries be published, but also that the foreign oil companies doing business in Nigeria publish what they have paid in order to conform to a checks and balances system.¹⁸⁴ He pointed out that the Nigerian Government published a comprehensive auditory report showing physical finance and physical flow in February 2006.¹⁸⁵ The requirement that oil companies doing business with

¹⁸² *Id.*

¹⁸³ Peter Eigen, Fighting Corruption in a Global Economy: Transparency Initiatives in the Oil and Gas Industries, Address at the University of Houston International Law Journal symposium (April 12, 2006), in HOUS. J. INT’L L., Spring 2007.

¹⁸⁴ *Id.*

¹⁸⁵ *Id.* (stating that “Nigeria has gone beyond the most basic level of EITI, and requires the open publication not only of aggregated payments from oil companies to government, but also the breakdown by individual companies production fields and category of payment”).

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Nigeria publish production fees and capital has brought criticism from companies who are unhappy with this degree of disclosure and believe that with this move, Nigeria has gone far beyond what is required under the EITI.¹⁸⁶

Although Nigeria is heading in the right direction with its efforts to eradicate corruption, they cannot accomplish this daunting task in solitude. The help of the international community is needed to win the war against corruption because, as the President stated “less rhetoric and more actual support would help reinforce anti-corruption reforms in our countr[y].”¹⁸⁷ He urged TI to publish a Corruption Encouraging Index and a Corruption Reduction Effort Index in addition to the currently published Corruption Perception Index “to give the total picture on the campaign against corruption and corrupt practices nationally and globally.”¹⁸⁸ He believes that only such a holistic approach will give a realistic picture of the task that certain nations like Nigeria have undertaken to see that corruption is a thing of the past in their country.¹⁸⁹

It is obvious that Nigeria has recognized its corruption problem, and it is clear that it has to implement reforms and measures to combat it, however, despite Nigeria’s efforts more work is still required to restore Nigeria’s integrity.¹⁹⁰ There is a general distrust of the government among Nigerian citizens and as such most of these reforms are viewed as politically motivated. This distrust has risen to a greater height in the wake of the President’s move to amend the Nigerian Constitution to allow for third term re-election.¹⁹¹

However, the renewed drive to curb corruption and improve transparency in government affairs may renew confidence in the government to combat corrupt practices and reduce financial crimes. This, in turn, may attract foreign investors to Nigeria and restore the rule of law. While the problem of

¹⁸⁶ *Id.* (describing it is disappointing to discover that companies, previously arguing that their position is to comply with legal requirements of host government, is now objecting when required to adhere to a higher degree of transparency than they expected).

¹⁸⁷ Obasanjo, *supra* note 32.

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ Christina Katsouris, *Nigeria’s Anti-Corruption Drive Serious This Time, Official Says*, INTERNATIONAL OIL DAILY, Apr. 19, 2004, <http://www.energyintel.com> (stating that because corruption “pervades many layers of the Nigerian government and energy sector”, the task to eradicate corruption in Nigeria is a “Herculean” one); *see also* Ezekwesili, *supra* note 43 (stating that “corruption, a development challenge that Nigeria must crack for its greatness to emerge is definitely not a piece of cake. But one thing is certain. And that is, that the courage to take it on with all arsenals possible is half the battle won”).

¹⁹¹ Alfred Obiorah Uzokwe website, <http://www.nigeriaworld.com/columnist/uzokwe/051506.html> (stating that if Obasanjo “succeeds in changing the Constitution to rule for a third term or what others call a fourth term, the floodgates would have been opened; a precedent would have been set that amendment of Nigeria’s constitution is as easy as ABC”).

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corruption has been prevalent for a significant period of time in Nigeria, judging by the number of programs currently implemented, the will to combat corruption has become more resilient and creates a renewed hope for a corrupt-free Nigeria in the future. The war against corruption in Nigeria is far from being over. Progress has been made, but the President, the people of Nigeria and the global community look forward with anticipation to the day when Nigerians can say that their country has triumphed over corruption and restored integrity to its institutions and the nation as a whole.

KINDER MORGAN: WHEN MANAGEMENT CONCEALS A BUYOUT FROM THE BOARD OF DIRECTORS

*Jonathan Tiegerman**

Chief management officials at Kinder Morgan, Inc. considered the prospect of a leveraged buyout for months before letting the oil-and-gas pipeline company's Board of Directors in on the deal.¹ The actions of management, keeping the Board in the dark about the developing private equity buyout, which marks one of the largest of its kind (\$14.8 billion), illustrates the divergent interests of top management and directorial boards in today's public companies.

The wedge driven between a company's Board of Directors and its managerial foremen, often in the form of handsome compensation packages promised to management by private equity buyers, highlights an old concern for public investors but with a new twist: In private equity deals, investment banks are now seeking to concurrently don multiple hats as both advisor to the target company and as investor in the target. This is precisely the scenario that has unwound in the Kinder Morgan buyout whereby Goldman Sachs Group Inc. initially acting as financial advisor to Kinder Morgan later became a principal investor in the public-to-private buyout of its client.²

The story begins in February of 2006 when Kinder Morgan president C. Park Shaper enlisted Goldman Sachs to propose strategies in order to augment the gas-and-oil pipeline company's shareholder value. The alternative of a leveraged buyout was not suggested until March. In April, president Shaper was joined by Rich Kinder, founder of Kinder Morgan and 18% owner of the company at the time, who was to lead a potential buyout group. The private equity arm of the world's foremost investment bank, Goldman Sachs Capital Partners had negotiated a not-so-shabby arrangement with the Kinder Morgan management buyout group to serve as the leveraged buyout's principal investor.

In the subsequent months, the terms of the buyout were negotiated (although negotiations imply a degree of contentiousness which I surmise was lacking here) with Goldman Sachs Group on one side of the negotiation table

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¹ See Berman, Dennis and Henny Sender, *In Kinder LBO, Board Was Left in Dark For Over 2 Months as Deal Percolated*, WALL STREET JOURNAL, Sept. 29 2006 at C1.

² See *id.*

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advocating the interests of Kinder Morgan shareholders opposite Goldman Sachs Capital Partners, representing the investment bank's proprietary interests. News of these ongoing developments did not reach Kinder Morgan's Board until May 13.³ Already in place at that time were the armies of lawyers, from Weil, Gotshal & Manges LLP, and Wachtell, Lipton, Rosen & Katz, hired to advise the management buyout group in the public-to-private transaction.

REVLON: DUTY TO AUCTION THE CONCERN TO THE HIGHEST BIDDER

In this situation, the Board and management possess conflicting interests. Consequently, the amount of time the Board is given before shareholders vote on the buyout may significantly weigh upon the success of the buyer's bid. The Board of Directors, upon learning of the potential sale of the company, will attempt to control the process and the terms of the sale in a manner most favorable to the company's shareholders. This reflects the edict handed down by the *Revlon* case adjudicated during the leveraged buyout boom of the 1980s.⁴ In *Revlon*, the court opined that the directors' fiduciary duty to maximize shareholder profits could only be accomplished by obtaining the highest price for the benefit of the stockholders.⁵

Application of a Revlon duty depends upon the effect the corporate combination will have on stockholders' meaningful participation in corporate governance.⁶ Thus, the demarcation between Revlon and non-Revlon deals hinges upon a change of corporate control.⁷ If there is a change in corporate control, as in a leveraged buyout, wherein shareholders will no longer participate in corporate governance because they are "cashed out", a Revlon duty is triggered. This is in contrast to a stock-for-stock merger, for instance, wherein shareholders will retain their voting rights via newly issued stock in the surviving company: this transaction is entitled to business judgment deference.⁸ This result is equitable since the shareholder who receives stock in the surviving corporation has preserved her right to enjoy the future maximization of wealth and has presumably lost nothing.

The significance of a change in corporate control is deserving of a Revlon duty to protect shareholder interests: "there are few events that have a

³ See *id.*

⁴ See *Revlon, Inc. v. Macandrews and Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

⁵ *Id.*; see also *Smith v. Van Gorkom*

⁶ See ALLEN, WILLIAM T. & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 540 (Aspen Publishers 2003).

⁷ *Id.*

⁸ See *In re Santa Fe Pacific Corp. Shareholder Litigation*, 669 A.2d 59 (Del. 1995).

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more significant impact on the stockholders than a sale of control or a corporate break-up. Each event represents a fundamental (and perhaps irrevocable) change in the nature of the corporate enterprise.”⁹ Revlon reaches a logical result since a holder of equity who is pushed out of the company is denied participation in the future profits of the company. That shareholder has a compelling right to enjoy a maximization of profits today since there is no pot of gold at the end of the rainbow.¹⁰

Faced with a buyout which would effectuate an immediate divestiture of the shareholders’ present and future interests in Kinder Morgan, Inc., the Board of Directors owed a Revlon fiduciary duty to put the company up for auction in order to fulfill its obligation to shareholders to obtain the richest purchase price. The competing financial interests of the management buyout group to see the private equity bid succeed were furthered by CEO Rich Kinder’s evasive tactics. As aforementioned, the Board of Directors only became aware of Goldman’s buyout proposal two months after the advisory firm initiated discussion of the transaction due to management’s careful concealment of the matter. Mr. Kinder and his constituents appeared to entrench the company from competing offers agreeing, at the behest of Goldman’s private equity arm, not to negotiate competing bids with third parties for 90 days.¹¹ Such maneuvers suggest that the rights of Kinder Morgan shareholders to enjoy a present maximization of wealth may have been pretermitted.

THE ROLE OF THE BANKER

Investment banks are generally responsible for pricing and structuring transactions that satisfy the needs of market participants. By distributing products and making markets, investment banks provide a forum for buying and selling in the context of business combinations (M&A) and underwriting (capital formation). More simply, investment banks lead clients who are mired in some quandary to firmer ground by advising clients on creating frameworks for internal capabilities and proposing external opportunities. Financial advice may take the form of negotiating the terms of a deal, analyzing financial, commercial operational, and strategic assumptions of a business, rendering valuation assessments of a business combination’s price risk, implementing a stock price performance analysis, a discounted cash flow analysis of a target

⁹ See *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34 (Del. 1994).

¹⁰ See *supra* note 6 (explaining that “public shareholders cannot participate in the long-term strategic value of the [merger].”)

¹¹ See Berman, Dennis and Henny Sender, *In Kinder LBO, Board Was Left in Dark For Over 2 Months as Deal Percolated*, WALL STREET JOURNAL, Sept. 29 2006 at C1.

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company's earnings and estimated future earnings, or various other services.

The horizontal design of investment banks and pedigree personnel provide the heavy firepower that clients desire in devising and executing business strategies in short periods of time. Because of the technical nature and exclusivity of the complex solutions engineered by investment bankers, a kind of trustee-client relationship naturally follows.

Of considerable controversy are the fairness opinions issued by investment banking institutions. The opinion is supposed to provide assurance that a deal is fair from a financial standpoint. Because the fairness opinion insulates a company's officers and directorial Board from legal liability to company shareholders¹², companies are willing to pay hefty sums for this flimsy document.¹³ Moreover, the subjective nature of the determination that a deal is fair makes the opinion nearly immune from challenge and of minimal value to shareholders in deciding whether to support or vote against a deal.

CONFLICTS OF INTERESTS: BANKERS CAN DO WHAT LAWYERS CANNOT

The relationship existing between investment bankers and their clients during the rendition of advisory services is not substantially unlike the attorney-client relationship. From the perspective of the client, the advisor (whether a law firm or an investment bank) is expected to remain loyal to the client's interests for which the advisor has been employed. On the basis of this expectation of loyalty, investment bankers will be privy to confidences and secrets that the client would not otherwise reveal. Thus, analyzing the potential conflicts of interest that may eventuate in the analogous attorney-client relationship, according to the ethical boundaries of legal standards, may provide some insight into the potential means by which banker-client conflicts should be addressed.

The "conflicts of interest" issue is one that lawyers have struggled with for many years in determining when an attorney is not fit to represent a client because of a conflict of interest. The conflict of interest embodies the age-old premise that "no man can serve two masters."¹⁴ As admitted by Roy Simon, preeminent professor in the field of lawyers' ethics, conflicts of interests remain thorny matters to evaluate because of the corresponding "complexities of even

¹² See *e.g.* Weinberger v. UOP, Inc., 517 A.2d 653 (Del. 1986).

¹³ See *e.g.* Daimler-Chrysler Merger Agreement (substantiating the \$55 million that the Chrysler Board paid Credit Suisse First Boston for its opinion that the terms of the merger of equals with Daimler Benz were fair.).

¹⁴ Thomas D. Morgan & Ronald D. Rotunda, PROFESSIONAL RESPONSIBILITY: PROBLEMS AND MATERIALS at 174 (8th ed. 2003)(quoting Matthew 6:24).

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garden variety conflicts questions.”¹⁵ The analysis begins with a discussion of concurrent conflicts. Under the New York Code of Professional Responsibility and the equivalent ABA Model Rule, a lawyer is prohibited from accepting or continuing representation of a client where doing so would be directly adverse to the interests of another client; i.e. advocating the interests of one client directly harms the interests of another current client. This was the holding of the Second Circuit¹⁶, thereafter enacted in the New York Code of Professional Responsibility (DR § 5-105(a)):

A lawyer shall decline proffered employment if the exercise of independent professional judgment in behalf of a client will be or is likely to be adversely affected by the acceptance of the proffered employment, or if it would be likely to involve the lawyer in representing differing interests, except to the extent permitted under subdivision (c) of this section.¹⁷

Subsection (c) elaborates on the former providing that independent professional judgment is not deemed to be adversely affected “if a disinterested lawyer would believe that the lawyer can competently represent the interest of each and if each consents to the representation after full disclosure of the implications of the simultaneous representation and the advantages and risks involved.”¹⁸ Therefore, notwithstanding a concurrent conflict, a lawyer may accept or continue representation of directly adverse clients if each client gives informed consent (preferably confirmed in writing) and if the lawyer meets the “disinterested lawyer” standard defined in DR § 5-105(c). This standard is an objective one: if Jiminy Cricket believes the lawyer will be able to provide competent and diligent legal representation, then the attorney’s independent professional judgment is deemed in tact and the representation is free to commence or continue.

Another kind of conflict involves the situation where the lawyer

¹⁵ Roy D. Simon, *Final Conflicts Exam: There’s a Will, but Is There a Way?* THE NEW YORK PROFESSIONAL RESPONSIBILITY REPORT, Jul. 2006, at 1.

¹⁶ *Cinema 5 v. Cinerama, Inc.*, 528 F.2d 1384 (2d Cir. 1976).

¹⁷ Stephen Gillers & Roy D. Simon, *Regulation of Lawyers: Statutes and Standards*, NEW YORK DISCIPLINARY RULE § 5-105 (2006); *see also e.g.* NY DR § 5-101 (2004)(stating that “a lawyer shall not accept or continue employment if the exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer’s own financial, business, property or personal interests, unless a disinterested lawyer would believe that the representation of the client will not be adversely affected thereby and the client consents to the representation after full disclosure of the implications of the lawyer’s interest.”).

¹⁸ NY DR § 5-105(c) (2006).

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obtains a financial interest that is potentially adverse to the interests of his/her client. Ethical Consideration 5-4 of the New York Code of Professional Responsibility illustrates the drafters' concerns in one instance where during the course of an attorney-client representation, a client under criminal prosecution agrees in place of a fee (either in whole or in part) to grant the lawyer a beneficial ownership in literary rights relating to the subject matter of the legal representation. Here, there is a risk that the lawyer "may be tempted to subordinate the interests of the client to the lawyer's own anticipated gain. For example, a lawyer in a criminal case who obtains from the client television . . . rights with respect to the case may be influenced, consciously or unconsciously, to a course of conduct that will enhance the value of the [television] right to the prejudice of the client."¹⁹ This conflict can also be cured by informed consent so long as the attorney's independent professional judgment is uncompromised.

Several policy arguments underlie the legal profession's cynicism toward legal practitioners engaging in representations, which pose potentially significant risks of concurrent conflicts. Specific to lawyers alone, the attorney client relationship binds the attorney with a duty of confidentiality.²⁰ Hence, there is concern where a concurrent conflict exists, an attorney possessing confidential information about Client A in an earlier or present matter would be tempted to use such confidential information when later representing Client B against Client A to the disadvantage of Client A.

The other policy reason against concurrent conflict representations stems from the client's expectation of loyalty from his trusted advisor. The sacrament that is the expectation of loyalty was best illustrated by a Connecticut state court:

When a client engages the services of a lawyer in a given piece of business he is entitled to feel that, until that business is finally disposed of in some manner, he has the undivided loyalty of the one upon whom he looks as his advocate and his champion. If as in this case, he is sued and his home attached by his own attorney who is representing him in another matter, all feeling of loyalty is necessarily destroyed, and the profession is exposed to the charge that it is interested only in money.²¹

¹⁹ Stephen Gillers & Roy D. Simon, *Regulation of Lawyers: Statutes and Standards*, NEW YORK CODE OF PROFESSIONAL RESPONSIBILITY DISCIPLINARY RULE § 5-101 (2004).

²⁰ See NY DR § 4-101 (2006).

²¹ *Grievance Committee v. Rottner*, 203 A.2d 82 (Conn. 1964).

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While this duty is legally binding betwixt lawyers and their clients, the expectation of loyalty is not exclusive to the legal profession. The legal seal stamped upon the attorney-client relationship is largely a consequence of the sacred regard with which we behold the relationship due to its historical significance and longevity in Western society. Our protection of the former relationship is also the result of longstanding concern that the erosion of the attorney-client relationship, and consequently the fiduciary's violation of this confidence, poses catastrophic damages to the client's interests.

Substituting a single law firm for Goldman Sachs in the Kinder Morgan scenario and applying the aforementioned ethical standards, we reach the undeniable conclusion that concurrent representation of both the leverage buyout group (headed by CEO Rich Kinder) and Kinder Morgan, Inc. in this public-to-private transaction would certainly lie outside the realm of ethical standards maintained by any of the 50 States.²²

SARBANES OXLEY, ENRON, AND THE VOID LEFT FOR SELF-DEALING IN PRIVATE EQUITY BUYOUTS

The scandalous accounting practices that unwound beginning with the fall of Enron embodied the many shortcomings of the safeguards that were put in place to prevent the cloth from being pulled over the eyes of corporate shareholders, regulators, the media, and the investing public.²³ Many were to blame: Arthur Andersen, Enron, the investment banks, the convoluted network of partnerships through which Enron masked its true colors, etc. . . . The writing was on the wall: "[o]ne can violate the SEC laws and still comply with' generally accepted accounting principles."²⁴ The sacrificial lambs remained the lowly public, standing on the outside and bearing the expense of wrongdoing by corporate insiders. In the 2000 fiscal year, shareholders who had invested in companies which restated their earnings suffered losses of \$31.2 billion.²⁵

²² See e.g. ABA MODEL RULE § 1.10(a) (2006)(prohibiting two lawyers, in the same law firm, from representing directly adverse parties in the same matter. Rules of imputation therefore treat a law firm as one lawyer.); see also RESTATEMENT THIRD, THE LAW GOVERNING LAWYERS § 122(2); see also ABA MODEL RULE 1.7(b) (2006)(prohibiting the representation of two clients in the same litigation where one client will assert a claim against the other.).

²³ See *Accountability Issues: Lessons Learned From Enron's Fall*, United States Senate Committee on the Judiciary, 107th Cong. (Feb. 6, 2002) (Statement of Susan P. Koniak, Professor of Law, Boston University School of Law).

²⁴ Steve Liesman, *SEC's Accounting Cop Warns Firms: Playing by Rules May Not Be Enough*, THE WALL STREET JOURNAL, Feb. 12, 2002 (statement of Charles Niemeier, Chief Accountant for the Securities and Exchange Commission's Enforcement Division.).

²⁵ David Wessel, *When Standards Are Unacceptable*, THE WALL STREET JOURNAL, Feb. 7, 2002.

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Enron Chief Financial Officer, Andy Fastow, demonstrated the potential damage that can be done to shareholder value as a result of insider wrongdoing, specifically executive self-dealing. The convoluted network of Enron partnerships was instrumental in the energy giant's concealment and perpetuation of corporate frauds. The partnerships purchased and sold assets to Enron of an estimated value in the hundreds of millions of dollars.²⁶ In some cases, in order to meet earnings expectations, "these executive-run partnerships were used to keep debt and losing ventures off Enron's books."²⁷ In another instance, partnership LJM2 renegotiated a deal that saved it millions of dollars at the expense of parent company Enron.²⁸ These transactions beg the question, where do management's loyalties lie? Were the executives of this company seeking to maximize the wealth of the firm and derivatively the shareholders of the firm to whom they owed a duty of loyalty? Or, rather were the terms of negotiation with parent company Enron intended to maximize the wealth of the partnership in which the executives held a proprietary interest?

Consequently, the billions in losses shouldered by public voters marked one of the rare instances where partisans stood on the same side of an issue. Democratic Senator Paul Sarbanes and Republican Representative Michael Oxley bore the sweeping legislation aimed at prosecuting the fraudulent accounting practices that infected what had previously been deemed the model firms of Corporate America. Among other things, the Sarbanes Oxley Act of 2002 set higher procedural standards for the auditors of public companies. SOX regulations blew the doors off of corporate compliance requirements in place at the turn of the century.

A law's effectiveness in deterring future corporate wrongdoing in response to prominent scandal of the recent past necessarily hinges upon legislators' skillful definition of the underlying problem in the present. Characterizing the shortcomings of regulations appurtenant to the enactment of Sarbanes Oxley in 2002, the independence of executives in the context of deal-making remains a sparsely regulated matter as implicated by federal law. Where private equity funds express interest in a target company for a buyout, corporate executives are crucial players in advising their constituents and shareholders in the public-to-private transaction. Yet, their fiduciary role in maximizing shareholder wealth appears to be under attack by private equity firms showering the executives with promises of stock options, bonuses, and golden parachutes upon the consummation of the leveraged buyout. Such

²⁶ See John R. Emshwiller and Rebecca Smith, *Murky Waters: A Primer On the Enron Partnerships*, THE WALL STREET JOURNAL, Jan. 21, 2002.

²⁷ *Id.*

²⁸ See *id.*

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incentives weaken the expectation that executives and managers will be able to render objective advice (with absolute loyalty) in the best interests of shareholders when management stands to benefit so handsomely from the public-to-private bid. The extravagant riches promised to executives are exemplified by the purchase of German chemical company, Celanese, by private equity concern Blackstone Group.²⁹ Blackstone, in December 2003, paid a 13% premium above market capitalization for a total deal value of \$4 billion.³⁰ For its success in buying out the German concern, and a subsequent initial public offering, the private equity group rewarded Celanese's executives with a \$13 million bonus to be split up among them.³¹ Options on 7.8 million shares of common stock were granted to the executives with an additional 1.6 million shares offered at a steeply discounted price.³² At the end of the rainbow, Celanese executives ultimately shared a pot of gold valued at greater than \$65 million.³³

The duty of loyalty (by legal standards) requires that corporate officers exercise institutional power over corporate process in a good faith-effort to advance the interests of the company. Executives, when transacting with the corporation, have a duty to fully disclose all material facts to the corporation's disinterested representatives and to deal with the corporation on terms that are intrinsically fair. Officers of the corporation cannot deal with the corporation in any way that benefits them at the corporation's expense. The fiduciary duty owed by corporate management and directorial boards has been held by Courts to extend far beyond the more blatant instances of executive disloyalty. In *Dodge v. Ford Motor*³⁴, Ford Motor Company's operations had sustained an extended period of profitability. With these profits, CEO Henry Ford decided to raise employee wages, reinvest in the company, and cut prices to consumers. Shareholders brought suit in Delaware courts. The Delaware Court presiding opined that Ford Motor Company had a duty to pay dividends to its shareholders, who behold a primacy interest in the company. While the outcome of this case would fall presently under business judgment deference, Delaware continues to hold that the duty of loyalty is owed strictly to shareholders.

²⁹ See John Christy, et al., *On Going Private: Investors Beware*, THE WALL STREET JOURNAL, Nov. 18, 2006.

³⁰ See *id.*

³¹ See *id.*

³² See *id.*

³³ See *id.*

³⁴ See *Dirks v. SEC*, 463 U.S. 646 (1983)(quoting *Dodge v. Ford Motor Co.*, 204 Mich. 459, 506-09 (1919)(Henry Ford's philanthropic motives did not permit him to set Ford Motor Company dividend policies to benefit public at expense of shareholders.)).

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If the duty of loyalty owed solely to the corporation's shareholders proscribed (under certain circumstances) a company from paying increased wages to workers, lowering prices to customers, and plowing back earnings into the going concern prior to distributing dividends to shareholders, how can this duty be deemed sufficed when corporate officers welcome the same bankers who are advising the company in the sale of itself to be the primary purchasers of the company thereby ensuring that the going concern will not be sold for the highest possible price? After all, a purchaser wouldn't spend \$18 billion on an asset unless it believed it stood to earn substantial returns on its investment which were not accounted for in the purchase price (otherwise, it would realize no gain on the purchase).

Similarly, how can the independence of Goldman Sachs Group, Inc. be found unquestionably in tact in advising Kinder Morgan with the objective of obtaining the optimal price for Kinder's shareholders in the sale of the company when the advisory branch's coworkers and compatriots in Goldman Sachs Capital are sitting across the table bargaining for the cheapest purchase price it can negotiate? Furthermore, what assurances do a target company's shareholders have that the investment bank advising the target in a leveraged buyout won't hold back or pull its punches at the negotiating table when the bank is also acting as a principal investor in the purchase of the target? Investment banks risk only their reputations in rendering quality services to their clients; banks are not bound by a legal duty short of a general obligation not to defraud their clients. When comparing the loyalty a client expects from his/her banking advisor versus the legally binding duties owed by lawyer-to-client and corporate officer-to-shareholder, bankers seem to have little to fear in the way of legal consequence or discipline. Law firms on the other hand appear to be looking down the barrel of a loaded gun: the firm's license to practice law is at stake, the State Bar is vested with the authority to slap lawyers with heavy disciplinary fines, and the firm risks substantial monetary damages for malpractice lawsuits should the firm breach ethical standards by accepting or continuing representation involving an unwaived or unconsentable conflict of interest. Nor do corporate officers have it as easy as bankers: management and board members may be held personally liable for breaches of their fiduciary duties through shareholders' derivative lawsuits.

Investment bankers are free to engage in ethically compromised conduct because the business practice operates without the constraints of a binding code of conduct. Consider the recent adjudication of four Merrill Lynch bankers in the notorious "barge deal." This deal involved an equity interest in several power-generating barges on the coast of Africa. The four bankers agreed that its employer Merrill Lynch would purchase and retain the equity interest from Enron for a six month period after which Enron executives

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(including Andy Fastow) promised the energy giant or one of its affiliates would buyback the equity interest. To Enron, temporarily removing the asset from its book for the purpose of reporting year end earnings and meeting analyst forecasts was worth a flat fee of \$250,000 and a guaranteed 15% annual rate of return over the six-month period that Merrill retained its equity interest in the barges.³⁵ The deal allowed Enron to record an additional \$12 million in earnings thereby defrauding public investors as to the true state of the company. For allowing Enron to park its assets on Merrill Lynch's books, the investment bank earned \$775,000 on the barge deal. Prosecutors averred, rightfully so, that the transaction was a lease in substance and therefore Merrill bankers and Enron officials had conspired to defraud Enron and its shareholders.

The Merrill four were initially convicted by the trial court. The conviction was reversed on the appellate level. According to Dr. Barbara Jennings, the appellate court sympathized with the bankers' Nuremberg defense: "Fraud requires proof of intent to defraud someone, and where a company is so fraught with fraud that fraud becomes its business those on the outside doing transactions cannot be expected to ferret through the smoke screens. Such a requirement would set a dangerous legal precedent with its imposition of duties on bankers."³⁶ From this outcome, what dangerous legal precedent have we avoided now that the letter of the law condones bankers to aid and abet fraud so long as this is the wish of the client? This result enables the moral turpitude of financial advisors despite the so called reputational risks faced by investment bankers. No doubt finance professionals will weigh the benefits of aiding client fraud against reputational risk and choose the more lucrative of the two. And since courts refuse to attach penalties to the unethical practices of investment bankers, the scale seems heavily tipped in favor of the economic benefits to stem from abetting client manipulations and wrongdoings.

Certainly, the system would be better off if advisor (i.e. Goldman Sachs Group, Inc.), upon perceiving unrealized profit potential bound up within its client, was legally compelled to advise its client on actualize such profits and legally prohibited from reaping such gains for itself (i.e. Goldman's private equity arm) at a bargain price. There can be no doubt that Kinder management has enabled its future employer and owner (Goldman Sachs Capital Partners) to deal with the corporation in a way that benefits the buyers at the corporation's expense. "[T]hese arrangements present the possibility for conflicts of interest, as clients become wary that the strategic advice is tilted in a way that favors the

³⁵ See Dr. Barbara Jennings, *Ethics in Finance*, FINANCIAL ENGINEERING NEWS, Nov. 06, 2006.

³⁶ *Id.*

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adviser's own investing role.”³⁷

A less than zealous effort on the part of the advisory firm to represent the interests of the shareholders in the sale of the target company engenders a resulting sale that falls short of satisfying the company's Revlon duty. The essence of an auction is that the highest bidder wins the bidding. It is difficult to imagine that the company has really been sold for the highest price it would otherwise have been purchased for where the investment bank plays the part of both auctioneer and bidder while locking competitive bidders out of the auction hall. The result is that the shareholders of Kinder Morgan have sold their securitized right to participate in corporate governance and the future profits of company at a discounted price.

The new regulations under Sarbanes Oxley serve as a solution to a specific problem: material misrepresentations and fraud in public companies' accounting statements filed with the S.E.C. The 2002 legislation fell short of regulating management's self dealing in private equity buyouts despite reports that Andy Fastow, for his self dealing, defrauded Enron shareholders to the tune of \$30 million.³⁸ This is likely the case since regulations sought to deter frauds committed primarily in the accounting statements of public companies, which is outside the scope of mergers and acquisitions. Additionally, fraud-doers may be subject to criminal prosecution in contrast to the less reprehensible civil offence of self-dealing; arguably, the magnitude of the monetary loss suffered by Kinder Morgan's shareholders cashed out at a discounted price is greater than some of the losses induced by the corporate frauds that Sarbanes Oxley was purported to address. Shareholders remain exposed in private equity transactions to the conflicting financial interests of management and the proprietary interests of the corporation's bankers.

RESOLVING THE CONFLICTS

In order to protect the shareholder from the conflicts of interest born by managerial officials and investment bankers, a number of resolutions should be considered. Centralizing authority in a regulatory body with a heightened purpose toward overseeing the conduct of investment advisors and corporate executives in private equity deals is a first step. Public investors are ill-equipped to monitor the conduct of corporate insiders and their bankers. This is especially the case where, as in the current predicament, even the Board of Directors is kept in the dark as to management's clandestine plotting to ensure a

³⁷ Berman, Dennis and Henny Sender, *In Kinder LBO, Board Was Left in Dark For Over 2 Months as Deal Percolated*, WALL STREET JOURNAL, Sept. 29 2006 at C1.

³⁸ See Diana B. Henriques, *Even a Watchdog Not Always Fully Awake*, THE NEW YORK TIMES, Jan. 5, 2002.

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successful buyout. The government must expand its role as advocate for the lowly shareholder whose final opportunity to enjoy a wealth maximization event is outmatched by the power and influence of corporate officers to manipulate the terms of the prospective sale.

Another strategy to deter management's subordination of shareholder interests in favor of personal gain would be legislation vesting in shareholders and corporations a cause of action to sue the corporation's officers. Currently, certain kinds of expropriation by corporate officials do not rise to the threshold of illegality. Legal reforms would go a long way to protecting minority shareholders from corporate insiders by discouraging the self-dealing of management which accentuates the conflict of interest. In doing so, the U.S. stock market as a whole would appreciate in value³⁹ – "[w]here laws are protective of outside investors and well enforced, investors are willing to finance firms, and financial markets are both broader and more valuable."⁴⁰ This hypothesis was substantiated by the findings of a recent study. As a significant component of the study, academic scholars and financial theorists analyzed how firms' valuations were related to the legal protections afforded to minority shareholders by the respective countries in which the firms engaged in regular business.⁴¹ Data was compiled by sampling 539 large firms from 27 international economies of wealth. The researchers closely monitored the relationship between investor protection and corporate valuation throughout the 27 countries. The findings were conclusive:

When [shareholders'] rights are better protected by the law, outside investors are willing to pay more for financial assets such as equity and debt. They pay more because they recognize that, with better legal protection, more of the firm's profits would come back to them as interest or dividends as opposed to being expropriated by the entrepreneur who controls the firm. By limiting expropriation, the law raises the price that securities fetch in the marketplace. In turn, this enables more entrepreneurs to finance their investments

³⁹ See e.g. Claessens, Stijn et al., *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 JOURNAL OF FINANCE 2741-2770 (Dec. 2002); see also La Porta, Rafael et al., *Corporate Ownership around the World*, 54 JOURNAL OF FINANCE 471-517 (Apr., 1999).

⁴⁰ La Porta, Rafael et al., *Investor Protection and Corporate Valuation*, 57 JOURNAL OF FINANCE 1147 (Jun., 2002).

⁴¹ La Porta, Rafael et al., *Investor Protection and Corporate Valuation*, 57 JOURNAL OF FINANCE 1147-1169 (Jun., 2002).

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externally, leading to the expansion of financial markets.⁴²

Vis-à-vis strong evidentiary support that poor legal protection of shareholders diminishes firm value and derivatively lowers the values of a nation's debt and equity markets, there is strong economic incentive to impress more pronounced legal protections. In a related study of the consequences of entrenched controlling shareholders on firm valuation, a consistent conclusion was reached.⁴³ The authors of the study found a significant propensity for large investors to represent their personal proprietary interests which were often at odds with the interests of the firm and its investors.⁴⁴ A further revelation was an "inverse U-shaped relationship between managerial equity ownership and firm valuation for a sample of U.S. firms,"⁴⁵ confirming the notion that firm value is negatively effected by the entrenchment of managements and controlling shareholders. Responding to the leveraged buyout boom of the 1980s, Shleifer and Vishny were interested in qualifying and quantifying the costs to a target corporation of entrenched manager ownership in blocking value-enhancing turnovers. Somewhat ironically, the findings of Shleifer and Vishny appear equally applicable to the situation where management attempts to expropriate or diminish shareholder wealth by facilitating a buyout while minimizing the number of competing bidders participating in the purchase of the company. The buyout firm has conceivably saved hundreds of millions of dollars by paying a sliver of its cost savings over to management in the way of weighty golden parachutes in exchange for management's complicity, shutting the auction house doors closed in order to exclude competing bidders. In both the entrenched controlling shareholder scenario and the situation involving managerial efforts to entrench a buyout bid, the risk is the same – the risk of expropriation by an authority bearing substantial control over corporate affairs. Increased legal protection for minority shareholders could be achieved by enacting a statutory right of shareholders to force the corporation to sue itself for managerial expropriation. This would relieve some of the conflicting interests between management and investors in the course of a buyout, as well as furnish the United States' securities markets with economic enrichment.

Finally, the fairness opinion is far from an affirmation that shareholder

⁴² *Id.* at 1147.

⁴³ Claessens, Stijn et al., *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 JOURNAL OF FINANCE 2742 (Dec. 2002).

⁴⁴ *Id.* (quoting Shleifer, Andrei, and Robert Vishny, *A Survey of Corporate Governance*, 57 JOURNAL OF FINANCE 758 (1997)).

⁴⁵ *Id.* (citing Morck, Randall, Shleifer, Andrei, and Robert Vishny, *Management Ownership and Market Valuation: An Empirical Analysis*, 20 JOURNAL OF FINANCIAL ECONOMICS 293-315 (1988)).

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wealth has been maximized via the private equity buyout (especially when the advisors are regularly stamping each others' deals as fair and will thus be weary of declining another bank's deal with the possible consequence of a backlash in obtaining fairness opinions for its own deals and the forbearance of hefty revenues⁴⁶). Additionally, the conflicting interests of management in leveraged buyouts are inadequately addressed by fiduciary duties imposed by corporate governance laws. Rather than waiting for a bright line case to reach the courts (i.e. a private equity firm enlisting management in facilitating the purchase of a controlling equity interest in a company for peanuts), shareholder losses and litigation expenditures could be avoided by imposing "disinterested banker" and "disinterested executive" standards similar to that used by lawyers' ethics oversight bodies in regulating the representations of conflicted lawyers. By analogizing to the objective standard requiring lawyers to maintain independent professional judgment in representing clients' interests⁴⁷, a disinterested banker standard would condemn unethical relationships wherein banking advisors might be tempted to subordinate the interests of clients to the banker's own anticipated gain. It does not take a lawyer to perceive the risk of economic immorality posed by sell-side bankers taking money out of the pockets of shareholders and placing it directly into the pockets of the bankers' buy-side coworkers. Centralizing authority in an oversight committee empowered to regulate the dealings of investment bankers and private equity funds in ethically questionable dealings protects the unsophisticated investor from self-dealing by corporate insiders and conflicted advisors. As for management, where a potential conflict exists, imposing upon corporate officials a disclose-or-abstain requirement might remedy some of the conflicts that are likely to arise in the context of a buyout. Executives, during a buyout, would owe a legal duty to timely report any personal knowledge of any offer to buyout the company with a failure to do so creating the possibility of legal liability. Alternatively, the executive would be legally obligated to abstain from any preliminary negotiations with outside bidders. This prescription would certainly prevent any further instances of clandestine scheming on the part of overzealous managerial officials.

⁴⁶ See supra note 13 (Chrysler's Board paid \$55 million for a fairness opinion as to its combination with Daimler Benz.).

⁴⁷ See Stephen Gillers & Roy D. Simon, *Regulation of Lawyers: Statutes and Standards*, NEW YORK CODE OF PROFESSIONAL RESPONSIBILITY ETHICAL CONSIDERATION § 5-4 (2004).

A SECRET SOCIETY: HEDGE FUNDS AND THEIR MYSTERIOUS SUCCESS

*Matthew Goldstein**

INTRODUCTION

On June 23, 2006, the U.S. Court of Appeals for the D.C. Circuit invalidated the Securities and Exchange Commission's ("SEC" or "Commission") "Hedge Fund Rule."¹ This act vacated the SEC's requirement for hedge funds and their advisers to register with the SEC and to release significant financial and management disclosures to the public.² According to

* J.D. Candidate, 2007, Hofstra University School of Law. First and foremost, I wish to express the utmost appreciation for the hard work and effort of the senior staff of the Journal of International Business and Law, in particular my Notes and Comments Editor, Ms. Shari Chernio. I would like to thank Dean Miriam Albert for her encouragement and meaningful advice. Also, I want to express my love and gratitude for my girlfriend, Cassie, for believing in me. Lastly, but by no means least, I would like to dedicate this note to my family, Leslie, Barry and Mark Goldstein, whose unconditional support has been the invaluable element of my success.

¹ *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006) (explaining that the hedge fund rule which had required investors in a hedge fund to be counted as clients of the fund's adviser was ruled invalid); see also *Registration Under the Advisers Act of Certain Hedge Fund Advisers*, 69 Fed. Reg. 72,054, 74,059 (Dec. 10, 2004) (codified at 17 C.F.R. §§ 275, 279). See also 15 U.S.C. § 80a-3(c)(1) (2006) (A private fund is an investment company that (a) is exempt from the registration process under the 40 Act by virtue of having fewer than one hundred investors or only qualified investors and (b) permits its investors to redeem their interests within two years of investing and (c) markets itself on the basis of the skills, ability or expertise of the investment adviser; see also 17 C.F.R. § 275.203(b)(3)-1(d)(1) (2006). For these private funds the rule specifies that "for purposes of section 203(b)(3) of the Advisers Act, you must count as clients the shareholders, limited partners, members or beneficiaries of the fund. The rule had the effect of requiring most hedge fund advisers to register by February 1, 2006).

² *Goldstein*, 451 F.3d at 880; see *Registration Under the Advisers Act of Certain Hedge Fund Advisers*, 69 Fed. Reg. 72,054 (explaining that private fund or hedge fund advisers, prior to the D.C. Circuit vacating the Hedge Fund Rule, were required to file Form ADV with the SEC, the data from which will provide the Commission with information they need to better understand the operation of hedge fund advisers, to plan examinations, to better develop regulatory policy and to provide data and information to members of Congress and other government agencies. The form ADV was amended to include hedge funds by labeling them as "private funds." Registration requires hedge funds to adopt compliance policies and procedures and appoint a chief compliance officer. The hedge fund advisers are subject to Advisers Act requirements regarding examinations by the SEC, recordkeeping, personal securities transaction reporting, custody, voting of proxies, an insider

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the D.C. Circuit, the SEC exceeded its authority by abruptly attempting to regulate a notoriously complex industry whose business model is far too complicated for the average investor to understand.³ The Commission adopted the Staff Report's primary recommendation by voting three to two in favor of requiring hedge fund managers to register as investment advisers under the Investment Advisers Act of 1940 ("Advisers Act").⁴ Subsequent to the SEC's regulation to require certain hedge fund managers to register with the SEC, an investment advisory firm, Kimball & Winthrop and Opportunity Partners, L.P., a hedge fund in which Kimball & Winthrop is the general partner and investment adviser (collectively "Goldstein") successfully challenged the Hedge Fund Rule's equation of the term "client" with the term "investor."⁵

Specifically, the SEC amended Rule 203(b)(3)-1 ("Safe Harbor Rule") under the Advisers Act, effectively removing a provision which provided an exemption for registration for hedge fund advisers.⁶ In other words, prior to the

trading policy, use of performance data and other advertising activities, as well as a limitation on when a registered adviser may charge its clients performance based fees. With respect to the recordkeeping requirements, the Form ADV amendment specified that a registered adviser's books and records also include the books and records of any private fund which it advises and for which it or any of its related persons act as the private fund's general partner or managing member. Registration via form ADV is accomplished by way of the SEC's Division of Investment Management Electronic Filing for Investment Advisers on the Investment Adviser Registration Depositor ("IARD") and usually may take up to 45 days to file properly); *See also* Division of Investment Management: Electronic Filing for Investment Advisers on IARD, available at <http://www.sec.gov/iard> (last visited Apr. 13, 2007).

³ Adam R. Bolter, *Regulation of Hedge Fund Advisers: A Valid Exercise of Rulemaking Authority or the Promulgation of New Law?*, 57 ADMIN. L. REV. 595, 596 (2005); *see also* S.E.C., *Implications of the Growth of Hedge Funds* (2003), available at <http://www.sec.gov/news/studies/hedgelfunds0903.pdf> (summarizing a study of 65 registered and unregistered hedge fund advisers indicating that there are approximately 7,000 hedge funds operating in the United States, managing approximately \$870 billion in assets).

⁴ *See* Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054; 17 C.F.R. § 275.203(b)(3)-1(a) (stating that "you may deem the following to be a single client for purposes of section 203(b)(3) of the [Advisers] Act: (2)(i)...A corporation, general partnership, limited partnership, limited liability company, trust (...), or other legal organization (...) to which you provide investment advice based on its investment objectives rather than the individual investment objectives of its shareholders, partners, limited partners, members or beneficiaries"); *see also* *Lowe v. S.E.C.*, 472 U.S. 181, 194 (1985) (explaining that when Congress passed the Investment Company Act in 1940, Congress also passed the Advisers Act as a companion statute to regulate persons who provide personalized investment advice to others for compensation).

⁵ *See Goldstein*, 451 F.3d at 874 (explaining that the petition for review originated by Philip Goldstein, portfolio manager of Opportunity Partners LP, alleged the SEC exceeded its authority by making new law, a process delegated to Congress).

⁶ *Id.* at 875; *see also* S.E.C., *supra* note 3, at 88-89 (discussing the purposes of exposing the hedge fund advisers to the SEC registration requirements. The SEC shall look through the entity and

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implementation of the Hedge Fund Rule, the Safe Harbor Rule, provided managers of “private funds” relief from counting each investor in a hedge fund as a separate client. As a large majority of hedge funds have more than the fourteen investor statutory maximum (“fifteen client rule”) the vacated client counting rule had “precluded most managers from relying on the ‘small adviser’ exemption under the Advisers Act.”⁷

This Note argues that the D.C. Circuit was correct in its invalidation of the Hedge Fund Rule and that the SEC exceeded its regulatory authority by arbitrarily construing the meaning of the “Hedge Fund Rule” beyond the interpretation intended by Congress. However, given the nature of the hedge fund industry and its complicated business models, the SEC was consistent with its regulatory goal of promoting investor protection, although a distinct attempt by the SEC must be explored. Part I of this Note provides an explanation of the business model for a typical hedge fund and the relative lack of regulation the privatized industry has attracted. Furthermore, it will explain the lack of a concrete statutory definition of a hedge fund and the key differences between the trading strategies hedge funds and other investment vehicles such as those entities subject to the Advisers Act administer. Part II of this Note analyzes the SEC’s authority to enact the Hedge Fund Rule, its legislative history and purpose and whether or not the effects of the rule were consistent with the SEC’s intent in amending Rule 203(b)(3)-1. Part III of this Note analyzes the D.C. Circuit’s decision in *Goldstein v. SEC*, the implications of the holding and whether the court was correct in its determination that the “look through” provision of the private adviser exemption does not permit the SEC to equate the term “client” with the term “investor” of a hedge fund. Part IV concludes by recommending alternative regulatory mechanisms by which the SEC may affect the hedge fund industry in a manner which is rationally related to the Commission’s concerns for investor protection rather than by an arbitrary attempt to require the hedge fund’s advisers to register with the SEC.⁸ Finally, this Note will explore the alternative regulatory mechanisms implemented internationally.

count each individual investor as a client, rather than refer to the hedge fund itself as the client).

⁷ See Bolter, *supra* note 3, at 596; see also 15 U.S.C. § 80b-3(b)(3) (2006) (identifying the prerequisites for the small investment adviser exemption: (1) the adviser must have fewer than 15 clients; (2) must not hold itself out generally to the public as an investment adviser; and (3) cannot act as an investment adviser to a registered investment company or business development company).

⁸ *S.E.C. Decides It Won’t Appeal on Hedge Funds*, N.Y. TIMES, August 8, 2006, at C1.

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I. AN OVERVIEW OF HEDGE FUNDS

A. Overview of the Hedge Fund Structure

The federal securities laws of the United States do not define the term “hedge fund.” However, a hedge fund has been defined as “a privately offered investment vehicle that pools the contributions of its investors in order to invest in a variety of asset classes,”⁹ such as debt and equity securities, future contracts¹⁰, options¹¹, over-the-counter derivatives¹² and foreign currencies. The expectation is that hedge funds will generate positive returns in both bull and bear markets.¹³ Initially, the term “hedge” derived from the fund taking both long¹⁴ and short¹⁵ positions in debt and equity securities in order to ensure or offset inherent investment or market risks, a strategy of “hedging an investment portfolio.”¹⁶ Hedge funds are typically structured as limited partnerships, limited liability companies or in other business organizational

⁹ David A. Vaughan, *Selected Definition of “Hedge Fund”* (2003), <http://www.sec.gov/spotlight/hedgefunds/hedge-vaughn.htm> (citing fourteen different definitions found in government and industry publications).

¹⁰ Willa E. Gibson, *Is Hedge Fund Regulation Necessary?*, 73 TEMP. L. REV. 681 (2000) (defining a future as “standardized agreement that requires the delivery of some underlying commodity or financial instrument at a future date at a specified price.”).

¹¹ *Id.* at 684, 715 n.20 (splitting options into two categories whereby a call option will give an investor a right, but not the obligation to buy a specified financial instrument during a specific time period, as distinguished from a put option whereby the investor is given the right to sell).

¹² *Id.* at 684, 715 n.21 (defining over-the-counter derivatives as “bilateral agreements that derive their value from an underlying asset, such as stocks, commodities, or currency holdings, or from the value of an underlying reference or index rate, such as interest rates, exchange rate or indices”).

¹³ “A bull market is a prolonged period of time when prices are rising in a financial market faster than the historical average in contrast to a bear market which is a prolonged period of time when prices are falling.” Alternatively, a financial market is generally successful when the bulls or buyers outnumber the bears or sellers, http://en.wikipedia.org/wiki/Bull_market.

¹⁴ Long (or Long Position) is defined as the buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value, http://en.wikipedia.org/wiki/Long_position.

¹⁵ Short (or Short Position) is defined as the sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, http://en.wikipedia.org/wiki/Short_%28finance%29. (The use of short selling by hedge funds has led to allegations that some hedge funds may be engaging in short selling as part of a manipulative scheme as alleged by issuers who claim that hedge funds accumulate bearish or short positions in their stocks and subsequently issue reports to drive down the security prices.); *see also* Judith Chase, *The State of Hedge Funds*, SIA Research Reports, Vol. IV, No. 2 (March 10, 2003).

¹⁶ Gibson, *supra* note 10, at 715 n.18 (The first hedge fund was established by A.W. Jones in 1949 where he implemented a system of taking long and short positions in securities so that it would generate returns in both bullish and bearish markets).

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forms that provide for pass-through tax treatment of investor earnings.¹⁷ Given the very high levels of capital and leverage utilized in a hedge fund's investments, "hedge funds cater to sophisticated investors and [more importantly] are not subject to the [SEC] regulations that apply to mutual funds geared towards the general public."¹⁸ Since hedge funds generally trade securities on a secondary basis whereby their interests are not sold in a registered public offering ("IPO"), they are not subject to the registration requirements under the Investment Company Act of 1940 ("40 Act").¹⁹ As an alternative, to maximize flexibility, hedge funds typically offer their investments structured as private placement or Rule 144 transactions²⁰, offerings exempted from the federal securities registration laws.²¹ As hedge funds predominately attract wealthy and sophisticated investors, it is fitting they comprise only a small portion of the investing community.²² In fact, hedge funds typically have either no more than one hundred beneficial owners²³ or require their investors to meet rigid minimum size requirements.²⁴ Management

¹⁷ *Report of the President's Working Group on Financial Markets, Hedge Funds, Leverage and the Lessons of Long-Term Capital Management*, B-3 (1999),

<http://www.ustreas.gov/press/releases/reports/hedfund.pdf> (explaining that these forms of entities are all treated as partnerships. A partnership structure eliminates the dividend tax levied upon profits realized by the owners of a corporation. The dividend tax is an income tax on money paid to the stockholders of a company through dividend payments).

¹⁸ Vaughan, *supra* note 12 (quoting GEORGE SOROS, OPEN SOCIETY: REFORMING GLOBAL CAPITALISM 32 n.† (2000)).

¹⁹ S.E.C., *supra* note 3, at 3 (recognizing that the modern hedge fund maintains a diversified investing strategy beyond equities).

²⁰ S.E.C., *Rule 144: Selling Restricted and Controlled Securities* (2006), <http://www/sec.gov/investor/pubs/rule144.htm> (explaining that Rule 144 transactions are exempt from the registration requirements in order to sell the security in the marketplace so long as (1) before the restricted securities are sold in the marketplace they must be held for one year; (2) there must be adequate information available about the issuer of the securities; (3) The amount of securities sold in any three-month period may not exceed specific volume limitations; (4) Sales must be made in ordinary brokers' transactions or transactions directly with a market maker; (5) The sales must not be advertised nor may additional commissions be paid and (6) A Form 144 must be filed with the SEC). *See also*, S.E.C., *supra* note 3, at x (noting that Regulation D under the 1933 Securities Act governs private offerings offered exclusively to accredited investors).

²¹ Gibson, *supra* note 10, at 483.

²² *Id.* at 683.

²³ *Report of the President's Working Group, supra* note 17, at 3 (defining "beneficial owner" as one who must have voting rights, generally owning 10% or more of the fund's voting securities, and is either an investment company or a private fund).

²⁴ *Id.* *See also* 15 U.S.C. § 80a-3(c)(1) (2006) (requiring a fund relying on this exclusion to comply with the 100 beneficial owner prerequisite. The funds are not to propose or make available its securities in a public offering); 15 U.S.C. §80a-3(c)(7) (2006) (requiring hedge funds to sell their securities only to those persons who are qualified purchasers, or "(i) any natural person who owns

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is compensated generally by taking a percentage of the assets investors have in their portfolios in addition to a percentage of the firm's profits, or a performance fee.²⁵

B. Hedge Fund Trading Strategy

Generally, hedge funds are some of the more active trading entities that “can provide benefits to financial markets by enhancing liquidity and efficiency.”²⁶ Hedge fund trading strategies are typically focused on short selling (the sale of a borrowed security), arbitrage (simultaneously buying and selling a security in different markets to exploit and profit from pricing discrepancies) and leverage (magnifying returns by investing with borrowed money).²⁷ The use of leverage enables hedge funds to take short term positions or sell short because the hedge fund will borrow the stock, bond or other security instrument from a broker-dealer.²⁸ If the security declines in price (as compared to the selling price it initially offered) before the fund must replace the borrowed security, the fund will realize a gain.²⁹ Just as easily as leverage may result in enormous profits, the opposite can easily occur. Given this inherent risk, the ten to twenty percent performance-based advisory fees are presumptively justified. Still, the underlying issue with regard to leverage surrounds the possibility of a loss. Even so, hedge funds divert large levels of risk from those investors finding risk adverse investments attractive since hedge funds “have a great desire to assume such risk.”³⁰ However, excessive use of economic leverage or a very high ratio of borrowed money to available capital can prevent hedge funds from meeting margin calls³¹ in the event hedge fund

not less than \$5 million in investments, (ii) a family-owned company that owns not less than \$5 million in investments, (iii) certain trusts, and (iv) any other person, (e.g. an institutional investor that owns and invests on a discretionary basis not less than \$25 million in investments”).

²⁵ 15 U.S.C. § 80a-3(c)(1) (2006).

²⁶ *Report of the President's Working Group*, *supra* note 17, at 2.

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ Gibson, *supra* note 10, at 688; *see also Hedgefunds: Hearing before the House Committee on Banking and Financial Services*, 105th Cong. (1999) (statement of Patrick M. Parkinson, Associate Director, Division of Research and Statistic, Board of Governors of the Federal Reserve System) (“Leverage plays a positive role in our financial system, resulting in greater market liquidity, lower credit costs, and a more efficient allocation of resources in our economy.”). *See generally Report of the President's Working Group*, *supra* note 17, at 4-5.

³¹ “When the margin posted in the margin account is below the minimum margin requirement, the broker or exchange issues a margin call. The investor now either has to increase the margin that he has deposited, or he can close out his position. He can do this by selling the securities, options or futures if he is long and by buying them back if he is short,”

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strategists incorrectly predict market movements. Therefore, hedge funds are constrained in some cases by initial margin and collateral at the transaction level.³² To ensure the exposure of leverage is adequately collateralized relative to the creditworthiness of the hedge fund, the leverage is acquired through derivatives transactions, short sales and direct financing.³³ Still, the practice of leveraging investments exerts a positive influence on a hedge fund's returns because they are only "limited in their use of leverage by the willingness of their creditors and counterparties to provide such leverage."³⁴ Beyond that, regulatory capital requirements are only applicable to financial institutions apart from hedge funds.³⁵

C. Hedge Funds versus Mutual Funds

The primary difference between hedge funds and mutual funds is that mutual funds must be registered as investment companies. Although both entities may invest in similar types of securities and offer investors the opportunity to diversify their investments through professionally managed investment pools, "mutual funds do not charge performance-based advisory fees, nor do they typically engage in the short-term investment strategies of hedge funds."³⁶

An implication of the distinct trading strategies employed by mutual and hedge funds is the possibility of conflict of interests. For example, an investment adviser managing a mutual fund using a long-only strategy may, at the same time, manage a hedge fund using a different strategy.³⁷ "The investment adviser may determine that an equity security that the mutual fund holds long is appropriate for the hedge fund to sell short,"³⁸ and in turn the short sale may have a negative effect on the security and therefore the mutual fund's performance. It follows that as facially similar hedge funds and mutual funds may appear to be, their trading strategies provide for significant differences,

http://en.wikipedia.org/wiki/Margin_call#Margin_call; see *Report of the President's Working Group*, *supra* note 17, at 23 (suggesting that excessive use of leverage potentially causes substantial financial difficulties for the markets and in turn forces regulators to recognize the fears of market disruption).

³² See *Report of the President's Working Group*, *supra* note 17, at 23 ("In a volatile market, high levels of leverage increase the likelihood that a leveraged entity will fail, in part because the size of potential losses can seriously deplete and even wipe out the entity's net worth").

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Report of the President's Working Group*, *supra* note 17; see also Bolter, *supra* note 3, at 599.

³⁷ S.E.C., *supra* note 3, at 84; see Definition of Long Position, *supra* note 14.

³⁸ S.E.C., *supra* note 3.

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substantial enough to adversely affect their respective performances.

D. Long Term Capital Management, L.P.

It may be argued that a direct result of the lack of regulatory restrictions placed upon hedge funds is the collapse of the hedge fund Long Term Capital Management, L.P. ("LTCM").³⁹ LTCM operated Long Term Capital Portfolio in the late 1990s when LTCM's trading strategy caused the fund to lose substantial sums of money, through the misuse of leverage, primarily as a result of economic problems in Russia.⁴⁰ LTCM's loss resulted from "using borrowed money to purchase about \$120 billion of its estimated \$125 billion of assets, causing the fund to be leveraged 25 times over."⁴¹ The problem with that approach "was that the \$125 billion in capital that LTCM raised would not be sufficient to realize substantial profits."⁴² As a result, worried creditors coupled with counterparties looked to liquidate their collateral assets to protect themselves from the fund's failure and "bailed out the fund."⁴³ The Federal Reserve along with a few of the prominent banks and brokerage houses provided a short-term solution to the LTCM problem by investing \$3.65 billion in equity capital in LTCM in exchange for 90 percent of the firm's equity, and in turn, provided to shareholders a better result and permitted management to continue to collect their management fees.⁴⁴ However the long term effects of the Federal Reserve's involvement was likely the eventual action taken by the SEC.

Although not immediate, a regulatory response by the SEC was inevitable and did eventually result in the allegedly appropriate solution of requiring hedge fund advisers to register as authorized by the Advisers Act. However, the stepping stone to the briefly implemented registration requirement was the financial securities industry tightening its credit risk management

³⁹ Gibson *supra* note 10, at 682 (explaining how the enormous size of LTCM and its trading positions caused its counterparties and creditors to lose substantial amounts of money due to the extension of excessive credit, and in turn, the fund's financial collapse "has led federal legislators and financial regulators to question whether additional regulatory constraints were necessary on a hedge fund's use of leverage to protect against financial market disruption"); *see also Report of the President's Working Group*, *supra* note 17.

⁴⁰ Daniel K. Liffman, *Registration of Hedge Fund Advisers Under the Investment Advisers Act*, 38 LOY. L.A. L. REV. 2147, 2172-2173 (2005).

⁴¹ *Id.*

⁴² Justin Asbury Dillmore, *Leap Before You Look: The SEC's Approach to Hedge Fund Regulation*, 32 OHIO N.U. L. REV. 169, 171 (2006).

⁴³ Liffman *supra* note 40 at 2173; *see also* Gibson, *supra* note 10, at 681.

⁴⁴ Dillmore, *supra* note 42 at 173; *see also* Kevin Dowd, *Too Big To Fail? Long-Term Capital Management and the Federal Reserve*, Cato Institute Briefing Papers, (Sept. 23, 1999), available at <http://www.cato.org/pubs/briefs/bp52.pdf>.

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practices. Additionally, “financial regulators implemented guide-lines for regulated entities when extending credit through either lending or counterparty relationships.”⁴⁵ The issues of hedge fund fraud, misuse of leverage and speculation support the pro-registration argument and accordingly compel the SEC to act.

Registration would provide for the SEC to “(i) begin to understand the hedge fund industry, (ii) attempt to curb some of the illegal activity of individual funds and their advisers, and (iii) prevent market disruptions by monitoring overleveraged funds.”⁴⁶ Although these three rationales do in fact support the need for hedge fund regulation, the hedge fund rule encompassing hedge fund adviser registration was not necessarily the best approach for the SEC in their attempt to learn more about the intricacies of a hedge fund. Concurrently, it has been suggested that “the effects of LTCM’s failure on financial markets were exaggerated” and the Federal Reserve’s bailout “simply helped the shareholders and managers of LTCM to get a better deal for themselves than they would otherwise have obtained.”⁴⁷ Further, the bailout may have served as a regulation wake up call for the Federal Reserve as well as the SEC in that it “encouraged more calls for regulation of hedge-fund activity, which may drive such activity further offshore,” and “encourage irresponsible risk taking” of large financial institutions.⁴⁸

II. THE HEDGE FUND RULE

A. The Rulemaking Authority of the SEC

Section 211(a) of the Advisers Act provided the rulemaking authority for the SEC to rely on in its amendment to the Safe Harbor Rule.⁴⁹ More specifically, Section 211(a) affords the ability to “classify and prescribe different requirements for different classes of people and allows the SEC to issue, amend and rescind rules as are necessary or appropriate.”⁵⁰ Irrespective of the SEC’s broad authority, it is permissible for an appropriate court to set

⁴⁵ Liffman, *supra* note 40, at 2173; *see also* Gibson, *supra* note 10, at 681, (citing *Hearing before the H. Comm. on Banking and Fin. Servs.*, 106th Cong. (1999) (testimony of Anne Nazareth, Director of Division of Market Regulation, S.E.C., Concerning the Report of the President’s Working Group on Financial Markets on Hedge Funds, Leverage and the Lessons of Long-Term Capital Management), *available at* 1999 WL 16947258).

⁴⁶ Liffman, *supra* note 40, at 2174.

⁴⁷ Dowd, *supra* note 44, at 1.

⁴⁸ *Id.*

⁴⁹ 15 U.S.C. § 80b-11(a) (2000).

⁵⁰ Bolter, *supra* note 3, at 599.

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aside the Commission's rule if it is said to be inconsistent with the underlying Congressional intent.⁵¹ In assessing such intent, the reviewing court must consider whether Congress has directly addressed the issue, whether the statute is ambiguous as to the issue or whether the Commission's amendment was based on a permissible reading of the legislative history.⁵²

Arguably, the legislative history of 203(b)(3) ("Small or Private Adviser Exemption") provides for the Commission's ability to maintain broad authority in their interpretation of the rule. This is because the Small Adviser's Exemption leaves unanswered the "question as to whether advisers are entitled to the no "Look Through" provision in counting beneficial owners of entities other than business development companies (more commonly known as venture capital companies) as single "clients."⁵³ Additionally, there is no history addressing the purpose behind the 15 client rule within the Small Adviser Exemption.⁵⁴ Therefore, at first glance, the Commission is presumptively justified in its interpretation and implementation of the meaning of the Safe Harbor Rule, the look through provision and the Private Adviser Exemption.⁵⁵ However, in the case that the Commission is strikingly inconsistent with Congress, their interpretation will incur a standard of review comparable to that of strict scrutiny.⁵⁶

B. Rule 203(b)(3)-2: Background and Purpose

In *SEC v. Capital Gains Research Bureau*, the Supreme Court reasoned that the Advisers Act and the investment advisers who are subject to the Act are to prevent the continued discrepancies in knowledge between the investment adviser and their respective clients.⁵⁷ A fundamental purpose of the

⁵¹ *SEC v. Sloan*, 436 U.S. 103, 118 (1978) (reasoning that courts need not hold steadfast to an agency's rulemaking or interpretation of such).

⁵² *Chevron U.S.A. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-843 (1984) (expressing that if Congressional intent is clear or if the agency's interpretation is plainly inconsistent with said intent, the agency has exceeded their allowable scope of authority and the statute must be struck down).

⁵³ H.R. REP. NO. 1341, at 4 (1980); *see also* Bolter *supra* note 3, at 599; *see also* 15 U.S.C. §80a-2(a)(48) (2006) (defining a business development company as a "closed-end company which operates for the purpose of making investments in certain securities and making available significant managerial assistance with respect to the issuers of such securities").

⁵⁴ *Id.*

⁵⁵ S.E.C., *supra* note 3 (where the staff issued a report to the Commission suggesting the implications of the growth and hedge funds and the proposal that the Commission should consider requiring hedge fund advisers to register as investment advisers under the Advisers Act).

⁵⁶ *Chevron*, 467 U.S. at 837 (holding that if the agency's authority has violated Congressional intent, a more exacting standard of review should be applied).

⁵⁷ *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963) (noting that the Advisers Act

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Advisers Act was “to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry.”⁵⁸ Therein, the Advisers Act defines an investment adviser as “any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities.”⁵⁹ An individual who engages in such services intentionally and not incidentally is generally required to register with the SEC as an investment adviser.⁶⁰

Hedge fund managers rely on the Small Adviser Exemption or 15 client rule, providing those managers who would normally fit within the definition of an investment adviser with an exemption from registration.⁶¹ If the hedge fund manager has not advised more than 15 clients in the preceding 12 months, the managers may properly utilize the exemption.⁶² This rule works in conjunction with the Safe Harbor rule which provides that for purposes of determining who constitutes a client under § 203(b), investment advisers may count a “legal organization,” such as a corporation or any form of a partnership as a single client.⁶³

was prompted by Congress’ hope that its impact would relieve advisers and their clients of any conflicts of interests which may be detrimental to a client’s best interests). Discrepancies in knowledge may refer to insider information that an investor’s investment adviser may possess and is reluctant to disclose to the investor due to the possibility of adversely affecting the investor’s portfolio.

⁵⁸ *Id.*

⁵⁹ 15 U.S.C. § 80b-2(a)(11) (2000).

⁶⁰ *Id.* (stating that those professionals such as lawyers or broker-dealers performing services incidentally and without compensation are not required to register with the SEC).

⁶¹ 15 U.S.C. § 80b-3(b)(3) (2000) (explaining the circumstances where someone akin to the definition of an investment adviser need not register with the SEC).

⁶² *Id.* (identifying the prerequisites to comply with the Small Adviser Exemption: (1) the adviser must have no more than 14 clients; (2) must not hold itself out generally to the public as an adviser; and (3) cannot act as an investment adviser to a registered investment company or development company). The recently vacated Look-Through Provision temporary removed the Small Adviser Exemption from investment advisers not generally subject to registration with the SEC.

⁶³ Bolter, *supra* note 3, at 602; *see also* 17 C.F.R. §275.203(b)(3)-1(a)(2)(i) (2003) (stating you may deem the following a single client including “a corporation, general partnership, limited partnership, limited liability company...or other legal organization to which you provide investment advice based on its investment objectives rather than the individuals investment objectives of its shareholders, partners, limited partners, members or beneficiaries”). The issue of advising individuals in the form of a shareholder or a partner is yet to be addressed as fiduciary relationships between the investment adviser and the client are considered in *Goldstein*. The rule goes on to clarify that so long as the investment adviser is providing advice to the entity itself and not the individual, the manager of a legal organization need not “look through to the beneficial owners of

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Upon the findings spelled out in the Staff Report, the SEC Commissioners voted to disregard the current Safe Harbor Rule in order to remove the presumptive secrecy the exemption afforded hedge fund managers and their private funds.⁶⁴ This amendment to the Safe Harbor Rule is arguably inconsistent with Congressional intent because of §§3(c)(1) and §3(c)(7) of the Investment Company Act of 1940 (“‘40 Act”). This broad provision excluded from the “definition of an investment company any issuer whose securities are owned exclusively by qualified purchasers (sophisticated investors) and who does not propose a public offering of such securities.”⁶⁵ Since hedge funds fit within this definition as they are private funds who do not engage in the proposition of public offerings, the Hedge Fund Rule “seemingly contradicts congressional intent by specifically requiring advisers funds relying on §§3(c)(1) and §3(c)(7) to register under the Advisers Act.”⁶⁶ Irrespective of Congressional intent, the SEC went forward with its reinterpretation of the term “client,” prompting the D.C. Circuit’s consideration of the rule in *Goldstein*.

C. The “Client” of a Hedge Fund and the Advisers Act

The definition of a “client” is not defined anywhere within the Advisers Act but was amended by the SEC to bring hedge fund advisers within the boundaries of the Commission’s registration regulations.⁶⁷ Until 2004, both the SEC and Congress were consistent in treating a “legal organization receiving advice from an investment adviser as a single client, declining to look through the entity and count individual shareholders as clients.”⁶⁸ Although the

the organization in counting clients” and as a hedge fund manager generally advises a fund, although comprised of individuals, the manager will avoid registration under the Advisers Act.

⁶⁴ Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054 (Dec. 10, 2004) (codified at 17 C.F.R. §§ 275,279) (defining a private fund as an entity that would be subject to regulation under the Investment Company Act of 1940 but for the exceptions provided under § 3(c)(1) or § 3(c)(7)). Additionally, the private advisers exemptions were narrowed as of December 2004 through an amendment of Rule 203(b)(3)-1 that redefined the term “clients” to preclude “private funds” in certain circumstances).

⁶⁵ 15 U.S.C. § 80a-3(c)(7) (2000).

⁶⁶ *Regulation of the Hedge Fund Industry Before the U.S. Senate Comm. on Banking, Housing, and Urban Affairs*, 108th Cong. (2004) (testimony of Adam C. Cooper, Chairman, Managed Funds Association) (recognized that the currently regulatory framework provides for resources to be expended on investors who actually need protection and not on those investors who have demonstrated sophistication and knowledge in their investment objectives); see also Regulation Under the Advisers Act of Certain Hedge Fund Advisers; Proposed Rule 69 Fed. Reg. 45, 172 (proposed July 28, 2004) (stating that a “private fund” or hedge fund is ordinarily one that meets the definition of an investment company, but for its exemption afforded under § 3(c)(1) or § 3(c)(7)).

⁶⁷ Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054.

⁶⁸ Bolter, *supra* note 3, at 620; see Wilmer Cutler Pickering Hale and Dorr LLP, Comment Letter Re: Investment Advisers Act Release No. 2266 (File No. S7-30-04): *Registration under the*

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SEC broadened the Safe Harbor Rule to encompass hedge fund advisers, it reaffirmed the plain meaning of a “client.”⁶⁹ As a result, it seemed that the SEC, in adopting the Hedge Fund Rule focused more on the Staff Report’s finding that hedge fund growth itself along with changed circumstances has warranted their changed interpretation.⁷⁰

The Hedge Fund Rule requiring that each shareholder or beneficiary of a “private fund,” including hedge funds, be considered a separate client in counting towards the “15 client rule” within the Small Adviser Exemption.⁷¹ It is arguable that the SEC’s redefinition of a “client” is inconsistent with Congressional intent as it is a term so pertinent to the meaning of the Advisers Act.⁷² For example, the term “client” is generally accepted as an individual or organization that receives direct advice from an investment adviser rather than passive or inactive investors in the legal organization such as those whose only role is capital contribution.⁷³ As a result, “not only does the plain language of the term conflict with the SEC’s reinterpretation in the Hedge Fund Rule, but judicial interpretation and the legislative intent behind the Advisers Act affirm the longstanding interpretation that a “client” is a party who receives particularized advice.”⁷⁴ However, from the SEC’s perspective, the reinterpretation of the term “client” and the implementation of the Hedge Fund Rule are consistent with the regulatory framework of the securities industry. The practices of fraud, misuse of leverage and speculation are three enormous and worrisome issues that the SEC cites to as authority for their change of the definition of “client.”⁷⁵ As far back as the 1920’s and the Depression Era, these concerns have been prevalent in the securities markets and were problems that prompted the adoption of the Securities Act of 1933.⁷⁶ Therefore, the government had to and did respond by regulating the securities industry “in order to restore public confidence and make capitalism live up to its promise.”⁷⁷

Investment Advisers Act of Certain Hedge Fund Advisers 1-2 (Sept. 8, 2004) (explaining that the hedge fund adviser provides investment advice to the partnership itself rather than each beneficial owner), available at <http://www.sec.gov/rules/proposed/s73004/wilmer090804.pdf>; see generally 17 C.F.R. § 275.203(b)(3)-1(a)(2)(i) (2003).

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054 (explaining the methods for counting clients for purposes of private funds).

⁷² Bolter, *supra* note 3, at 602.

⁷³ *Id.*

⁷⁴ *Id.* at 603.

⁷⁵ Liffman, *supra* note 40.

⁷⁶ *Id.*

⁷⁷ *Id.* at 2174.

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In consideration of the Staff Report's findings, the sheer growth of hedge funds have transcended the private fund boundaries and have dived into the public arena where the SEC would serve its functional goal of securities regulation through the registration of hedge fund advisers, requiring them to provide data, including financial and trading practice disclosures for the purpose of protecting investors.⁷⁸

Even if the SEC was in fact attempting to hold fast to their primary objective of investor protection, their method in doing so may be inconsistent with Congress and legislative history. Consistent with regulation is arguably bestowing registration upon hedge fund advisers since it is overwhelmingly consistent with the SEC goal of disclosure. However, in considering Congressional intent, the language of the Advisers Act "advances the argument that the term "client" refers to a person or organization that receives personalized investment advice," rather than equating the term "client" with a legal organization or more specifically a hedge fund.⁷⁹ Further, it has been emphasized that the Advisers Act is supposed to administer those situations where "individualized advice is given specific to a client's particular needs."⁸⁰ Again, a hedge fund's business model does not provide for individualized advice, as its objectives are to advise the partnership itself, whereby the look through provision should prevent the SEC from looking through the entity to the partners themselves. Further evidence of Congressional intent to exclude private funds or hedge funds from registration under the Advisers Act was at the recommendation of the SEC, requiring advisers of registered investment companies, such as mutual funds to register under the Advisers Act.⁸¹ Congress looked to amend the Small Adviser Exemption, explicitly removing the "fewer than 15" exemption for advisers of companies registered under the '40 Act.⁸² In doing so, it is apparent that Congress did not design the Small Adviser Exemption to "count each individual as a "client," because if that were true, there would be no need to specifically deny the exemption to advisers of registered funds."⁸³ Instead, the provision would have read more broadly and generally included advisers of private funds. Therefore, it may be argued that the SEC has not currently justified registration in order to protect investors.

⁷⁸ *Id.* at 2176.

⁷⁹ Bolter, *supra* note 3, at 602 (arguing that the SEC is guilty of this in their implementation of the Hedge Fund Rule).

⁸⁰ See *Lowe*, 472 U.S. at 208 (holding that in order to come within the purview of the Advisers Act individualized advice must be given).

⁸¹ Bolter, *supra* note 3, at 605.

⁸² *Id.*

⁸³ *Id.*

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D. The “Look Through” Provision

In prompting the challenge in *Goldstein*, the SEC justified the Hedge Fund Rule on the supposition that an increasing number of investment advisers were taking advantage of the Small Adviser Exemption, allegedly providing for circumvention of the purpose of the rule.⁸⁴ The SEC contended that investment advisers created limited partnerships solely to incur the benefits of the Exemption rather than manage their clients’ money directly.⁸⁵ To support such a contention, the SEC cited only a district court case where an investment adviser persuaded a client to reorganize its trust accounts in order to avoid regulation.⁸⁶ Furthermore, the Proposed Release of the Safe Harbor Rule notes the rule was strictly available to circumstances where the general partner advises the partnership based on the fund’s investment objectives, not those of its partners.⁸⁷ As a result, contrary to the SEC’s belief, it seems the Safe Harbor Rule was “itself established to prevent circumvention, not solely to exempt from registration those advisers whose business is so limited that it does not raise federal interest.”⁸⁸ In other words, the Small Adviser Exemption seems to reflect that there is no federal interest in regulating investment advice on a personal level to friends or family.⁸⁹ Therefore, as argued in petitioner’s complaint in *Goldstein*, the use of the “look through” provision by the SEC functions as an instrument to create new law, rather than a legitimate means of enforcing the rule’s primary objective.⁹⁰

III. GOLDSTEIN V. SEC

A. Background

Phillip Goldstein, a shareholder activist mainly participating in proxy

⁸⁴ *Id.* at 608.

⁸⁵ *Id.* at 609. (citing Adopting Release, *supra* note 1, at 72,054.)

⁸⁶ SEC v. Gary Smith, No. 93-CV-74410-DT, 1995 U.S. Dist. LEXIS 22352, at *1 (S.D. Mich. Jan. 6, 1995).

⁸⁷ Liffman, *supra* note 40.

⁸⁸ Regulation Under the Advisers Act of Certain Hedge Fund Advisers; Proposed Rule 69 Fed. Reg. at 45,199 (dissenting from the majority’s opinion that the Hedge Fund Rule is a loophole allowing advisers to manage the assets of more than 14 clients while remaining unregistered); *see also* Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054.

⁸⁹ Liffman, *supra* note 40, at 2177 (stating that where critics of this argument suggest that Congress created the exemption specifically for advisers who have a few clients consisting of family and friends but did not intend it to be used by fund managers who take advantage of the look through provision and maintain hundreds of clients).

⁹⁰ *Goldstein*, 451 F.3d at 873.

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battles, is the President of Kimball & Winthrop, Inc., the general partner of Opportunity Partners L.P.⁹¹ He has been described as “the most visible of a new breed of closed-end-fund activists known as a fundbuster.”⁹² He is a retired New York City civil engineer operating a \$40 million hedge fund from the basement of his Brooklyn, New York home. Staying true to his activist role, Goldstein, in conjunction with Kimball and Winthrop and Opportunity Partners, petitioned for review of an order of the SEC regulating hedge funds under the Advisers Act via the “Look Through” Provision and the accompanying Hedge Fund Rule. Previously exempt because Goldstein had fewer than 15 clients, the SEC’s adoption of the Hedge Fund Rule required Goldstein’s advisers to register with the Commission since the funds they advise have fifteen or more shareholders, limited partners, members or beneficiaries.⁹³

B. Petitioner Goldstein’s Argument

Goldstein advances two main theories in order to invalidate the Hedge Fund Rule. First, Goldstein argues the Hedge Fund Rule violates Congressional intent by regulating private investment entities and advisers which Congress has expressly exempted from regulation under the Investment Company Act and Advisers Act.⁹⁴ Goldstein claims the Commission does not have the authority to regulate hedge funds by rewriting a statute as delineated by Section 211(a) of the Advisers Act.⁹⁵ Secondly, Goldstein focuses squarely on the definition of “client” as used in the Advisers Act and argues that its definition is unambiguous and clear as interpreted by Congress and as such requires no further interpretation by the SEC.⁹⁶ More specifically, Goldstein alleges the Hedge Fund Rule transforms the term “client” to include the security holders who have invested in the hedge fund. Goldstein posits the term “client” should signify the entity or fund itself that engaged the adviser to provide investment advice to the fund as a whole rather than based on the investment objectives of

⁹¹ Phillip Goldstein is a hedge fund adviser to Opportunity Partners, a hedge fund partnership and its general partner, Kimball & Winthrop.

⁹² Blake A. Bell, *Do Shareholder Activists Violate Federal Proxy Solicitation Laws Through Internet Message Boards?*, Sept. 15, 1998, <http://www.stblaw.com/content/publications/pub275.pdf>, (last visited Jan. 7, 2006) (describing a fundbuster as an activist who seeks to buy shares at deep discounts and then maneuvers to reduce the discounts, thereby increasing their overall returns vis-à-vis the funds’ market performance).

⁹³ See 15 U.S.C. § 80b-3(b)(3) (2006); see also 17 C.F.R. § 275.203(b)(3)-2(a) (2006).

⁹⁴ Brief for Petitioner, *Goldstein*, 451 F.3d 873 (No. 04-1434).

⁹⁵ See *supra* section II. A. (where it is argued that the SEC does indeed have broad rulemaking authority).

⁹⁶ Brief for the Petitioner, *supra* note 94.

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any individual investor.⁹⁷ Additionally, Goldstein diligently contends that the SEC's regulatory position until the adoption of the Hedge Fund Rule was consistent with congressional intent and the Safe Harbor Provision.⁹⁸ Therefore, Goldstein claims the adjustment to the Safe Harbor Provision is justified solely on arbitrary and capricious grounds where no satisfactory reasoning is advanced.⁹⁹

C. Respondent SEC's Argument

The SEC attempted to take a step away from petitioner's arguments, focusing on statutory language and the definition of "client" by simply promoting the need for hedge fund regulation. As previously stated, the SEC relied on growth in hedge funds and the impact of hedge fund advisers on the markets, an increase in fraud cases involving hedge fund advisers and an increase in exposure of retail investors to the risks of hedge fund investing.¹⁰⁰ The growth stems from the increase in hedge fund activity.¹⁰¹ As a result, hedge fund advisers have become significant participants in the national securities markets since their trading represents a reported 10 to 20 percent of the equity trading volume in the United States as of December 2004.¹⁰² Further, between 1999 and 2004, the Commission instituted 51 enforcement actions alleging that hedge fund advisers defrauded either their own investors or other market participants in amounts estimated to exceed \$1.1 billion.¹⁰³ The Commission also argues that hedge fund advisers were actively involved in the recent scandals regarding "late trading" and "market timing" of mutual fund shares that harmed mutual fund investors.¹⁰⁴ Additionally, the SEC focuses on

⁹⁷ *Id.*

⁹⁸ *Id.*; see *Lowe*, 472 U.S. at 194 (the SEC had recently adopted the safe harbor rule to ensure that security holders of a limited partnership were not considered "clients" of an adviser to the entity. The SEC articulated in *Lowe* that the Advisers Act addressed a client relationship in which an adviser provided personalized investment advice based upon an understanding of the investment objectives and the financial situation of the client).

⁹⁹ Brief for the Petitioner, *supra* note 94.

¹⁰⁰ Brief for Respondent, *Goldstein*, 451 F.3d 873 (No. 04-1434).

¹⁰¹ Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054.

¹⁰² Brief for the Respondent, *supra* note 100; see Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054.

¹⁰³ Brief for the Respondent, *supra* note 100; see Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054.

¹⁰⁴ Brief for the Respondent, *supra* note 100; see Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054; see Banc of Am. Cap. Mgmt., LLC 84 S.E.C. Docket 2780, at *4, (Feb. 9, 2005) (defining 'market timing' as "the practice of "(a) frequent buying and selling of shares of the same mutual fund or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing, both of which can dilute the value of the shares of

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the increased involvement of non-traditional investors or those investors not generally considered wealthy in the activities of hedge funds. This was a direct result of hedge funds decreasing their minimum investment capital requirements through the development of funds of hedge funds and the increase of pension funds, universities and charitable organization investment.¹⁰⁵

It seems that the SEC's attempt to justify the Hedge Fund Rule relied heavily on their goal of protecting the investor rather than promoting or stabilizing the prominent effect on capitalism that hedge funds employ. However, it seems consistent with the changing times and economy that the SEC sought out a measure of regulation for hedge funds since it is clear their services have become available to those investors who simply can't afford to lose their investments and may in fact do so without having sufficient knowledge to understand what their investments entail. Therefore, it is logical to argue that hedge funds and their privatized nature dove into a realm that is no longer predominately secretive, one that as the SEC correctly points out, has reached retail investors.

Although Goldstein argued the SEC did not have the authority to adopt the Hedge Fund Rule and contradicted congressional intent, it is arguable that registration may have been the correct approach to "gauge the prevalence of problematic practices that hedge funds currently engage in,"¹⁰⁶ as the Safe Harbor Provision has not been used in a manner closely related to its purpose.¹⁰⁷ For the brief period that registration under the Advisers Act was in effect for hedge fund advisers, the SEC was able to gather information about the number of hedge funds which an adviser manages, the amount of assets in the funds, employees of the funds, clients of the funds, other business activities the adviser conducts and the identity of those in control of the fund.¹⁰⁸ It seems that disclosure of the information is specifically related to preventing future instances of fraud and may decrease the likelihood of a disaster comparable to

mutual fund shareholders, disrupt the management of the mutual fund's investment portfolio and cause the targeted mutual fund to incur costs borne by other shareholders to accommodate frequent buying and selling of shares by the market timer and defining 'late trading' as "the practice of placing orders to buy or sell mutual fund shares after the time as of which a mutual fund has calculated its [net asset value] (usually as of the close of trading at 4:00 p.m. ET), but receiving the price based on the prior [net asset value] already determined as of 4:00 p.m., thus allowing the trader to profit from market events that occur after 4:00 p.m. but that are not reflected in that day's price").

¹⁰⁵ See Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054; see Jenny Anderson & Riva D. Atlas, *If I Only Had a Hedge Fund: Is This the New Emerald City, or the Road to the Next Crash?*, N.Y. TIMES, Mar. 27, 2005, §3, at 1.

¹⁰⁶ Liffman, *supra* note 40, at 2176.

¹⁰⁷ See Regulation Under the Advisers Act of Certain Hedge Fund Advisers; Proposed Rule 69 Fed. Reg. 45,172.

¹⁰⁸ See Liffman, *supra* note 40, at 2177.

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that of LTCM by recognizing fraud in its early development.

Additionally, registration barred criminals with long criminal records from managing funds and arguably erased the decrease in minimum investment problems by compelling compliance with minimum requirements for investors under rule 205-3 of the Advisers Act.¹⁰⁹ As a result, it seems that registration does curb some of the illegal activity and investor abuse that hedge funds attract and as such the SEC's requirement of registration was rationally related to hedge fund regulation. However, a rational relationship may not be sufficient as hedge fund regulation, vis-à-vis registration, has garnered a higher level of scrutiny since the Hedge Fund Rule has arguably departed from the purpose and intent of the Safe Harbor Rule.¹¹⁰

D. The D.C. Circuit's Decision

Statutory Interpretation

The D.C. Circuit held the Hedge Fund Rule to be arbitrary and capricious on its face and upon its application invalidated the SEC's attempt to regulate hedge funds vis-à-vis registration.¹¹¹ The court was emphatic in siding with Goldstein by agreeing that although the term "client" is not defined in the Advisers Act, this fact does not confer a right upon the Commission to imply its own definition on grounds on ambiguity.¹¹² Rather than allowing the Commission to redefine the term "client," the Second Circuit Court of Appeals ("court") appropriately considered the legislative history of § 203(b)(3) of the Advisers Act dating back to 1970.¹¹³ The court points to an amendment in 1970 which in the court's opinion, is a reflection of congressional understanding that investment company entities, not the shareholders, be it an individual or other entity, were the advisers' clients.¹¹⁴ The court goes on to explain that the prohibition of a separate exemption for advisers who advised only investment companies would be unnecessary if the shareholders of investment companies

¹⁰⁹ *Id.*; see Regulation Under the Advisers Act of Certain Hedge Fund Advisers; Proposed Rule 69 Fed. at 45,176.

¹¹⁰ See S.E.C., *supra* note 3; see Bolter, *supra* note 3 at 601 (discussing how a reviewing court will engage in a more scrutinizing analysis where an agency, like the SEC has departed from the consistent and longstanding precedents or policies where the presumption of agency regulatory authority has been slighted).

¹¹¹ See *Goldstein* 451 F.3d 873.

¹¹² *Id.* at 878 (explaining that the lack of a statutory definition of a word does not necessarily render the meaning of a word ambiguous and the presence of a definition does not necessarily make that term clear).

¹¹³ *Id.*

¹¹⁴ *Id.*

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could be counted as clients. Further, the court implicates the probative value of a Second Circuit decision its in holding that hedge fund general partners were investment advisers¹¹⁵ under the Advisers Act. Although the Second Circuit did not explicitly hold that general partners were advisers to the limited partners, therefore giving merit to the ambiguity of the term “client” as suggested by the Commission, the mere mention of those words may be construed as reiterating the definition of a client to not be equal to that of an investor.¹¹⁶ It seems the court associates the Commission’s reliance on the Second Circuit’s interpretation of the 1980 amendment to demonstrate such ambiguity of “client” as hypocritical because it was the Commission who established the Safe Harbor provision in 1985.¹¹⁷

Investment Adviser, “Client” and Fiduciary Duties

With all the doubt surrounding the existence or lack thereof a concrete definition for the term “client,” the court emphasizes the existence of a statutory definition for the term “investment adviser.”¹¹⁸ The court reasons that an investor in a private fund may benefit or suffer directly from the investment adviser’s advice but he does not receive that advice directly like that of a general retail investment relationship between an investment representative and an individual who is neither a shareholder nor a corporation.¹¹⁹ For example, it is not as if the investor walked into a brokerage and openly discussed his investment strategy with another investment representative. In the hedge fund scenario, the investor invests a portion of his assets in the fund and in turn he receives no direct advice. In a hedge fund, the court explains the fund manager is the adviser, and in turn, “controls the disposition of the pool of capital in the fund.”¹²⁰ Further, it is not the adviser who tells the investor how to spend his money because the investor made that initial decision when he embarked on investing in the hedge fund. Acting out the investor-adviser relationship leads the court to demonstrate the investors’ maintenance of a passive role. Since the person or entity controlling the hedge fund is not an investment adviser by definition¹²¹ to each individual investor, it follows that each investor can not be

¹¹⁵ 15 U.S.C. § 80b-2(11) (2006).

¹¹⁶ *Abrahamson v. Fleschner*, 568 F.2d 862, 869-71 (2d Cir. 1977).

¹¹⁷ *Goldstein*, 451 F.3d at 879 (explaining that the Safe Harbor provision allowed advisers to count certain limited partnerships as single clients specifically in order to provide some form of certainty about the meaning of the term); see Definition of “Client” of Investment Adviser for Certain Purposes Relating to Ltd Partnerships, 50 Fed. Reg. 8740 (Mar 5. 1985).

¹¹⁸ *Goldstein*, 451 F.3d at 879; see 15 U.S.C. § 80b-2(a)(11) (2000).

¹¹⁹ *Goldstein*, 451 F.3d at 879.

¹²⁰ *Id.* at 880.

¹²¹ 15 U.S.C. § 80b-2(a)(11) (2000).

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a “client” of that person or entity. As the court explains, “these are just two sides of the same coin.”¹²²

This relationship in and of itself seems simple, fair and may lend credence to resolve the issue of when an investor receives direct advice from an adviser and how this situation does not arise in the context of a hedge fund. Ironically enough, this was the view of the SEC until it issued the Hedge Fund Rule.¹²³ The SEC had agreed with the court’s reasoning when it provided hypothetical scenarios demonstrating the impact of individualized advice.¹²⁴ As mentioned above, a “client” of an investment adviser will receive individualized advice on his investment objectives given his financial situation. But if the investment adviser works for an investment company or corporation, he will not and is not required to consider the individual needs of the company’s shareholders when making investment decisions. Also, in contrast to the former situation with the “client,” the adviser is not obligated to ensure that each security purchased for the company’s portfolio is also a financially responsible investment for each shareholder.¹²⁵ Coincidentally, it was the SEC and subsequently the court, who reasoned that when an adviser to an investment pool manages the assets of the pool on the basis of investment objectives of a group of investors rather than an individual it seems appropriate to consider the pool rather than each individual investor as a client of the adviser.¹²⁶

Another important aspect which the court considers in *Goldstein* is the character of the advice rendered.¹²⁷ More specifically, the court cites a Supreme Court case where it was held that those engaged in the investment advisory industry will “provide personalized advice to a client’s concerns” and a fiduciary relationship is indicative of the investment adviser-client relationship.¹²⁸ Consistent with the legislative history of the Advisers Act it seems as though this direct relationship only exists between the adviser and the hedge fund, but not between the adviser and the investors in the fund.¹²⁹ As explained above, the adviser is concerned with the fund’s performance, not with each investor’s financial status. This is the crux of the case against the Commission’s Hedge Fund Rule and more importantly, the correct

¹²² *Goldstein*, 451 F.3d at 880.

¹²³ See Status of Investment Advisory Programs Under the Investment Company Act of 1940, 62 Fed. Reg. 15,098, at 15,012 (Mar. 31, 1997).

¹²⁴ *Id.*

¹²⁵ *Goldstein*, 451 F.3d at 880.

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.* (quoting *Lowe*, 472 U.S. at 208).

¹²⁹ *Id.* (quoting *Lowe*, 472 U.S. at 208).

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interpretation of the intent of the Advisers Act. Therefore, the court is correct in its assertion that the Commission's interpretation of the term "client" is beyond reasonable bounds and illegitimately characterizes the investors in a hedge fund as the "clients" of the adviser.¹³⁰ The court unequivocally refuses to define the term "client" but makes clear that the Commission's interpretation is inconsistent with the fiduciary duties owed in the adviser-client relationship since the adviser owes fiduciary duties to the fund, not the individual investors.¹³¹ Therein, a breach of the fiduciary duty by the adviser is a violation of the duty of loyalty owed to the client.¹³² This cause of action for breach will only extend to investors in a hedge fund alleging fraud against the fund's adviser.¹³³ Coincidentally, the Hedge Fund Rule expands upon the duty of loyalty by recognizing that advisers must manage their clients' portfolios in the best interest of the client and in the result of any conflict of interest the adviser is obligated to disclose such conflict that exists with the client.¹³⁴ A conflict of interest is assured if the adviser owes a fiduciary duty to the investors and the hedge fund entity.¹³⁵ As the court correctly opines, investment advisers cannot be the "servants of two masters in this way."¹³⁶ Therefore, contrary to the Commission's argument, suggesting that hedge funds are structured with the intent of avoiding significant legal obligations such as registration with the Commission, "form does matter in this area [Small Adviser Exemption] of the law because it dictates to whom fiduciary duties are owed."¹³⁷

¹³⁰ *Id.*

¹³¹ *Id.*

¹³² 15 U.S.C. § 80b-6 (stating it is "unlawful for any investment adviser...[registered or not,] to engage in any transaction...which operates as a fraud or deceit upon any client or prospective client"); see *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963) (holding that 15 U.S.C. §80b-6 created a fiduciary duty of loyalty between an adviser and his client).

¹³³ *Abrahamson*, 568 F.2d at 869-71.

¹³⁴ Regulation Under the Advisers Act of Certain Hedge Fund Advisers; Proposed Rule 69 Fed. Reg. 45,172, at 72,059.

¹³⁵ *Goldstein*, 451 F.3d at 880 (explaining how a conflict of interest will arise if the adviser owes a fiduciary duty to both the investor and the entity by considering "an investment adviser to a hedge fund that is about to go bankrupt. His advice to the fund will likely include any and all measures to remain solvent. His advice to the investor in the fund, however, will likely be to sell." On the same level, the shareholders in the corporation are not deemed clients of the corporation's lawyer. For example, an adviser, or more easier understood a lawyer, can't represent both side sides of the same coin. For the adviser to owe a fiduciary duty to the investors and the fund itself is analogous to a lawyer representing both the corporation and the shareholders or beneficial owners of a corporation. Even though the shareholders may indeed benefit indirectly from the lawyer's representation of the corporation, "their individual interests easily can be drawn into conflict with the interests of the entity.").

¹³⁶ *Id.*

¹³⁷ *Id.* at 883.

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The court is correct in suggesting that the Commission has used an illegitimate course to require hedge fund regulation. Although the Commission justifies its Hedge Fund Rule by pointing to the surrounding growth of hedge funds, an increase in fraud actions and retail exposure, these factors are inconsistent with manipulating the use of the term “client.” The Commission has failed to explain away the obvious conflict of interests which may occur amongst fiduciary duties which as a result of the Hedge Fund Rule. Therefore, the court is correct in its reasoning that the relationship between hedge fund investors and advisers does not currently justify treating the former as clients of the latter.¹³⁸ Moreover, even if a hedge fund is comprised of separate investment accounts, which in turn must be counted as separate clients, this is not evidence to support the claimed relationship between the investor and the adviser. Even if the alleged activity does exist, the court correctly suggests that the Commission has not supported the argument that all investors in hedge funds are clients. If in fact there exists investors within a hedge fund with different rights or privileges, the Commission may have been successful if they adequately explained how these rights justify treating each of those investors with such rights as separate clients. Simply, the court refuses to look past the Commission’s former interpretation of the Safe Harbor Rule¹³⁹ in order to allow the Hedge Fund Rule to hold merit.¹⁴⁰

The court then correctly explains how it is the Commission who was responsible for the creation of the Safe Harbor Rule and its Small Adviser Exemption and in turn the Commission can not carve out another exception to the rule. The Hedge Fund Rule seems to provide an exception from the Safe Harbor Rule solely for investment entities that have fewer than one-hundred but more than fourteen investors.¹⁴¹ This rule outlandishly creates a situation in which investment companies with one hundred or fewer investors are exempt from the Investment Company Act, but those with fifteen or more investors triggers registration under the Advisers Act.¹⁴² The court goes on to call the hedge fund rule arbitrary because of its lack of justification for any change in nature of the investment adviser-client relationship since the Commission only points to growth and fraud involving hedge funds, not incidents specifically

¹³⁸ *Id.*

¹³⁹ 17 C.F.R. § 275.203(b)(3)-1(a)(2)(i) (2004), (confirming the court’s reasoning that advice to a collective investment vehicle will allow such vehicle or partnership to be treated as a single client since the objectives are based on that of a group and not that of individuals).

¹⁴⁰ *Goldstein*, 451 F.3d at 883.

¹⁴¹ *Id.*; see 17 C.F.R. § 275.203(b)(3)-1 (making available the benefits of the Safe Harbor provision to hedge funds taking the form of corporations, limited liability companies and business trusts).

¹⁴² *Goldstein*, 451 F.3d at 884.

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related to the adviser-client relationship.¹⁴³ For example, the number of investors in a hedge fund does not reveal anything about the fund's activities that relate to the Commission's purported justifications of hedge fund growth, an increase in fraud and retail exposure. Further, the relationship between the investor and adviser does not bear upon the national securities markets; it is the volume of assets or level of indebtedness of a hedge fund that determines the fund's influence on the U.S. securities markets.¹⁴⁴ As a result, the Commission's justifications for the hedge fund rule are irrational and their argument for registration is misplaced since it incorrectly targets the relationship between investment adviser and client.

IV. IMPACT ON INTERNATIONAL MARKETS AND DOMESTIC REGULATORY ALTERNATIVES

A. Asian Markets

It is arguable that the Asian Market Crisis was the catalyst in prompting international recognition of the hedge fund industry's significant role in the plight of emerging markets as well as the likelihood of a global regulatory effort.¹⁴⁵ Given that it was the affected nations who made the emergency call for regulation, it is worth mentioning that the U.S. regulatory authorities may have overlooked the need to temporarily halt U.S. hedge fund abuse of the struggling regions abroad.¹⁴⁶ Surprisingly, the U.S. or the generally stringent regulatory body that is the SEC allowed for the sudden withdrawal of highly leveraged activity in Southeast Asia currency trading and other speculative investments.¹⁴⁷ This lack of intervention by the Commission, whereby their attention focused squarely on a decidedly arbitrary attempt to regulate hedge funds domestically was exhibited by the Staff Report's purported focus on the U.S. market and the overriding concern of rebuilding U.S. investor confidence.¹⁴⁸ Despite the lack of involvement by the U.S. in international

¹⁴³ *Id.*; see *Northpoint Tech., Ltd. v. F.C.C.*, 412 F.3d 145, 156 (D.C. Cir. 2005) (explaining that a statutory interpretation that results from an unreasonable interpretation of prior agency policy must be struck down).

¹⁴⁴ *Goldstein*, 451 F.3d at 884.

¹⁴⁵ Sherry M. Shore, *SEC Hedge Fund Regulatory Implications on Asian Emerging Markets: Bottom Line or Bust*, 13 CARDOZO J. INT'L & COMP. L. 563, 564 (2005).

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*; see *S.E.C.*, *supra* note 3 (the report contains less than a page in a more than a one hundred page report which is dedicated to offshore hedge fund activity and even then no mention is made of the trouble brewing in Asian nations including Malaysia, Singapore, Indonesia and Thailand where

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hedge fund regulation, several affected Asian nations stepped up to the plate. Unlike the U.S., the Monetary Authority of Singapore as early as 2002 kept retail investors informed of the risk involved in hedge fund activity and implemented certain disclosure requirements.¹⁴⁹ Additionally, rather than simply claiming the hedge fund industry has become endangered due to retail exposure in the U.S., both Hong Kong and the United Kingdom installed regulations to allow hedge fund product offerings to the retail investor.¹⁵⁰ Coincidentally, it is Hong Kong, Singapore and the United Kingdom who are deemed the most active in regulating the hedge fund industry.¹⁵¹ Further, it is Hong Kong, rather than the U.S., who took the right approach in trying to mitigate the risk associated with hedge funds. Hong Kong implemented a difficult licensing exam for potential hedge fund managers and investment advisers.¹⁵² It seems odd that the U.S., the most highly sophisticated and well-funded nation, took an approach akin to hedge fund investment adviser registration via statutory reinterpretation rather than a means similar to that of Hong Kong. The SEC criticized a hedge fund's structure before allowing it to start its operations. Rather than exhibit the unity that the Hong Kong Monetary Authority maintained when it regulated hedge fund activity, the divisiveness amongst SEC commissioners likely resulted in the extensive criticism that domestic hedge fund regulation attracted.¹⁵³

B. Canadian Markets

Since the collapse of two large Canadian hedge funds whose presence was felt most by retail, the Chair of the Ontario Securities Commission has designed measures to "ensure that hedge fund managers provide fair, full, accurate and timely information to their investing clients, [in] addition to improving transparency surrounding management fees and risk."¹⁵⁴ Most

hedge funds once had a short position in Thai currency so significant that it amounted to approximately five percent of Thailand's Gross Domestic Product at its peak).

¹⁴⁹ See S.E.C., *supra* note 3.

¹⁵⁰ *Id.* at 584.

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054 (explaining that where the adoption of the Hedge Fund Rule ignited great uproar amongst the hedge fund and financial communities as well as the SEC itself as the SEC commissioners voted 3-2 in approving the amendment, prompting one of the most publicized and controversial regulatory conflicts in modern financial history).

¹⁵⁴ *Id.*; see DAVID WILSON, CHAIRMAN, ONTARIO SEC. COMM'N, DIALOGUE WITH THE OSC 2005: SETTING THE STANDARD (November 17, 2005), *available at* http://www.osc.gov.on.ca/About/Speeches/sp_20051117_dw_dialogue-opening-remarks.pdf, (last visited January 26, 2007).

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recently, the Ontario Securities Commission announced its intent to force hedge fund managers to register with regulators and to pass tests to prove their proficiency. This is likely in response to the collapse of hedge funds Portus Alternative Asset Management, and Amaranth Advisors who lost \$6.5 billion due to wrong bets on natural gas prices by a Calgary-based trader.¹⁵⁵ For the sake of the U.S. securities markets, the SEC should coordinate some logical form of regulation to prevent an occurrence similar to that of the Canadian hedge funds or the Asian Market crisis.

C. Domestic Alternatives

Since the D.C. Circuit vacated the Hedge Fund Rule, several alternatives to the rule have gained attention. First, Commissioner Cox recommended that the anti-fraud provisions of the Investment Advisers Act should apply only to clients, not to investors in hedge funds, or in the alternative, examine whether the Advisers Act may proscribe fraud by advisers against investors in hedge funds.¹⁵⁶ This suggestion seems superfluous given the overarching and well-defined rule 10b-5 of the Securities and Exchange Act of 1934 which suffices to prosecute insider trading and other methods of securities fraud. If the Commissioner follows through with this antifraud rule, a subsequent court challenge is imminent.

Citing the Staff Report's finding that hedge fund products have attracted less wealthy investors through retailization, the Commissioner suggested that the definition of accredited investor as applied to retail investment in hedge funds without registration may be worthy of a limited change.¹⁵⁷ As the foundation of the SEC is investor protection, an individual with insufficient assets that is investing in a product (like a hedge fund) incurs high risks encompassing the potential loss of their assets and in turn will need society to support them. Therefore, the purpose of this law would likely serve to ensure those with insufficient assets won't lose everything. However, if the

¹⁵⁵ Joe Schneider, *CSA Plans to Boost Oversight of Hedge Fund Managers*, BLOOMBERG, Feb. 20, 2007, available at <http://www.bloomberg.com/apps/news?pid=20601082&sid=az15yheIblcQ&refer=canada>, (last visited February 23, 2007).

¹⁵⁶ Carol Robinson Schepp, *SEC Chairman Cox's Senate Testimony Addressing SEC Hedge Fund Actions After Goldstein Decision*, WILMER HALE, July 26, 2006, <http://www.wilmerhale.com/publications/whPubsDetail.aspx?publication=3292>.

¹⁵⁷ *Id.* (explaining that the accredited investor will be redefined to be called an "accredited natural person" and that person would need a net worth of \$1 million, an old requirement, but would also have to have \$2.5 million worth of investable assets, excluding the value of a primary residence. The proposed rule provides for inflation adjustments, with the first adjustment to \$2.5 million to the nearest \$100,000 on April 1, 2012 and an adjustment every five years thereafter); see Regulation Under the Advisers Act of Certain Hedge Fund Advisers; Proposed Rule 69 Fed. Reg. 45,172.

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purpose of this accredited investor definition is to prevent such a risk, a version that places a cap on the amount invested in proportion to an investors' net worth in certain investment categories would be more efficient. Given that it is a virtual certainty that any legislation significantly amending the text of the SEC's rules is subject to challenge, amending minimum financial requirements is a practical solution. Up until now, the SEC's attempt to regulate hedge funds has seemed overly intrusive and has allegedly precluded the creativity, liquidity and flexibility of hedge funds that existed prior to the Hedge Fund Rule. At the same time, the collapse of Amaranth Advisors, a Greenwich, Connecticut based hedge fund in September of 2006 is a blow to the argument that hedge funds need not be regulated.¹⁵⁸ In response, it is assumed that local lawmakers will respond by introducing legislation that would require more disclosure and eliminate conflicts of interest between investors and fund managers,¹⁵⁹ laws that would seemingly resemble that of the vacated Hedge Fund Rule. Although Connecticut is home to a significant amount of hedge funds, this is a poor idea by Connecticut regulators. By unilaterally imposing regulations that no other state has, hedge funds will likely move their offices elsewhere and adversely affect the state's economy. This transition would be disliked by the federal government given the revenues contributed to the United States Treasury by Connecticut's hedge funds. Regulation at the state level is undoubtedly a catalyst for increased costs and inconsistent rules across state lines.

In order for hedge funds to be as successful as they were previously and concurrently promote investor protection and confidence, the SEC must focus its regulation on informing its investors of the risks involved in hedge fund trading activity without significantly disclosing any trading strategy, portfolio or irrelevant information. This approach is akin to that of the Financial Services Authority ("FSA"), the United Kingdom's securities regulator whose culture provides for daily dialogue with hedge funds.¹⁶⁰ This dialogue seems more practical than the SEC's approach because hedge funds presumably know what the risks are and will have procedures in place so that if something does indeed go wrong, there is a connection at the FSA or the SEC. Coincidentally, Hong Kong, Singapore, France and Dubai have all altered their regulatory mechanisms to mirror the FSA.¹⁶¹

¹⁵⁸ *Hedge-Fund Lawyers See New Rules Ahead*, Dealbook, <http://dealbook.blogs.nytimes.com/2006/10/27/hedge-fund-lawyers-see-new-rules-ahead/> (Oct. 27, 2006, 10:33 EST).

¹⁵⁹ *Connecticut Considers Stricter Hedge-Fund Rules*, Dealbook, <http://dealbook.blogs.nytimes.com/2007/02/09/connecticut-stricter-hedge-fund-rules/> (Feb. 9, 2007, 15:34 EST).

¹⁶⁰ *Id.*

¹⁶¹ Stephen Labaton, *Officials Reject More Oversight of Hedge Funds*, N.Y. TIMES, February 23,

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There is also the suggestion that hedge funds themselves should be left alone, diverting our regulatory resources to those sophisticated and wealthy investors who so frequently support hedge fund growth. Most recently, the President's Working Group proposed a series of nonbinding principles, placing the onus primarily on companies, investors and buyers and sellers of hedge fund securities to impose a "market discipline."¹⁶² It has been the large financial institutions that have brought despair to the economy as well as the homes of certain American taxpayers. The collapse of Long Term Capital Management and the Savings and Loan Industry is likely attributable to the insurmountable levels of leverage taken on by lenders that resulted in economic disaster rather than the investment decisions of someone with a net worth of a million dollars. By regulating hedge funds, the SEC arguably has it in reverse. Although some pension funds invest the funds of unaccredited investors (by the SEC standard of an accredited investor) in hedge funds, the funds invested are presumably substantial enough to hire the expertise necessary to evaluate the hedge fund products. If not, perhaps the SEC needs to promulgate requirements for pension funds, such as acquiring a minimum level of expertise similar to the idea of an intermediate financial exam serving to qualify an individual as an eligible investor.¹⁶³ Additionally, the accredited investor standard restricts certain financial opportunities to the wealthy and supports the "rich get richer" notion. It is one thing to limit one's freedom of choice. It is another thing entirely to make sure people have the information they need to make these choices. Therefore, informing the investors of the risks associated with hedge funds vis-à-vis pension fund managers is a plausible regulatory mechanism.

CONCLUSION

It is questionable as to how far the SEC can and will go in their subsequent attempt to regulate hedge funds. The boundaries of patience and efficiency will be tested as hedge funds may look to the advantages of offshore fund establishment as regulation may hinder the foundations of financial success generated in the private sector. If the majority of hedge fund assets do

2007, at A1.

¹⁶² *Id.*

¹⁶³ *Many Investors Fume over Hedge-Fund Rule*, Dealbook, <http://dealbook.blogs.nytimes.com/2007/02/12/many-investors-fume-ove-hedge-fund-rule/> (Feb. 12, 2007, 12:37 EST) (explaining that board members of pension funds are charged with the task of making asset allocation decisions which undoubtedly play into the hedge fund business model. These assets come from the salaries and savings of individuals who do not necessarily meet the SEC's accredited investor standard such as that of a firefighter contributing to his local county's pension plan. Therefore, a wealth requirement such as the accredited investor standard is seemingly missing a large portion of investors whose assets find their way into hedge fund products).

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indeed find their way offshore, thus potentially incurring virtually zero transactional disclosure or prohibitions, the largest and most liquid securities market that is the U.S. will undoubtedly face a situation analogous to that of driving foreign issuers of initial public offerings (“IPO”) to register with foreign exchanges rather than entering the U.S. capital markets.¹⁶⁴ If a statute is written in haste like that of the Hedge Fund Rule, subsequent measures will serve as barriers to further enhancement of the U.S. securities markets.

¹⁶⁴ In fact, of the top 25 global IPOs in 2005, only one took place in the U.S. Prior to Sarbanes Oxley’s implementation, in 2000, 9 of the top 10 were listed on U.S. soil; see W. Carson McLean, *The Sarbanes Oxley Act: A Detriment to Market Globalization & International Securities Regulation*, 33 SYRACUSE J. INT’L L. & COM. 319, 319 (2005).

INTERNATIONAL SANCTIONS: THE PRESSURE ON IRAN TO ABANDON NUCLEAR PROLIFERATION

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INTRODUCTION

On March 24, 2007, the United Nations Security Council unanimously approved stringent sanctions intended to deter Iran's nuclear ambitions. These sanctions were issued in response to Iran's failure to comply with previous sanctions issued by the Security Council in December 2006. Despite the efforts of the Security Council, Iran has vowed to continue nuclear development. The Iranian government has asserted that Iran's nuclear development is intended only for peaceful use. However, Iran has failed to be candid about its nuclear activities. A February 2006 report from the International Atomic Energy Agency ("IAEA") revealed that Iran has expanded its nuclear program more quickly than expected. Experts predict that Iran could potentially produce a nuclear bomb within the next few years.

Iran's nuclear development is a cause for international concern. Recently, tensions have further escalated in the Middle East. The U.S. has accused Iran of providing weapons to insurgents battling against the U.S. military in Iraq. Adding to the turmoil, Iran captured 15 British sailors off the coast of Iran and accused them of espionage. Iran has a turbulent history of providing funding and weapons to terrorist groups like Hizballah and Hamas. There are significant dangers of a nuclear Iran. If Iran were to attain a nuclear bomb, the country might be able to support terrorism more aggressively, because Iran would be less worried about retaliation from the U.S. and other nations. Other Middle Eastern nations might also develop nuclear weapons as a deterrent, contributing to unstable conditions in an area of the world where tension already exists.

U.N. sanctions have failed to impede Iranian President Mahmoud Ahmadinejad's nuclear program expansion. During the negotiations which led

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to the pre-2007 sanctions, Russia and China opposed strict penalties supported by the U.S. and its European allies. The current trade relationships between members of the Security Council and Iran could explain the positions taken by each member with regard to penalizing Iran. Realizing that U.N. sanctions are not enough to stop Iran's nuclear proliferation, the U.S. has sought to prevent international financial funding to Iran by pressing foreign countries to refuse to deal with Iran. An analysis of the social climate in Iran reveals that President Ahmadinejad's policies are losing both political and popular support. Continued international pressure is necessary to compel Iran to cooperate with the IAEA.

Part I of this note will discuss the U.N. Security Council sanctions imposed in December 2006 and March 2007, as well as Iran's response to these sanctions. Part II will explore Iran's evasiveness regarding current nuclear development and assess reports of Iran's recent nuclear milestones. Part III will review the history of Iran's relationship with the U.S. Part IV will examine the reluctance of China and Russia to impose strict sanctions on Iran because of each country's significant economic ties with Iran. Part V will explain new tactics employed by the U.S. to prevent international financial funding to Iran's illicit activities. Part VI will analyze the effects of increasing international pressure on Iran's social and political climate. Finally, Part VII will evaluate the likelihood of war with Iran.

I. U.N SECURITY COUNCIL SANCTIONS FAIL TO IMPEDE IRAN'S NUCLEAR PROLIFERATION

On December 23, 2006, the Security Council unanimously approved sanctions designed to curtail Iran's nuclear development.¹ The resolution, prepared by Germany and the Security Council's five permanent members—the United States, Britain, France, Russia and China—represented the culmination of months of negotiations to determine the proper sanctions to impose in response to Iran's failure to adhere to the Security Council's demand that nuclear activities be suspended by August 31, 2006.²

Sanctions included a ban on the import and export of materials and technology used in uranium enrichment and ballistic missiles.³ The resolution also froze the assets of 12 individuals and 10 entities involved in Iran's nuclear

¹ Elissa Gootman, *Security Council Approves Sanctions Against Iran Over Nuclear Program*, N.Y. TIMES, Dec. 24, 2006, at A18.

² *Id.*

³ S.C. Res. 1737, U.N. Doc. S/RES/1737 (Dec. 23, 2006).

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and ballistic missile programs.⁴ In addition, the Director General of the IAEA was required to report to the Security Council within 60 days on whether Iran had complied with sanctions and suspended its enrichment program.⁵ Also included in the resolution was a warning to Iran that failure to comply would result in further sanctions.⁶ The resolution, however, restricted further measures to nonmilitary actions.⁷

The U.N. has come under attack for delaying the imposition of sanctions on Iran.⁸ Critics argue that “nothing of any seriousness comes out of the U.N.”⁹ The U.N. is “supposed to embody. . . ‘collective security[.]’” but critics argue that “[t]’s an illusion[.]”¹⁰ Instead, member nations avoid resolutions that could potentially conflict with their own interests.¹¹ For example, the U.N. has been criticized for failing to effectively deal with the situation in Darfur.¹² The U.S. defined genocide as the “displacement, starvation, rape and mass slaughter” of hundreds of thousands of civilians in Darfur by the government of Sudan and its allied Janjaweed militias.¹³ The Security Council has passed resolutions which call for the Sudanese government to disarm the Janjaweed, and the Security Council has also authorized a U.N. peacekeeping force.¹⁴ However, these efforts have proven ineffective, and experts have called for further action by the Security Council to deploy a peacekeeping force with orders to protect civilians by force if necessary.¹⁵ China, a permanent member of the Security Council, has presented a stumbling block to international efforts to end the genocide in Darfur.¹⁶ China’s dependence on the area for oil has led its government to oppose “forceful intervention in Sudan’s sovereign affairs.”¹⁷ As a result of member nations’ individual interests, the U.N. has continued to play the role of a passive bystander when confronted with pressing international issues, and Iran’s nuclear

⁴ *Id.* at 4.

⁵ *Id.* at 7.

⁶ *Id.*

⁷ Gootman, *supra* note 1.

⁸ Charles Krauthammer, *But Not At The U.N.*, TIME, Oct. 23, 2006, at 39.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² *UN: A Chance for a Safer World*, THE ECONOMIST, Jan. 6, 2007, at 40.

¹³ *Save Darfur: Policy Talking Points*, available at <http://www.savedarfur.org/pages/background/> (last modified March 1, 2007).

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *UN: A Chance for a Safer World*, *supra* note 12.

¹⁷ *Id.*

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program is no exception.¹⁸ The U.N. has been criticized for postponing sanctions on Iran because of Russian and Chinese economic interests.¹⁹

The December 2006 resolution, considerably weaker than earlier proposed resolutions, did little to compel Iran to discontinue its nuclear activities.²⁰ Russia, which has strong economic ties with Iran, objected to previously proposed resolutions.²¹ China, also economically linked to Iran, often supported objections made by Russia during negotiations.²² During negotiations Russian Ambassador Vitaly I. Churkin objected to language in the sanctions that would threaten Russia's current business deals.²³ In order to facilitate a solution, the U.S. and its European allies agreed to eliminate a travel ban on Iranians suspected of involvement in nuclear activities.²⁴ Previous drafts of the resolution directed "that all states 'prevent entry' of such people, [but] the final version of the resolution simply 'calls upon' states to 'exercise vigilance' over their borders."²⁵ To appease Russia, the other Security Council members agreed to exclude any sanctions against a nuclear power plant that Russia is building in Bushehr, Iran.²⁶ In addition, prior to approving the resolution, Russia demanded the removal of Aerospace Industries Organization from the list of companies involved in Iran's nuclear and ballistic missile programs.²⁷

In response to the Security Council's sanctions, Iranian officials defiantly vowed to continue nuclear development.²⁸ Iran insists that it is entitled to enrich uranium under the Nuclear Non-Proliferation Treaty.²⁹ Immediately following the announcement of Security Council sanctions, President Ahmadinejad declared that "nuclear technology is our right, and no one can take it away from us."³⁰ Ahmadinejad also warned that the U.S. would

¹⁸ Krauthammer, *supra* note 8.

¹⁹ *Id.*

²⁰ Helene Cooper & Steven R. Weisman, *West Tries a New Tack to Block Iran's Nuclear Agenda*, N.Y. TIMES, Jan. 2, 2007, at A3.

²¹ Gootman, *supra* note 1.

²² *Id.*

²³ Warren Hoge, *U.N. Draft Resolution on Iran Loosens Travel Ban and Time Limits*, N.Y. TIMES, Dec. 21, 2006, at A26.

²⁴ *Id.*

²⁵ Gootman, *supra* note 1.

²⁶ Colum Lynch, *U.N. Security Council Votes to Restrict Iran's Trade in Nuclear Materials*, WASH. POST, Dec. 24, 2006, available at 2006 WLNR 22436326..

²⁷ *Id.*

²⁸ Nazila Fathi, *Iran is Defiant, Vowing to U.N. It Will Continue Nuclear Efforts*, N.Y. TIMES, Dec. 25, 2006, at A14.

²⁹ *Id.*

³⁰ *Id.*

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regret the imposition of these sanctions.³¹ Ali Larijani, Iran's Chief Nuclear Negotiator, was unfazed by the Security Council sanctions, and said that Iran's response to the resolution would be to "begin activities at Natanz—site of 3,000 centrifuges—and we will drive with full speed."³²

However, a milder reaction from members of the Iranian Parliament demonstrated the willingness of some members to cooperate with the U.N.³³ Mohammad Reza Bahonar, Deputy Speaker of the Iranian Parliament, said, "Our efforts should be reasonable and moderate[, which] means we should be after getting our rights and also show that we are not after a fight[;] if they are willing to recognize our rights, we will cooperate."³⁴ Kazem Jalali, a member of Parliament and its foreign policy committee, said that "it did not appear to be the right time to bar United Nations' inspectors or withdraw from the treaty[.]"³⁵ Muhammad Saeedi, the deputy leader of the country's Atomic Energy Organization, "doubted a majority in Parliament wanted to pull out" of the IAEA.³⁶

On March 24, 2007, in response to Iran's failure to comply with December 2006 sanctions, the Security Council unanimously approved a resolution containing more stringent sanctions.³⁷ The new resolution froze the foreign assets of 15 individuals and 13 entities involved in nuclear or ballistic missile activities or the Revolutionary Guard in addition to those already listed in the December 2006 sanctions.³⁸ The resolution instructed the Director General of the IAEA to issue a report within 60 days about whether Iran had complied with the new sanctions and suspended its nuclear activities.³⁹ The sanctions did not include a travel ban for Iranians suspected of nuclear activity, as had been previously proposed by the U.S. and its allies, but instead called upon member states "to exercise vigilance and restraint regarding entry into or transit through their territories" of individuals engaged in nuclear activities.⁴⁰

Iran appeared unmoved by the adoption of more stringent sanctions,

³¹ *Id.*

³² *Id.*

³³ Nazila Fathi, *Iran Parliament Debates Reply to U.N. Penalties*, N.Y. TIMES, Dec. 27, 2006, at A3.

³⁴ Fathi, *supra* note 28.

³⁵ Fathi, *supra* note 33.

³⁶ *Id.*

³⁷ Thom Shanker, *Security Council Votes to Tighten Iran Sanctions*, N.Y. TIMES, March 25, 2007, at 11.

³⁸ S.C. Res. 1747, U.N. Doc. S/RES/1747 (March 24, 2007).

³⁹ *Id.* at 3.

⁴⁰ Colum Lynch, *U.N. Backs Broader Sanctions on Tehran*, WASH. POST, March 25, 2007, at A1.

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and asserted that its nuclear program would not be suspended.⁴¹ Following the unanimous approval of sanctions, Iran Foreign Minister Manouchehr Mottaki told the Security Council that its sanctions were “unlawful, unnecessary, and unjustifiable.”⁴² Iran also announced that it would limit cooperation with the IAEA and will no longer provide information to the IAEA prior to developing new facilities capable of producing atomic fuel.⁴³

II. RECENT NUCLEAR DEVELOPMENT IN IRAN

Although President Ahmadinejad claims that the nuclear fuel cycle is needed only to run fuel reactors and generate electricity, the international community has questioned his true intentions where nuclear development is concerned.⁴⁴ Experts speculate that Iran is adamant in its quest for a nuclear weapon because Iran fears that the U.S. wants to destroy the Islamic Republic and a nuclear weapon would help ensure the regime’s security.⁴⁵ Iran also likely desires a nuclear weapon to increase Iran’s influence in the Middle East.⁴⁶ Possession of a nuclear weapon is a status symbol and Iran wants to show that it is a major power in the Middle East.⁴⁷

Iran has asserted that it has the right to continue nuclear development under the Nuclear Non-Proliferation Treaty, which it signed in 1970.⁴⁸ The Treaty permitted Iran “to pursue peaceful nuclear development under the watchful eyes of the IAEA.”⁴⁹ However, on July 31, 2006, amid continuing reports that Iran was not fully cooperating with the IAEA, the Security Council adopted a resolution that mandated suspension of Iran’s nuclear enrichment and processing by August 31, 2006.⁵⁰ In December 2006, sanctions were issued in response to Iran’s failure to suspend nuclear enrichment by the Security

⁴¹ *Id.*

⁴² *Id.*

⁴³ Thom Shanker & William J. Broad, *Iran to Limit Cooperation With Nuclear Inspectors*, N.Y. TIMES, March 26, 2007, at A6.

⁴⁴ William J. Broad & Nazila Fathi, *Iran’s Leader Cites Progress on Nuclear Plans*, N.Y. TIMES, Nov. 15, 2006, at A8.

⁴⁵ Daniel Byman, Director, Center for Peace and Security Stud., *The Iranian Nuclear Crisis: Latest Developments and Next Steps*, Testimony Before the House Committee on Foreign Affairs and Subcommittee on the Middle East and South Asia (Mar. 15, 2007).

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ Johanna McGeary, *What Will Make Them Stop? Carrots? Sticks? Inside Bush’s Diplomatic Struggle to Persuade Iran and North Korea to Give Up Their Nuke Programs*, TIME, Nov. 3, 2003, at 36.

⁴⁹ *Id.*

⁵⁰ S.C. Res. 1696, U.N. Doc. S/RES/1696 (July 31, 2006).

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Council's deadline.⁵¹

The IAEA, although unable to prove that Iran's nuclear fuel is being used for nuclear weapons, revealed in its June 2006 report that Iran continued to evade questions about its atomic program.⁵² The report noted that "Iran [had] failed to provide full access to records needed to confirm its claims in June of having enriched uranium to a level of 5 percent, which is suitable for reactors."⁵³ In addition, "inspectors [had not resolved] the origin of previously discovered traces of highly enriched uranium[.]"⁵⁴ The report also disclosed that "inspectors [had] recently found traces of yet another unexplained particle—plutonium—on samples from containers at Karaj."⁵⁵ Plutonium and uranium are both used to fuel atomic bombs.⁵⁶

Significant dangers would be presented by a nuclear Iran.⁵⁷ Experts fear that if Iran produces a nuclear bomb, it might begin to support terrorism more aggressively, because retaliation by the U.S. and other nations would be less likely.⁵⁸ A nuclear weapon in the hands of the Iranian government might also cause other Middle Eastern countries, fearful about Iran's intentions, to develop a nuclear weapon as a deterrent.⁵⁹ Nations observing the situation in Iran might also conclude that they could also acquire a nuclear weapon without risking serious repercussions, which could further aggravate existing international conflicts.⁶⁰

Increasing international pressure has not deterred Iran; instead, it may have motivated the Iranian government to press on with its nuclear program. In February 2007, the IAEA reported that Iran was operating or close to operating 1,000 centrifuges that are capable of enriching uranium at its nuclear facility in Natanz.⁶¹ David Albright, a former inspector and president of the Institute for Science and International Security, stated that "[t]hey are installing faster than was commonly expected."⁶² This report came as a surprise to many experts who did not believe Iran was capable of expanding its nuclear program so

⁵¹ Lynch, *supra* note 26.

⁵² Broad & Fathi, *supra* note 44.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ Byman, *supra* note 45.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ David E. Sanger & William J. Broad, *Iran Expanding Nuclear Efforts, Agency Reports*, N.Y. TIMES, Feb. 23, 2007, at A1.

⁶² *Id.*

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quickly.⁶³ However, the report also confirmed that Iran had not met its nuclear goals.⁶⁴ In February of 2006, Iran claimed that it would have 3,000 centrifuges running by February of 2007.⁶⁵ Unfortunately, inspectors believe that Iran will be able to make up the shortfall and have 3,000 centrifuges operational by May 2007.⁶⁶

In addition to its nuclear activities, Iran has also demonstrated its defiant attitude toward U.N. sanctions by test firing missiles. In January 2007, Revolutionary Guards tested fire missiles in a three-day military exercise.⁶⁷ The Guards fired Zelzal and Fajr-5 missiles near the city of Garmsar, which is 60 miles outside the capital of Iran.⁶⁸

III. HISTORY OF UNITED STATES' TRADE SANCTIONS WITH IRAN

In 1951, when Iran's parliament voted to nationalize the oil industry, Great Britain and the United States Central Intelligence Agency (CIA) developed a plan to overthrow Prime Minister Mossadeqh and install a new leader.⁶⁹ The Prime Minister was successfully overthrown and replaced with the Shah.⁷⁰ The Shah ruled Iran for 26 years as monarch, during which time the U.S. and Britain exercised great influence over him to satisfy their economic interests.⁷¹ However, the Shah's excessive spending contributed to the disillusionment of the Iranian people as the country's economy suffered.⁷² At the same time, the Ayatollah Khomeini, an exiled Islamic leader, gained a large following.⁷³ On January 16, 1979, revolutionaries forced the Shah into exile and Ayatollah Khomeini became leader.⁷⁴ In the midst of the revolution, university students climbed the wall of the United States Embassy and took 52 hostages on November 4, 1979.⁷⁵ Ten days later, President Carter issued Executive Order 12,170 in response to the hostage situation, which declared a

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ Nazila Fathi, *Iran's Leader Stands by Nuclear Plans; Military Plans Exercises*, N.Y. TIMES, Jan. 22, 2007, at A4.

⁶⁸ *Id.*

⁶⁹ Layla Nouraei, *Reassessing U.S. Policy Toward Iran: Stimulating Reform Through Economic Means*, 25 SUFFOLK TRANSNAT'L L. REV. 535, 538 (2002).

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.* at 539.

⁷³ *Id.* at 540.

⁷⁴ *Id.*

⁷⁵ *Id.* at 542.

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national emergency with respect to Iran.⁷⁶ The Executive Order “blocked all property and interests in property of the Government of Iran, its instrumentalities and controlled entities and the Central Bank of Iran which are or become subject to the jurisdiction of the United States or which are in or come within the possession or control of persons subject to the jurisdiction of the United States.”⁷⁷

In 1984, Iran was placed on the U.S. list of state sponsors of terrorism after it was determined that Iran was responsible for the bombing of Marine barracks in Beirut in 1983.⁷⁸ The United States “blocked Iran from receiving U.S. foreign aid, sales of items on the U.S. munitions list, Eximbank credits, and U.S. support for foreign loans, and require[d] strict licensing requirements for any U.S. exports of controlled goods or technology.”⁷⁹

On March 15, 1995, President Clinton signed Executive Order 12,957, entitled “Prohibiting Certain Transactions with Respect to the Development of Iranian Petroleum Resources.”⁸⁰ Executive Order 12,957 was issued after the President had learned that the U.S. firm Conoco, Inc. had inked a deal with Iran to develop oil fields on Iran’s Sirri Island.⁸¹ The order prohibited any “United States person” from making “a contract that includes overall supervision and management responsibility for the development of petroleum resources located in Iran” or making “a contract for the financing of the development of petroleum resources located in Iran.”⁸² Following the issuance of Executive Order 12,957, Conoco withdrew from its contract with Iran.⁸³

On May 6, 1995, President Clinton extended the scope of sanctions with Iran by signing Executive Order 12,959, entitled “Prohibiting Certain Transactions With Respect to Iran.”⁸⁴ Executive Order 12,959 prohibited “the importation into the United States, or the financing of such importation, of any goods or services of Iranian origin” as well as “the exportation from the United States to Iran, the Government of Iran, or to any entity owned or controlled by the Government of Iran, or the financing of such exportation, of any goods, technology, or services[.]”⁸⁵ The order also prohibited the re-exportation by a

⁷⁶ Exec. Order No. 12,170, 44 Fed. Reg. 65,729 (Nov. 14, 1979).

⁷⁷ *Id.*

⁷⁸ H.R. Rep. No. 104-523, pt. 1, at 9 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1296, 1298.

⁷⁹ *Id.*

⁸⁰ Exec. Order No. 12,957, 60 Fed. Reg. 14,615 (Mar. 15, 1995).

⁸¹ H.R. Rep. No. 104-523, pt. 1, at 9 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1296, 1298.

⁸² Exec. Order No. 12,957, 60 Fed. Reg. 14,615 (Mar. 15, 1995).

⁸³ H.R. Rep. No. 104-523, pt. 1, at 9 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1296, 1298.

⁸⁴ Exec. Order No. 12,959, 60 Fed. Reg. 24,757 (May 6, 1995).

⁸⁵ *Id.*

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third country of any goods or technology exported from the United States to Iran.⁸⁶ Executive Order 12,959 forbade foreign affiliates of U.S. oil companies from purchasing Iran's oil exports for overseas trade.⁸⁷ Prior to this order, such foreign affiliates had been procuring 25% of Iran's oil exports.⁸⁸ Undersecretary of State Peter Tarnoff said, "The President's decision to sever American trade and investment with Iran signaled our commitment to exert the maximum efforts of this country to deny Iran financial resources."⁸⁹ By forbidding American investment, President Clinton hoped to cut off the flow of money from the U.S. to Iran.⁹⁰

Although President Clinton's Executive Orders were meant to isolate Iran, they had little impact on the interaction of U.S. allies with Iran.⁹¹ Allies of the U.S. failed to follow President Clinton's lead by initiating any trade or investment bans against Iran.⁹² On July 13, 1995, Total SA, a French company, signed a contract with Iran to develop oil fields on the Sirri Islands following the withdrawal of the U.S. company Conoco.⁹³ Iran also appeared unaffected by the sanctions.⁹⁴ The country found new purchasers for its oil resources that had previously been purchased by U.S. companies and their affiliates.⁹⁵ It also began negotiating ten multi-million dollar petroleum projects with foreign investors.⁹⁶ These developments convinced Congress and the President that "[further] steps were needed to choke off foreign investment in Iran's oil industry."⁹⁷

On August 5, 1996, President Clinton signed the Iran and Libya Sanctions Act of 1996 (the "Act").⁹⁸ The Act was aimed at furthering the U.S. policy of limiting Iran's revenues and petroleum resources.⁹⁹ It reinforced the opposition of the U.S. to Iran's support of international terrorism, and continued

⁸⁶ *Id.*

⁸⁷ H.R. Rep. No. 104-523, pt. 1, at 10 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1296, 1299.

⁸⁸ *Id.*

⁸⁹ H.R. Rep. No. 104-523, pt. 1, at 10 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1296, 1298.

⁹⁰ *Id.*

⁹¹ H.R. Rep. No. 104-523, pt. 1, at 10 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1296, 1299.

⁹² *Id.*

⁹³ S. Rep. No. 104-187, pt. 1, at 10 (1995), *reprinted in* 1995 WL 747811 1, 3.

⁹⁴ H.R. Rep. No. 104-523, pt. 1, at 10 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1296, 1299.

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ Iran and Libya Sanctions Act of 1996, Pub. L. No. 104-172, 110 Stat. 1541 (codified at 50 U.S.C. § 1701 (1996)).

⁹⁹ H.R. Rep. No. 104-523, pt. 1, at 10 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1296, 1298.

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efforts to acquire weapons of mass destruction.¹⁰⁰ Testifying before the Senate, Mr. Tarnoff stated that “[a] straight line [linked] Iran’s oil income and its ability to sponsor terrorism, build weapons of mass destruction, and acquire sophisticated armaments.”¹⁰¹ The Act sought to prevent Iran from further developing its petroleum resources by imposing sanctions on foreign investment.¹⁰² The policy sanctions were expected to “deny Iran the revenues and resources to develop weapons of mass destruction and fund groups that commit[ted] international terrorism and acts designed to derail the Arab-Israeli peace process.”¹⁰³ The U.S. recognized Iran’s need for foreign investment, and believed that Iran would abandon its policies under economic pressure.¹⁰⁴

The Act imposed sanctions on anyone who invested more than \$20 million in one year for the purpose of “directly and significantly contribut[ing] to the enhancement of Iran’s ability to develop [its] petroleum resources.”¹⁰⁵ A violation of the Act would give the President the ability to impose two of six possible sanctions, including:

denial of Eximbank assistance for any exports to the sanctioned person; denial of specific licenses for exports of controlled technology to the sanctioned person and prohibition on imports from that company; a prohibition on a sanctioned financial institution from serving as a primary dealer in U.S. Government bonds or as a repository for U.S. Government funds; a prohibition on any U.S. financial institution from making any loan to a sanctioned person over \$10 million per year; and a ban on any U.S. Government procurement of any goods or services from a sanctioned person.¹⁰⁶

Under the Act, the President could also waive sanctions under certain criteria.¹⁰⁷ The Act also provided for the withdrawal of sanctions if Iran stopped manufacturing or acquiring weapons of mass destruction and if Iran stopped supporting international terrorism.¹⁰⁸

The enactment of the Iran Libya Sanctions Act was immediately met with opposition from allies of the U.S.¹⁰⁹ U.S. allies did not oppose the

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ H.R. Rep. No. 104-523, pt. 1, at 10 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1296, 1299.

¹⁰⁴ *Id.*

¹⁰⁵ Iran and Libya Sanctions Act of 1996, Pub. L. No. 104-172, 110 Stat. 1541, 1543 (codified at 50 U.S.C. § 1701 (1996)).

¹⁰⁶ H.R. Rep. No. 104-523, pt. 1, at 8 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1296, 1297.

¹⁰⁷ Iran and Libya Sanctions Act of 1996, Pub. L. No. 104-172, 110 Stat. 1541, 1547 (codified at 50 U.S.C. § 1701 (1996)).

¹⁰⁸ *Id.*

¹⁰⁹ Bruce W. Nelan, *Taking on the World: Clinton says the New Long Arm of Uncle Sam is Striking*

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government's goal of fighting terrorism, but were outraged by U.S. efforts to control the extent of their foreign investments in Iran.¹¹⁰ Yves Doutriaux, spokesman for the French Foreign Ministry, commented that the United States "[was] one nation telling the rest on the earth what they can and can't do."¹¹¹ Many countries believed that the law was unlikely to curb Iran's objectionable behavior.¹¹² U.S. allies wondered whether the passage of the Iran sanctions bill, as well as a similar bill dealing with Cuba, were merely a tactic employed to bolster support for President Clinton's re-election campaign, since he had previously opposed both bills.¹¹³

Sir Leon Brittan, the European Commission's chief trade negotiator, brought the issue before the World Trade Organization.¹¹⁴ President Clinton was subsequently forced to waive European sanctions to avoid conflict.¹¹⁵ Other nations condemned the Act following its passage. A week after President Clinton had signed the Act, Turkish Prime Minister Necmettin Erbakan went ahead with a planned trip to Iran.¹¹⁶ The Prime Minister ignored Mr. Tarnoff's warning that Turkey would be contradicting U.S. efforts to isolate Tehran.¹¹⁷ The Turkish government claimed that it was "not investing in Iran[,] but simply buying its gas[.]"¹¹⁸

The Iran Libya Sanctions Act was also opposed by U.S. corporations.¹¹⁹ In April 1997, USA-Engage was formed by 500 companies to lobby against the overuse of unilateral trade sanctions by the U.S.¹²⁰ American businesses are often the ones to suffer as a result of unilateral sanctions, since foreign companies are likely to replace them.¹²¹ U.S. unilateral sanctions cost the U.S. economy an estimated \$15 to \$19 billion and 260,000 jobs in 1995.¹²² Many corporate executives complained that the U.S. government's policy of

at Terrorists, but Those Getting Hit are America's Friends Abroad, TIME, Aug. 26, 1996, at 26.

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ William Echikson, *Europe Shows Muscle in this Tussle*, BUSINESSWEEK, May 26, 1997, at 76.

¹¹⁵ Thomas Omestad, *Addicted to Sanctions: At This Rate, the Whole World Will Face U.S. Penalties*, U.S. NEWS & WORLD REPORT, June 15, 1998, at 2.

¹¹⁶ Nelan, *supra* note 109.

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ John Rossant & Stan Crock, *Is It Time to Rethink U.S. Sanctions Against Iran?*, BUSINESSWEEK, May 26, 1997, at 77.

¹²⁰ *Id.*

¹²¹ Omestad, *supra* note 115.

¹²² *Id.*

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unilateral sanctions gave American companies a reputation for being unreliable.¹²³

The U.S. has never sanctioned any entity for a violation of the Iran Libya Sanctions Act.¹²⁴ Due to the European Union's opposition to the Act, the U.S. and the E.U. agreed to avoid confrontation over the Act.¹²⁵ The E.U. "pledged to increase cooperation with the United States on non-proliferation and counter-terrorism."¹²⁶ As a result, President Clinton waived sanctions for France's Total SA project—as well as for its partners, Gazprom of Russia and Petronas of Malaysia—with respect to development of the South Pars gas field, after such development had been deemed a violation of the Act.¹²⁷

Various projects have been investigated for violations of the Act, but no sanctions were ever pronounced by President Clinton or President Bush.¹²⁸ These projects include: Elf Aquitaine (France) and ENI's (Italy) project to develop the Doroud oil field, worth approximately \$1 billion; a contract with Elf Aquitaine and Bow Valley (Canada) to develop the Balal oil field, estimated at \$300 million; a contract with Royal Dutch (U.K.) and Shell (the Netherlands) to develop the Soroush and Nowruz oil fields, worth approximately \$800 million; and a contract with GVA Consultants (Sweden) to explore for oil under the Caspian Sea.¹²⁹

IV. SECURITY COUNCIL MEMBERS RUSSIA AND CHINA RESIST STRINGENT SANCTIONS

The five permanent Security Council member nations negotiated proposed sanctions for Iran for months before agreeing to a final solution in December 2006.¹³⁰ While the U.S. called for strict sanctions to punish Iran for its defiance of the Security Council's demands to suspend nuclear enrichment, Russia and China were reluctant to impose more stringent sanctions.¹³¹ Although a final resolution was unanimously approved by all permanent members of the Security Council, including Russia and China, the final

¹²³ *Id.*

¹²⁴ Kenneth Katzman, *The Iran-Libya Sanctions Act*, CRS Report for Congress, July 31, 2003, at 4.

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.* at 5.

¹²⁹ *Id.*

¹³⁰ Gootman, *supra* note 1.

¹³¹ *Id.*

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resolution proved to be much weaker than earlier proposed solutions.¹³² A close look at China and Russia's economic relations with Iran reveals why each country has resisted implementing tough sanctions.¹³³ Since both Russia and China have strong economic ties to Iran, stricter sanctions could have a significant financial impact on them, whereas the U.S. would have little to lose because of its limited economic relationship with Iran.

Statistics reveal that the U.S. has a more limited economic relationship with Iran than other Security Council members. Iran's trade with Security Council members, excluding the U.S., was estimated to have topped \$22 billion in 2006, up from \$18 billion in 2005.¹³⁴ During the first half of 2006, the U.S. imported only \$99 million worth of goods from Iran, and exported only \$55 million of goods to Iran.¹³⁵ The U.S. primarily imports rugs, nuts, and juice from Iran, and exports cigarettes, pharmaceuticals, and wood pulp to Iran.¹³⁶

Although Russia and China have denied that their economic ties to Iran control their stance on sanctions, it appears that their financial relationships with Iran have indeed influenced the positions they have taken.¹³⁷ China is largely dependent on the Middle East for oil.¹³⁸ An estimated 45% of China's oil imports in 2006 were from the Middle East.¹³⁹ China gets an estimated 18% of its crude oil from Iran.¹⁴⁰ In 2006, Iran was China's third-biggest supplier of oil, providing 12% of the total amount of oil China receives.¹⁴¹ China imported \$5.16 billion of oil from Iran in 2006, which amounted to a 56% increase on the importation of oil from Iran in 2005.¹⁴² China has also inked a 25-year deal with Iran, worth up to \$100 billion, to develop a key oil field at Yadavaran, and also to buy oil and gas from Iran.¹⁴³

China's exports to Iran have significantly risen in the last four years.¹⁴⁴

¹³² *Id.*

¹³³ Neil King, Jr. & Marc Champion, *Embargo Politics: Nations' Rich Trade With Iran Is Hurdle For Sanctions Plan*, WALL ST. JOURNAL, Sept. 20, 2006, at A1.

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Chinese Foreign Policy: A Quintet, Anyone?*, THE ECONOMIST, Jan. 13, 2007, at 11.

¹³⁹ *Id.*

¹⁴⁰ King & Champion, *supra* note 133.

¹⁴¹ *Chinese Foreign Policy: A Quintet, Anyone?*, *supra* note 138.

¹⁴² King & Champion, *supra* note 133.

¹⁴³ Thomas Omestad, *Plan B For Iran: Sanctions that Bite*, U.S. NEWS & WORLD REPORT, May 1, 2006, at 29.

¹⁴⁴ *Id.*

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During the first half of 2006, Chinese exports to Iran increased by 25%.¹⁴⁵ Chinese companies ship over \$700 million dollars worth of goods to Iran, including air conditioners, engines, washing machines, and trucks.¹⁴⁶ China, a large international arms supplier, also supplies weapons to Iran.¹⁴⁷ Currently, Chinese construction companies are also employed in Tehran's transit system, power plants and merchant ships.¹⁴⁸

China's position on international issues demonstrates the government's reluctance to support Security Council measures that could potentially interrupt its oil supply.¹⁴⁹ For example, China has been unwilling to take punitive action against Sudan for its involvement with the genocide taking place in Darfur.¹⁵⁰ Sudan supplies China with 3% of its crude oil and China is averse to disrupting its investment in Sudan's oil infrastructure.¹⁵¹ Similarly, during Security Council negotiations, China objected to proposals for strict sanctions in Iran, in an apparent effort to protect its own economic interests there.¹⁵²

However, China has also demonstrated increasing support of international efforts to compel Iran to cooperate with the IAEA. China's endorsement of the December 2006 Security Council sanctions was "an important symbolic act."¹⁵³ Experts believe that since China is heavily dependent on the Middle East for oil, the Chinese government realizes that it has "little choice but to support efforts to stabilize the region."¹⁵⁴ China's U.N. Ambassador, Wang Guangya, has recently attempted to persuade the government of Sudan to agree to accept U.N. intervention in Darfur.¹⁵⁵ China, although at odds with American tactics to dismantle Iran's nuclear program, it "share[s] the same broad objectives."¹⁵⁶ Russia, which has significantly influenced China's position on Iran, has also been increasingly supportive of nuclear containment. China may be following Russia's lead.¹⁵⁷

A meeting between Mr. Larijani, Secretary of Iran's National Security Council, and Mr. Hu, China's President, to discuss the Security Council

¹⁴⁵ King & Champion, *supra* note 133.

¹⁴⁶ *Id.*

¹⁴⁷ Omestad, *supra* note 143.

¹⁴⁸ King & Champion, *supra* note 133.

¹⁴⁹ *Chinese Foreign Policy: A Quintet, Anyone?*, *supra* note 138.

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² Gootman, *supra* note 1.

¹⁵³ *Chinese Foreign Policy: A Quintet Anyone?*, *supra* note 138.

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

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sanctions highlighted China's diverging interests.¹⁵⁸ China recommended that Iran take the U.N. Security Council resolution seriously.¹⁵⁹ Demonstrating China's support for the imposition of sanctions, Mr. Hu relayed that sanctions were "the shared concerns of the international community over the Iranian nuclear issue[.]"¹⁶⁰ However, President Hu subsequently backed down from that position, claiming that "China continue[d] to believe the Iranian nuclear issue should be resolved through diplomatic negotiation[.]" which illustrated China's aversion to military action to deal with Iran.¹⁶¹ Mr. Larijani, in turn, blamed China's support of the Security Council's sanctions on the U.S., and announced that commercial ties between China and Iran would not be affected by China's vote.¹⁶²

Although Russia's trade relations with Iran are more limited than Iran's trade relations with the E.U. and China, strict sanctions could disrupt Russia's financial investment in Iran.¹⁶³ Currently, Russia is building a nuclear power plant in Bushehr worth \$800 million dollars. Additionally, Russia also has construction contracts worth \$5 billion dollars and arms contracts worth \$1.5 billion dollars.¹⁶⁴ In January 2007, despite the imposition of the December 2006 sanctions, Russia sold Iran \$700 million worth of TOR-MI antiaircraft batteries.¹⁶⁵

Russia played a major role in delaying approval of the Security Council's imposition of sanctions on Iran.¹⁶⁶ Permanent members were forced to appease Russia's demands in order to secure Russia's vote in favor of sanctions.¹⁶⁷ Mr. Churkin, Russia's Ambassador to the U.N., expressed concerns during negotiations that certain language in the resolution would threaten Russia's current business deals.¹⁶⁸ In order to facilitate a solution, Security Council members eliminated a mandatory travel ban on Iranians allegedly involved in Iran's nuclear program.¹⁶⁹ Russia objected to a draft of the resolution which directed that states "prevent entry" of Iranians involved in

¹⁵⁸ *Iran Should Give Sanctions 'Serious Response', China Says*, N.Y. TIMES, Jan. 6, 2007, at A6.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ King & Champion, *supra* note 133.

¹⁶⁴ Omestad, *supra* note 143.

¹⁶⁵ Steven Lee Myers, *No Cold War, Perhaps, but Surely a Lukewarm Peace*, N.Y. TIMES, Feb. 18, 2007, at 43.

¹⁶⁶ Lynch, *supra* note 26.

¹⁶⁷ *Id.*

¹⁶⁸ Gootman, *supra* note 1.

¹⁶⁹ *Id.*

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nuclear activities.¹⁷⁰ Instead, the final version of the resolution left it to individual countries to “exercise vigilance” over their borders.¹⁷¹ The final version also excluded sanctions against a nuclear power plant that Russia is building in Bushehr, and excluded Aerospace Industries Organization from the list of companies involved in Iran’s ballistic missile program, in accordance with Russia’s demands during the negotiation stage.¹⁷²

Recently Russia has demonstrated a greater commitment to containing Iran’s nuclear ambitions.¹⁷³ In March 2007, Russia told Iran that it would not deliver nuclear fuel for the Bushehr nuclear power plant unless Iran complies with U.N. sanctions.¹⁷⁴ Russia is also said to be pulling technicians, engineers and other specialists from the power plant, which could cause serious delays in production.¹⁷⁵ Experts believe that although Russia wants to protect its economic interests in Iran, Russia does not want to see Iran acquire a nuclear weapon.¹⁷⁶

V. U.S. POLICY INCREASES INTERNATIONAL FINANCIAL PRESSURE
ON IRAN

The U.S. and its European allies have acknowledged that the Security Council sanctions are too weak to compel Iran to suspend its nuclear activities.¹⁷⁷ The U.S. and its allies have since implemented a new tactic to increase international financial pressure on Iran by persuading foreign governments and banks to cut ties with Iran.¹⁷⁸ The Treasury Department has been working to persuade Western banks to refrain from doing business with Iran.¹⁷⁹ During IMF and World Bank meetings in September 2006, Treasury Secretary Henry M. Paulson Jr. warned financial institutions and government officials about the potential costs of doing business with Iran.¹⁸⁰ Paulson, Treasury Undersecretary for Terrorism and Financial Intelligence Stuart Levy,

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ Bay Fang, *Optimism Detected on Nuke Issue Russia Takes Tougher Stance Against Iran*, CHI. TRIB., March 22, 2007, at 8.

¹⁷⁴ *Id.*

¹⁷⁵ *Nice Move, Mr. Putin*, CHI. TRIB., March 21, 2007, at 24.

¹⁷⁶ Fang, *supra* note 173.

¹⁷⁷ Cooper & Weisman, *supra* note 20.

¹⁷⁸ *Id.*

¹⁷⁹ Robin Wright, *Iran Feels Pinch as Major Bank Curtail Business*, WASH. POST, March 26, 2007, at A10.

¹⁸⁰ *Id.*

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and Treasury Deputy Secretary Robert M. Kimmitt have all held meetings with banks to explain Iran's use of deceptive practices to finance illicit business activities.¹⁸¹

The U.S. announced in January 2007 that American financial institutions are barred from doing business with Bank Sepah, an Iranian bank.¹⁸² The ban "applies to domestic and foreign branches of American banks, as well as to American citizens working at overseas banks that deal with Bank Sepah anywhere in the world."¹⁸³ American banks must refrain from transferring dollars to Bank Sepah or its branches and subsidiaries.¹⁸⁴ Bank Sepah has subsidiaries in Rome, London, Frankfurt and Paris.¹⁸⁵ In September 2006, the United States barred American financial institutions from dealing with another Iranian bank, Bank Saerat, after determining that the bank had been involved in financing terrorist acts.¹⁸⁶ Bank Sepah is thought to be "the financial linchpin of Iran's missile procurement network, and has actively assisted Iran's pursuit of missiles capable of carrying weapons of mass destruction[.]"¹⁸⁷ Bank Sepah has provided financing to Iran's Aerospace Industries Organization and two Iranian missile companies.¹⁸⁸ Bank Sepah is also believed to have been used to facilitate business between Iran's Aerospace Industries Organization and a North Korean group that exports missile technologies.¹⁸⁹

The U.S. and its allies hope that increased international financial pressure will finally persuade Iran to cooperate with the Security Council. The new strategy has already resulted in some early success.¹⁹⁰ In the past, European countries have opposed U.S. policies which affect them without their consent, as evidenced by the international protest following the adoption of the Iran and Libya Sanctions Act.¹⁹¹ However, the Bush administration has not backed down, and financial institutions in Europe and Asia have begun cutting

¹⁸¹ *Id.*

¹⁸² Steven R. Weisman, *U.S. Prohibits All Transactions With a Major Iranian Bank*, N.Y. TIMES, Jan. 10, 2007, at A3.

¹⁸³ *Id.*

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ Guy Dinmore, *US Imposes Sanctions on Iranian Commercial Bank*, FINANCIAL TIMES (UK), Jan. 10, 2007, at 6.

¹⁸⁷ *U.S. Acts Against Iranian Entity*, L.A. TIMES, Jan. 10, 2007, at 4.

¹⁸⁸ *Id.*

¹⁸⁹ Dafna Linzer, *U.S. Bars Iranian Bank, Cites Missile Payments to North Korea*, WASH. POST, Jan. 10, 1997, available at WLNR 417030.

¹⁹⁰ Wright, *supra* note 179.

¹⁹¹ Weisman, *supra* note 182.

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back business with Iran.¹⁹² The Treasury Department reported that 40 international banks and financial institutions have either limited or severed economic ties with Iran.¹⁹³ UBS, HSBC, Standard Chartered, and Commerzbank have reported that they are limiting business with Iran.¹⁹⁴ The March 2007 sanctions also added Bank Sepah to the list of entities involved in Iran's nuclear and ballistic missile activities.¹⁹⁵ Security Council members will now be prevented from doing business with the bank.¹⁹⁶

As a result of the U.S. government's efforts, the Japanese government has also expressed their willingness to limit business dealings with Iran.¹⁹⁷ Japan is not a member of the Security Council, but the country is heavily dependent on the Middle East for oil.¹⁹⁸ Therefore, Japan's support will be crucial to the success of this strategy.¹⁹⁹ Citing concerns about Iran's nuclear program, Japan has reduced its stake in a \$2 billion deal to develop Iran's largest onshore oil field at Azadegan to 10%, down from 75%.²⁰⁰ In December 2006, the Japan Bank for International Cooperation announced that it would refrain from issuing any new loans for Iranian projects until Iran cooperated with the international community's demands to stop nuclear development.²⁰¹

Another tactic being used by the U.S. and Europe is to "undermin[e] the self-assurance of Iranian officials, especially those who travel abroad."²⁰² American troops in Iraq recently arrested four Iranian diplomats, two of whom were thought to be members of the Revolutionary Guard.²⁰³ The diplomats were suspected of providing explosives to Iraq to be used against U.S. military.²⁰⁴ Even though the diplomats were released, this strategy is intended to "chip away at their confidence."²⁰⁵ These arrests were met with protest from Iran.²⁰⁶

The U.S. and Great Britain are increasing their combined military

¹⁹² Wright, *supra* note 179.

¹⁹³ *Id.*

¹⁹⁴ *Id.*

¹⁹⁵ S.C. Res. 1747, *supra* note 38.

¹⁹⁶ *Id.*

¹⁹⁷ Cooper & Weisman, *supra* note 20.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Id.*

²⁰² *Id.*

²⁰³ *Id.*

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ *Id.*

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presence in the Middle East to deal with Iran.²⁰⁷ The U.S. has deployed a second aircraft carrier (the USS John C. Stennis) and accompanying ships to the Persian Gulf. This decision by the U.S. government doubles the U.S. military presence in the Gulf.²⁰⁸ Great Britain will also add two mine-hunting vessels to its ships stationed in the Persian Gulf.²⁰⁹ Although officials deny that the United States is preparing for an offensive strike, “they acknowledged that the ability to hit Iran would be increased.”²¹⁰ The increased military presence is intended “to make clear that the focus on ground troops in Iraq has not made it impossible for the United States and its allies to maintain a military watch on Iran.”²¹¹ The strengthened naval presence will also be able to enforce any subsequent sanctions that the U.N. may impose on Iran.²¹² Officials also hope that naval presence will prevent Iran from “block[ing] oil shipments from the gulf in retaliation for United Nations sanctions.”²¹³

Increasing international financial pressure has significantly affected Iran’s economy. Iran’s economic health is largely dependent on its foreign capital ties, especially with Western countries.²¹⁴ Experts argue that “Iran’s economy is in desperate need of reform.”²¹⁵ Iran needs \$70 billion dollars to restore its decaying oil industry.²¹⁶ In early 2006, as tensions over Iran’s nuclear program mounted and the threat of sanctions seemed imminent, trade and investment in Iran were negatively impacted.²¹⁷ Amir Cyrus Razzaghi, a Tehran consultant dealing with foreign investors, acknowledged that “[e]xports to Iran dipped, and tens of billions of dollars of capital [were] moved out of Iran.”²¹⁸ The stock market and real estate market have both suffered as a result.²¹⁹ Mr. Razzaghi also acknowledged that many foreign investors were hesitant to invest because of the fear of impending sanctions.²²⁰

²⁰⁷ U.S. *Ships Headed to Mideast Called a Warning to Iran*, L.A. TIMES, Jan. 24, 2007, at 6.

²⁰⁸ *Id.*

²⁰⁹ Thom Shanker, *U.S. and Britain to Add Ships To Persian Gulf in Alert to Iran*, N.Y. TIMES, Dec. 21, 2006, at A24.

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² *Id.*

²¹³ *Id.*

²¹⁴ Kenneth M. Pollack, *Iran: Three Alternative Futures*, 10 THE MIDDLE EAST REV. OF INT’L AFFAIRS 2, 3 (2006), available at <http://meria.idc.ac.il/journal/2006/issue2/jv10no2a5.html>.

²¹⁵ *Id.*

²¹⁶ *Id.*

²¹⁷ King & Champion, *supra* note 133.

²¹⁸ *Id.*

²¹⁹ *Id.*

²²⁰ *Id.*

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The implementation of the U.S. policy to encourage foreign banks and financial institutions to restrict ties with Iran has weakened the Iranian economy. President Ahmadinejad, responding to the threat of international financial pressure, announced a budget which would take a lower price for oil into account.²²¹ Since Iran's budget is heavily dependent on oil revenues, President Ahmadinejad anticipates that the U.S. and its allies will reduce the price of oil in order to pressure Iran into cooperating.²²² Last year, Iran's budget was based on \$44 a barrel for oil.²²³ The new budget is based on a price of \$33 a barrel.²²⁴ President Ahmadinejad does not appear to be yielding to economic pressure. He announced, "We are ready, and we will manage the country even if you lower the oil prices[.]"²²⁵

The economic effect of reduced international financial investment in Iran is apparent, notwithstanding the strength of President Ahmadinejad's conviction to the contrary. Gal Luft, Executive Director of the Institute for the Analysis of Global Security, revealed that "the Iranian economy is suffering a great deal as a result of the economic punishment[.]"²²⁶ Kazem Vaziri-Hamaneh, the Iranian oil minister, has admitted that Iran has "encounter[ed] obstacles in financing oil projects."²²⁷ Mr. Vaziri-Hamaneh further acknowledged that "overseas banks and financiers have decreased their cooperation[.]"²²⁸ International business withdrawal has led Iran to attempt "to secure gasoline imports from its allies, including Venezuela, and [to shift] some dependency from gasoline to natural gas."²²⁹ Iranian importers have also been affected by the major banks' decisions to cut ties with the private sector. As a result, "many [importers are] having to pay for commodities totally in advance when a year ago they could rely on a revolving line of credit."²³⁰

VI. SOCIAL AND POLITICAL CLIMATE IN IRAN

Members of the Iranian Parliament have become increasingly critical of President Ahmadinejad's nuclear policy. The Iranian political system consists of four political groups: reformists, pragmatic technocrats, radical

²²¹ Fathi, *supra* note 67.

²²² *Id.*

²²³ *Id.*

²²⁴ *Id.*

²²⁵ *Id.*

²²⁶ Cooper & Weisman, *supra* note 20.

²²⁷ *Id.*

²²⁸ *Id.*

²²⁹ *Id.*

²³⁰ Wright, *supra* note 179.

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hardliners, and mainstream conservatives.²³¹ The reformist party has little desire for a nuclear weapon, but instead advocates economic and social reform as well good relations with the West.²³² The pragmatic technocrats are concerned with “rebuilding Iran’s economy[,] and recognize that this is impossible without vastly improved relations with the West in order to encourage greater trade and investment in Iran.”²³³ They would like to see Iran acquire a nuclear weapon, but are willing to sacrifice a nuclear program for improved relations with the West.²³⁴ The radical hardliners, led by President Ahmadinejad, are known to “pay little heed to Iran’s economic woes, believing that the Iranian people are willing to make further sacrifices in the pursuit of the Islamic revolution.”²³⁵ President Ahmadinejad and the radical hardliners “are determined to acquire a nuclear weapon, because they believe it is necessary to their larger struggles with the United States, which they see as the principal threat to Iran[.]”²³⁶ The mainstream conservative political group includes National Security Council Chairman Ali Larijani and Supreme Leader Ali Khamenei.²³⁷ Khamenei has taken the “middle path, never curbing Iranian nuclear and terrorist activity enough to satisfy the Americans, but keeping things in check enough to allow the European and Japanese governments to continue to trade and invest in Iran.”²³⁸

Some experts believe that Iran’s leadership was surprised when sanctions were passed, and that members of Iran’s parliament have been discussing a course of action to deal with U.N. sanctions.²³⁹ Reactions by Parliament members reveal dissatisfaction with President Ahmadinejad’s nuclear policy. For example, Mohammed Atrianfar, a political commentator allied with former President Rafsanjani, has argued that “[i]f [Ahmadinejad] wants to start a new war, from where does he think he’s going to produce the army? We are not agreeing with his radical, extreme policies. It is because of the propagandist speech of Ahmadinejad all over the world that we’re in the situation we’re in.”²⁴⁰ Another member of Iran’s parliament, reformist Akbar Alami, said that “[Ahmadinejad is] making some adventures in foreign

²³¹ Pollack, *supra* note 214.

²³² *Id.*

²³³ *Id.*

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ *Id.*

²³⁷ *Id.* at 3.

²³⁸ *Id.*

²³⁹ Kim Murphy, *In Iran, a Chorus of Dissent Rises Over Nuclear Rhetoric*, L.A. TIMES, Feb. 8, 2007, at 1.

²⁴⁰ *Id.*

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relationships that don't benefit our country. The nuclear issue and the right of Iran to have nuclear power is a matter of national pride. But we cannot limit this issue to one person like Mr. Ahmadinejad."²⁴¹ Supreme Leader Ayatollah Ali Khamenei, a strong supporter of the nuclear program, has not done much to quiet critics of Ahmadinejad's policies, revealing that Khamenei may no longer support Ahmadinejad's tactics.²⁴²

The Iranian press, formally barred from criticizing Iran's nuclear policy, has nevertheless expressed disapproval of the government's policies.²⁴³ Over the past few years, more than a hundred newspapers that have condemned government policies have been shut down, and dozens of journalists have been jailed.²⁴⁴ Immediately following the Security Council's December decision, most newspapers either refrained from expressing an opinion about the Security Council's sanctions or criticized the imposition of sanctions on Iran.²⁴⁵ However, in the week following the announcement of the sanctions, several moderate newspapers discussed the potential for the sanctions to have a larger impact than the government had previously acknowledged.²⁴⁶ An editorial in the newspaper *Aftab-e-Yazd* explained that an "'unreasonable and emotional' reaction to the sanctions could be very dangerous."²⁴⁷ Newspapers affiliated with the reformist party similarly cautioned that the sanctions could have serious consequences for Iran.²⁴⁸ Fear of government censure is still apparent, however, and the authors of newspaper articles on the subject did not conclude that the government should suspend nuclear development.²⁴⁹

A new radio program called Goftegoo Radio has recently used the Iranian airwaves to promote scholarly debate of Iran's current nuclear position.²⁵⁰ Heated discussions about whether Iran should continue its nuclear program have been heard regularly on the program since its inception in May 2006.²⁵¹ Guests of the radio program have candidly confronted the nuclear issue.²⁵² The program's guests have spoken boldly, criticizing the government

²⁴¹ *Id.*

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ Nazila Fathi, *Tehran Radio Lets Critics Vent Over Iran's Nuclear Plans*, N.Y. TIMES, Jan. 1, 2007, at A4.

²⁴⁵ Fathi, *supra* note 28.

²⁴⁶ Fathi, *supra* note 33.

²⁴⁷ *Id.*

²⁴⁸ Fathi, *supra* note 244.

²⁴⁹ *Id.*

²⁵⁰ *Id.*

²⁵¹ *Id.*

²⁵² *Id.*

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for putting the nuclear program before the country's other more important interests.²⁵³ Their opinions suggest that many Iranians do not support the nuclear program and would rather see the government's budget be used to fund more vital needs.²⁵⁴ Sadeq Zibakalam, a professor of political science at Tehran University who has appeared on the show several times, expressed outrage over the government's attempt to link Iran's development with the nuclear program.²⁵⁵ Professor Zibakalam demanded, "Who says that we will lose our national identity if we give up our nuclear program?"²⁵⁶ Instead of pouring large amounts of money into the nuclear program, he argued that Iran should invest in hospitals and schools.²⁵⁷ He also criticized the government's failure to address "the costs of sanctions or a military confrontation—[neither of which would] contribute to the country's development."²⁵⁸

The results of recent municipal elections in Iran reveal that President Ahmadinejad's policies are losing popularity among Iranian citizens.²⁵⁹ Politicians aligned with President Ahmadinejad fared poorly in recent elections.²⁶⁰ Election winners came from two very different political groups: the conservative party and the reform party.²⁶¹ Analysts have theorized that the election winners, unlike President Ahmadinejad, "understand that [Iran's] future requires good relations with foreign investors, trade partners and educational institutions."²⁶² Voters have been dismayed that Mr. Ahmadinejad has been ruining relations with foreign investors "by defying the International Atomic Energy Agency and the United Nations[.]"²⁶³

Iranian university students have also protested President Ahmadinejad's policies.²⁶⁴ At one university where President Ahmadinejad was speaking, students interrupted his speech, calling him a dictator.²⁶⁵ University students have taken to protesting because they are angry that the Iranian government has removed professors because of their political affiliation,

²⁵³ *Id.*

²⁵⁴ *Id.*

²⁵⁵ Fathi, *supra* note 28.

²⁵⁶ *Id.*

²⁵⁷ Fathi, *supra* note 244.

²⁵⁸ *Id.*

²⁵⁹ *Saner Voices in Iran*, N.Y. TIMES, Dec. 22, 2006, at A34.

²⁶⁰ *Id.*

²⁶¹ *Id.*

²⁶² *Id.*

²⁶³ *Id.*

²⁶⁴ Christine Spolar, *Rumbles Against the Regime*, CHI. TRIB., Jan. 21, 2007, at 6.

²⁶⁵ *Id.*

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and limited their own basic personal freedoms.²⁶⁶ Students also argue that the Iranian government has damaged possibilities for their future by mismanaging the economy and adversely affecting diplomatic relations.²⁶⁷ Although many students still believe that a nuclear program is their right, many fear that the government's nuclear program is harming the country.²⁶⁸

VII. IS WAR LIKELY?

Tensions continue to escalate between the U.S. and Iran. The U.S. has accused Iran of providing weapons to Iraqi insurgents battling American soldiers.²⁶⁹ An undisclosed Iranian official has acknowledged that Iran could do more to prevent weapons from crossing over its borders.²⁷⁰ Some experts believe that the U.S. administration is preparing to attack Iran, although U.S. officials deny that military action is imminent.²⁷¹

If an attack were to be initiated by the American military, the U.S. government should be careful not to underestimate Iran's capabilities. In such a situation, the U.S. would likely use military air strikes to target Iran's nuclear facilities.²⁷² The Pentagon has contingency plans for a war with Iran which would include targeting "Iran's air-defense systems, its nuclear- and chemical-weapons facilities, ballistic missile sites, naval and Revolutionary Guard bases in the gulf, and intelligence headquarters."²⁷³ However, military officials argue that an attack on Iran will only delay Iran's eventual nuclear independence.²⁷⁴ Officials claim that the only way to eliminate the threat of Iran gaining a nuclear weapon would be to topple the Iranian government—and this is not a feasible solution, considering the U.S. military's current weakened condition.²⁷⁵ Although a U.S. air attack could destroy many nuclear facilities, such an attack is unlikely to destroy all of Iran's nuclear facilities because many sites are unknown.²⁷⁶ Experts believe that Iran would incite insurgents in Afghanistan and Iraq to attack U.S. troops.²⁷⁷ Iran could also disrupt oil shipments from the

²⁶⁶ *Saner Voices in Iran*, *supra* note 259.

²⁶⁷ *Id.*

²⁶⁸ *Id.*

²⁶⁹ Michael Hirsh & Maziar Bahari, *Rumors of War*, *NEWSWEEK*, Feb. 19, 2007, at 28.

²⁷⁰ *Id.*

²⁷¹ *Id.*

²⁷² Michael Duffy, *What Would War Look Like?*, *TIME*, Sept. 25, 2006, at 38.

²⁷³ Hirsh & Bahari, *supra* note 269.

²⁷⁴ *Id.*

²⁷⁵ *Id.*

²⁷⁶ *Id.*

²⁷⁷ *Id.*

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Persian Gulf in retaliation for an attack launched by the U.S.²⁷⁸

CONCLUSION

The imposition of U.N. Security Council sanctions in December 2006 and March 2007 has not impeded Iran's nuclear proliferation. The possibility of a nuclear Iran is a cause for international concern. If Iran develops a nuclear bomb, it is likely that Iran could support terrorism more aggressively, without fear of retaliation. In addition, other Middle Eastern nations might be encouraged to develop their own nuclear weapons. The Middle East is an area of the world where much turmoil already exists and the possibility of more countries gaining nuclear weapons would undoubtedly cause more tension.

Increased international cooperation is necessary to compel Iran to suspend its nuclear activities. Economic ties binding both Russia and China to Iran once seemed to explain the reluctance of both countries to implement strict sanctions against Iran. However, in recent months, both Russia and China have demonstrated an encouraging degree of commitment to containing Iran. Further support from Russia and China as well as other superpowers like Japan will be needed to pressure Iran to cooperate with the IAEA.

The U.S. and its European allies have acknowledged the limitations of U.N. sanctions, and have since instituted new strategies to isolate Iran by persuading foreign governments and banks to sever their financial ties with Iran. This initiative has already enjoyed some success. The economy of Iran is showing the effects of decreased financial investment. Iranian citizens are increasingly concerned about the state of the country's economy. President Ahmadinejad rose to power because of promises relating to economic reform, but he has done little to improve the situation.²⁷⁹ His focus on nuclear development and failure to fix the economy has further disillusioned his constituents. President Ahmadinejad's policies have also caused conflict in Iran's parliament. The international community should take advantage of the current economic, social and political climates in Iran by continuing to condemn Iran's nuclear activities, while simultaneously withdrawing foreign investment in order to further isolate Iran.

The U.S. and Great Britain have increased their naval presence in the Persian Gulf, leading some to believe that military action might be imminent. Military action should be a last resort. An air strike would be unlikely to destroy all of Iran's nuclear facilities and might further encourage Iran to in fact develop a nuclear weapon. A military action could also threaten troops

²⁷⁸ *Id.*

²⁷⁹ Pollack, *supra* note 214.

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currently battling insurgents in Afghanistan and Iraq, since Iran possesses the capability to supply those insurgents with weapons.²⁸⁰ A military action might also encourage Iran to support terrorist activities, including the bombing of U.S. embassies abroad.²⁸¹ Finally, a military action would likely lead to the deaths of innocent Iranian civilians, many of whom who do not support the President's nuclear policy.

If Iran fails to abandon its nuclear program within 60 days of the U.N.'s sanctions, the Security Council must act quickly to pass another set of more stringent sanctions in order to demonstrate its commitment to addressing the situation in Iran.²⁸² Increasingly strict U.N. sanctions, along with international financial pressure, will be necessary to significantly compel Iran to cooperate and suspend its nuclear activities.

²⁸⁰ Byman, *supra* note 45.

²⁸¹ *Id.*

²⁸² Pulling Tehran's Purse Strings: Leveraging Sanctions and Market Forces to Alter Iranian Behavior, Before the H. Comm. On Foreign Affairs, and Subcomm. on the Middle East and Central Asia, 110th Cong. (2007)(statement of Matthew Levitt).

THE ISSUE OF MEXICAN IMMIGRATION: WHERE DO WE GO FROM HERE?

*Nicholas R. Montorio**

INTRODUCTION

This note will examine the issue of Mexican immigration into the U.S. from three different perspectives: historical, economical, and political.¹ Analyzing this issue from these three perspectives will illustrate its multifaceted nature and each perspective is critical to understanding the delicacy of the Mexican immigration debate. Regardless of the standpoint from which one attacks this issue, the pivotal question remains: With a recent influx of Mexican immigrants into the United States, where do we go from here?

There are extremists on every side of this issue. Some believe the U.S. must literally close her borders, through the use of a wall to keep out Mexican immigrants who are damaging the country,² while others advocate that such immigrants are an essential component of the country's history and future.³ California provides a prime example of how both sides of the immigration coin

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¹ Although each of the three analyses will explore how legal and illegal immigration affect the nation and specifically California, much of the discussion should be understood as one about Mexican immigration in a general sense. By the end of this note, it should be clear that with a mere tinkering of US Immigration Law (i.e., amnesty) an illegal immigrant today may very well be legal immigrant tomorrow. Therefore, the distinction between these two types of immigrants serves more as a reference point rather than a permanent mark of demarcation. To focus primarily on what is or is not legal immigration would detract from the larger issue of how Mexican immigration affects the U.S., regardless of what label given to the individuals involved.

² See Pat Buchanan, *Treat Illegal Immigration as an Invasion and Repel It*, available at http://www.ontheissues.org/Celeb/Pat_Buchanan_Immigration.htm. (for an assortment of quotes against an open-immigration policy) (last visited Apr. 20, 2007).

³ See Gilbert Paul Carrasco, *Latinos in the U.S.: Invitation and Exile*, reprinted in IMMIGRANTS OUT! THE NEW NATIVISM AND THE ANTI-IMMIGRANT IMPULSE IN THE UNITED STATES at 310-319 (Juan F. Perea, ed.) (1997).

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exist simultaneously, particularly with regard to illegal immigration. As the U.S. considers the answer to that fundamental question, it is left with the unsettling feeling that both of these extremist positions have some merit, so any proposed resolutions appear untenable.

Each perspective presents unique dichotomies that cannot be answered without balancing complex nuances and various factors against each other; however, when it comes time for a final vote in Congress, the answer to the question above is reduced to its simplest form: one is either “pro”-immigration or “anti”-immigration. Historically, there is no doubt that immigrants have played a significant role in the development of the U.S., but does that mean that the country is required to alter its course to accommodate an endless stream of immigrants? Economically, California elicits many advantages from having a vast, cheap labor force of illegal immigrants, but when do the costs outweigh those benefits?⁴ Politically, Congress has periodically worked toward legislative reform to address specific immigration problems, but would even comprehensive legislation fix current immigration problems, and if so, for how long?⁵ Although few matters are easily resolved when it comes to the issue of immigration, it is clear that the stakes are high, and a miscalculation by Congress or the American people could lead to disaster.⁶

Over the years, Congress has vacillated between a pro-immigration stance and an anti-immigration stance.⁷ The image of a swinging pendulum is apt: no matter how far the pendulum swings to one side based on changes in circumstances, it always comes back to the other side in time to further immigration goals.⁸ America has presented itself to foreigners as Emma

⁴ In discussing the effect illegal Mexican immigration in California, the divide of opinions on this matter embodies the concept of how the immigration debate is shaped by extremists. For an “anti”-immigration opinion, See Richard Lamm, *I Have A Plan to Destroy America* (2005), available at <http://www.snopes.com/politics/soapbox/lamm.asp> (last modified June 16, 2005); (For a contrary “pro”-immigration understanding of this issue, see “DAY WITHOUT A MEXICAN,” (HBO April 2007).

⁵ See generally, Carrasco, *supra* note 3 (detailing how there are periodic shifts in the US Immigration law depending on the economic needs of the country).

⁶ In a post-9/11 world, border security and national unity are concerns which cannot be underestimated; both of which are intimately connected with immigration policy. For a perspective on how grave the future of the U.S. could be without comprehensive immigration reform, see Lamm, *supra* note 4.

⁷ See Carrasco, *supra* note 3, at 318.

⁸ See THOMAS ALEXANDER ALEINIKOFF, *IMMIGRATION AND CITIZENSHIP* 146-166 (West Publishing 2003) (explaining that despite significant changes in immigration law, the two primary purposes behind immigration laws have remained constant: (1) protect the native worker from foreign competition, and (2) prevent drastic changes in society’s racial composition.).

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Lazarus's words proclaim: indiscriminately and with open arms to all.⁹ However, when the immigrants were colored or non-Protestant, or if the country was experiencing a labor surplus, America's portrayal of itself as a welcoming host proved to be more fictional than factual.¹⁰ Throughout the history of the U.S., Congress has enacted various pieces of isolationist legislation by restricting immigration to certain ethnic groups,¹¹ deporting immigrants who had legally established themselves in America,¹² and by imprisoning Asian immigrants during the period of the Chinese Exclusion Laws.¹³

I. HISTORICAL PERSPECTIVE: A CHANGE FROM ASSIMILATION TO BALKANIZATION

A. The Modern Mexican: A Distinctive Immigration Experience

Proximity

The proximity between Mexico and the U.S. may provide one explanation for the difference between the modern Mexican immigrant's experience and those of European and Asian immigrants.¹⁴ The geographical closeness between Mexico and the U.S. is obvious, but worth mentioning, because of the effect that proximity has on tangential immigration issues, such as assimilation. As compared to their European and Asian counterparts, Mexican immigrants can venture to and from the U.S. every few months with

⁹ See Maurice Waters, *Social Trust and Foreign Policy: Immigration and Law Enforcement Issues* (1999) (the concluding words Emma Lazarus' words, which are inscribed into the Statue of Liberty, as follows: "Give me your tired, your poor/ Your huddled masses yearning to breathe free,/ The wretched refuse of your teeming shore./ Send these, the homeless, tempest-tost to me,/ I lift my lamp beside the golden door."), available at <http://immigration.about.com/library/blStateGovOpFo.htm>

¹⁰ See HOWARD ZINN, *A PEOPLE'S HISTORY OF THE UNITED STATES: 1492-PRESENT* 373 (First Perennial Classics ed.,) (HarperCollins 2001) (1995).

¹¹ See Waters, *supra* note 9 (explaining that although ultimately unsuccessful, there was a Popenoe eugenics movement in 1924 to limit certain races from immigrating to the US because they were deemed inferior in character and intellect.)

¹² See Carrasco, *supra* note 3, at 317.

¹³ For an understanding of how Congress treated Chinese immigrants from approximately 1882 through the 1960's, see generally TIEN-LU LI, *CONGRESSIONAL POLICY OF CHINESE IMMIGRANTS* (Arno Press 1979) available at <http://pds.harvard.edu:8080/pdx/servlet/pds?op=f&id=4697388&n=9&s=4>; for the Chinese Exclusion Case, see *Chae Chan Pong v. U.S.*, 130 U.S. 581 (1889).

¹⁴ See SAMUEL P. HUNTINGTON, *WHO ARE WE?: THE CHALLENGES TO AMERICA'S NATIONAL IDENTITY* 221-256 (Simon and Schuster Paperbacks 2004).

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relative ease.¹⁵ When an immigrant comes to the U.S. from a more distant country (i.e., the Philippines, Poland, Armenia), he or she is “barricaded in his new homeland by thousands of miles of ocean, with little hope of returning to the Old Country every few months, and thus [has] to deal with Americans.”¹⁶ Conversely Mexican immigrants can drive or even walk back to their native country, which removes a sense of finality from the decision to come to the U.S.¹⁷

The geographical relationship between the U.S. and Mexico creates a unique entrance point for the modern Mexican immigrant, as compared to immigrants in the early 1900’s. Whether Mexicans enter legally or illegally, there is no stop at Ellis Island or a view of the Statue of Liberty for them;¹⁸ instead, many enter illegally by foot or by car across various points of the desert land shared by the U.S. and Mexico.¹⁹ The U.S. is now “confronted by a massive influx of people from a poor, contiguous country with more than one third the population of the United States, who come across a two-thousand-mile border marked historically simply by a line in the ground and a shallow river.”²⁰

There is another important distinction between today’s Mexican immigrant and immigrants of earlier generations: the greeting.²¹ While Europeans, for example, were greeted by Emma Lazarus’s welcoming words in the early 1900’s, Professor Victor Davis Hanson quips that the modern Mexican immigrant is welcomed into the country under some unspoken conditions:

Beware all you who enter. Here are the rules: You are welcome to work hard between twenty and forty. But then please retire at fifty and return home. Stay young, healthy, single, sterile and lawful - and we want you; get old or injured, marry, procreate or break the law – and we don’t.²²

¹⁵ *Id.*

¹⁶ VICTOR DAVIS HANSON, *MEXIFORNIA: A STATE OF BECOMING* 21 (Encounter Books 2004).

¹⁷ *Id.* at 21-22 (explaining that this is a problem because the “umbilical cord” which attaches the Mexican native to Mexico US is never cut.).

¹⁸ See ANN NOVOTNY, *STRANGERS AT THE DOOR: ELLIS ISLAND, CASTLE GARDEN, AND THE GREAT MIGRATION TO AMERICA* 10-23 (Chatham Press 1971) (explaining the experience an average immigrant had in registering at Ellis Island after weeks on an immigrant ship).

¹⁹ See George W. Bush, *Immigration and Border Security*, Address Before the Davis Monthan Air Force Base (Nov. 8, 2005), available at <http://www.whitehouse.gov/news/releases/2005/11/20051128-7.html>

²⁰ Huntington, *supra* note 14, at 222

²¹ *Id.*

²² Hanson, *supra* note 16, at 55.

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As long as the Mexican immigrant's presence appears to be a societal benefit, he or she will be welcomed; yet, once the economical and social costs are balanced against those benefits, suddenly the Mexican immigrant *must* be discarded.²³

The proximity between the U.S. and Mexico only provides a partial explanation as to why Mexican immigrants pour into the U.S. by the hundreds of thousands each year.²⁴ If it were the only reason, then logically there would also be hundreds of thousands of Canadians attempting to cross into the U.S. at its northern border. The fact that no such immigration issue exists with Canadian immigration indicates that it is not merely convenience and proximity that leads Mexicans to leave their native land for the U.S.; there is also a widespread desire for a better life.²⁵

Mexico City

With the hope of a better life, or a chance to achieve the so-called "American Dream," many Mexicans want to leave their native country.²⁶ The impetus for many Mexicans to leave their native land for the U.S. has to do with economics. Mexico is one of the poorest countries in the world and it shares a border with one of the wealthiest.²⁷ While the U.S. continues to remain a prosperous nation, Mexico's economy continues to falter. The average wage in Mexico has not increased since 1993, and many Mexican citizens are underemployed or unemployed.²⁸ The U.S. is the only First World country that shares a border with a Third World country, which stretches for two thousand miles.²⁹ The combination of the economic opportunities presented by the U.S. with its close proximity is enough to lead hundreds of thousands of Mexicans to cross the border each year.³⁰

For every indigent Mexican citizen who travels to the U.S. in search of a better life, a Mexican elite gains political strength from his or her departure.³¹

²³ See Carrasco, *supra* note 3, at 313-14.

²⁴ See 2001 INS Statistical Yearbook, Table 3 *Immigrants Admitted from Top Twenty Countries of Birth Fiscal Years 1999-2001*, 2001 INS Y.B. (illustrating that immigrants from Mexico led all other countries over the three year period with an average annual admittance of 175,972; India, second on the list India, averaged 47,524 over the same period).

²⁵ See Hanson, *supra* note 16, at 26-31.

²⁶ *Id.*

²⁷ See Huntington, *supra* note 14, at 222-225.

²⁸ See Buchanan, *supra* note 2.

²⁹ See Huntington, *supra* note 14, at 222.

³⁰ See 2001 INS Y.B., *supra* note 24.

³¹ See Hanson, *supra* note 16, at 26-31; see also, ALEJANDRO PORTES, IMMIGRANT AMERICA: A PORTRAIT 7-23, 34-35, 48. (2d ed. 1996) (explaining that although the majority of those who leave

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Instead of preventing the mass exodus of its citizenry, the Mexican government provides safety tips in a “how-to guide” for crossing the border illegally.³² This position by the Mexican federal government has been widely criticized because it ultimately leads to burdens the U.S. must bear: One critic points out that “Mexico’s policy for a half-century has been the deliberate and illegal export of millions of its poorest citizens to the United States, which is expected to educate, employ, and protect them in ways not possible at home.”³³ The Mexican government is accused of encouraging its citizens to migrate north because the same citizens leaving the country are the same who would demand political reform; therefore, the status quo is more likely to remain in place.³⁴ America represents more than the “American Dream” to Mexicans living in areas that lack regular electricity and running water; instead, America is their only hope of changing the living conditions for their families.³⁵

The opportunities presented by immigration to the U.S. are so alluring that many are willing to risk their lives in the process.³⁶ In May 2003, 70 immigrants from Mexico, Central America, and the Dominican Republic packed themselves into a tractor trailer with the hopes of getting a ride to Houston, Texas.³⁷ Nineteen of those passengers died from dehydration, overheating, and suffocation.³⁸ The State prosecuted the driver, Tyrone Williams, for his role in the nation’s deadliest human smuggling attempt.³⁹ On

Mexico for the U.S. are impoverished or uneducated, there are who are many who are professionals and entrepreneurs.).

³² See Solomon Moore, *Mexico’s Border Crossing Tips Anger Some In U.S.*, (Californians For Population Stabilization 2005), available at http://www.capsweb.org/newsroom/media_coverage/moore_mexicos_border.html.

³³ Victor Davis Hanson, *Do We Want Mexifornia?*, CITY JOURNAL 2002, available at http://www.city-journal.org/html/12_2_do_we_want.html; But also consider the benefits at least some in the U.S. enjoy, particularly agricultural employers, as a result a large Mexican immigrant population in the U.S.).

³⁴ See Hanson, *supra* note 16, at 28. (explaining that phrase “Safety valve” is one way to indicate “how useful a mass outflow of the poorest is for the Mexican status quo... Without the promised land to the north, there might well loom either political revolution or African Style famine and plague.”).

³⁵ *Id.* at 79.

³⁶ See CNN, *Frist Fires Opening Shot on Immigration*, available at <http://www.cnn.com/2006/POLITICS/03/29/immigration/index.html> (March 31, 2006) (“Whatever the politics and despite the odds against them, people from countries south of the U.S. border continue to try to cheat death for a chance at the American Dream.”).

³⁷ See Juan A. Lozano, *Driver Gets Life for Smuggling Deaths*, available at <http://www.time.com/nation/article/0,8599,1580509,00.html> (Jan. 18, 2007).

³⁸ *Id.*

³⁹ *Id.*

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January 18th 2007, Williams was found guilty and received a life sentence for each of the passengers who died in his tractor.⁴⁰

The struggling economy is not the only motivation for native Mexicans to leave their country. They also live in a country where corruption and crime are a part of life.⁴¹ In 1996, Mexico's lead drug enforcement officer, General Jesus Gutierrez Rebollo, was arrested for supporting drug traffickers.⁴² This occurred at the apex of the Clinton administration's proclamations regarding the success of its efforts to curb Mexican corruption with regard to drug trafficking.⁴³ A more recent example of corruption within Mexican law enforcement occurred in 2006 when the Mexican government began investigating the crime epidemic plaguing Tijuana. The investigation uncovered evidence that local police officers aided criminals with the transportation of drugs as well as with conducting other illegal activities.⁴⁴ In Mexico, those responsible for deterring crime may very well be participating in it.⁴⁵

Mexicans view the U.S. as a country that preserves a vibrant middle class, a democratic form of government, personal rights, and much more. In other words, "America as antithetical to their homeland, and thus their last and only hope."⁴⁶

⁴⁰ *Id.*

⁴¹ See Dr. Ilya Adler, *El Que No Tansa...* (2001) (explaining that two different organizations have found high levels of corruption in Mexico. International transparency ranked Mexico 59th out of 90 countries it analyzed for corruption. The other organization, Price Water House Coopers, awarded scores to countries for how much corruption discovered where a score of zero represented the lowest level of corruption; this group determined Mexico to have a score of 48 out 150.), available at http://www.mexconnect.com/mex_/travel/bzm/bzmadler31.html.

⁴² See Susan E. Reed, *Certifiable: Mexico's Corruption and Washington's Indifference*, (the New Republic 1997), available at <http://www.pbs.org/wgbh/pages/frontline/shows/mexico/readings/newrepublic.html>.

⁴³ *Id.*

⁴⁴ See Fox News Special Report, (Fox Television Broadcast, Jan. 11 2007) (reporting that the Mexican Federal government ordered the police to turn in their weapons during the investigation due to uncovered incriminating evidence.).

⁴⁵ For an reason as to why the Mexican government has not come under more pressure from its citizenry, see Hanson, *supra* note 34, (explaining that the only way corrupt Mexican government has avoided revolutions because their indigent travel to the U.S. instead of "marching en masse on Mexico City.")

⁴⁶ Hanson, *supra* note 16, at 79.

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B. An Account of Mexican Immigration into the U.S.

During the early 1800's, the U.S. government was fascinated by the idea of expanding America's territory from "sea to shining sea."⁴⁷ Under the policy of Manifest Destiny, and later the Monroe Doctrine, no obstacle proved too difficult in turning the idea of expansion into a reality.⁴⁸ In 1848, Mexico ceded California to the US under the Treaty of Guadalupe-Hidalgo.⁴⁹ As a result, millions of Native American Indians and thousands of Mexicans were suddenly foreigners in a land they previously considered home.⁵⁰ Beyond a change in title, the Southwest did not change much in terms of its populous. Just one year after the Treaty, Anglo gold-miners invited local Mexican laborers now considered aliens under U.S. immigration law into their communities to meet their expanding need for workers during the California Gold Rush of 1849.⁵¹

The Gold Rush of 1849 is the first of many instances in American history that demonstrates how the U.S. has treated Mexican immigrants based directly on its economic needs at the time. Law professor and author Gilbert Paul Carrasco pinpoints the source of U.S. immigration law to the American labor supply: during labor shortages, immigrant workers have been enthusiastically welcomed, but during labor surpluses, they have been subjected to "xenophobic bigotry" and forced out of the country.⁵² He explains: "Mexican laborers have. . . become the United States' disposable workforce, brought in when needed, only to fulfill their use and be unceremoniously discarded, a trend that been recurring for over 150 years."⁵³ During the Gold Rush, there was a labor shortage which created a need for foreign laborers to fill that void; however, when job opportunities diminished as a result of the Panic of 1873 and the depression of 1877, an extreme anti-alien fervor spread throughout the country.⁵⁴ A return to the image of the swinging pendulum is appropriate: depending on America's economic needs at the time, the U.S. can either be a bright beacon of opportunity for foreigners, or it can play the role of a disgruntled, unappreciative neighbor.⁵⁵

⁴⁷ See generally, Zinn, *supra* note 10, at Chapter 12 *The Empire and the People*; for a reproduction of Katherine Lee Bates' *America The Beautiful*, see <http://www.llerrah.com/america.htm>

⁴⁸ *Id.*

⁴⁹ See Carrasco, *supra* note 3, at 311.

⁵⁰ See Huntington, *supra* note 14, at 229-230.

⁵¹ See Carrasco, *supra* note 3, at 311-12.

⁵² *Id.* at 310.

⁵³ *Id.* at 311.

⁵⁴ See Aleinikoff, *supra* note 8, at 171.

⁵⁵ See Nicole Gaouette, *Border Barrier Approved*, L.A. TIMES, Sept. 30, 2006, at A1 (Mexican

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The pendulum swung drastically toward opposition to immigration during the Great Depression in the 1930s. During that period, Americans were forced into taking the type of backbreaking, low-wage jobs that were previously held by immigrant workers.⁵⁶ Once Americans began competing for those types of jobs, the presence of Mexican immigrant workers became superfluous and unwanted.⁵⁷ Suddenly unemployed, the Mexican worker was forced to seek social welfare programs.⁵⁸ The benefits society received from a vast cheap labor workforce of Mexicans during a period of prosperity became nonexistent due to the labor surplus created by the Depression. No longer able to serve as a benefit to the U.S., immigrant workers from Mexico and elsewhere were quickly cast aside as a societal problem to which deportation was the only appropriate remedy.⁵⁹

World War II produced a sharp decline in European immigration, which encouraged the U.S. to once again pursue Mexican laborers to alleviate the labor shortage.⁶⁰ In 1942, the U.S. and Mexico signed a Mexican Laborer Program designed to allow Mexican citizens to work in the U.S.⁶¹ As a corollary to this Act, the two countries also agreed to protect the Mexican laborers against exploitation by U.S. employers.⁶² This aspect of the bill proved ineffective, as employers – primarily agricultural growers—routinely withheld large percentages from their laborers’ already reduced wages.⁶³ Such exploitative measures are still common today. Many illegal immigrants work for slave wages, have dangerous working conditions, and are still at the mercy of the employer when it comes to “deductions” from a paycheck.⁶⁴ Consider the options for the Mexican indigent: (1) working for slave wages in the U.S. or (2) remaining in utter poverty in a poor and corrupt Mexico. Hundreds of thousands choose the first as the lesser of two evils.

Foreign Minister Luis Ernesto Derbez expressing displeasure with Congress’ desire to build a border fence).

⁵⁶ See Carrasco, *supra* note 3, at 313.

⁵⁷ *Id.* (pointing out that the employers would often choose white laborers over immigrant workers).

⁵⁸ *Id.*

⁵⁹ *Id.* (U.S. legislation during this period resulted in the “repatriation” of some “400,000 Latinos without any formal deportation proceedings, including thousands of American citizens.”).

⁶⁰ *Id.* at 314.

⁶¹ *Id.* (this agreement was also commonly known as the *Bracero* or “worker” Program.)

⁶² *Id.*

⁶³ *Id.*

⁶⁴ See Hanson, *supra* note 16, at 39 (explaining that exploitation still continues in the modern day as “the labor contractor can withhold [their] check without cause, or deduct 30 percent of it for Cokes, rides to work, and everything in between.”).

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Pro-immigration legislation in the 1940s continued in the following decade with the McCarran-Walter Immigration Act in 1952, which gave “permanent” status to Mexican laborers who were already in the U.S.⁶⁵ Although the U.S. appeared to be entrenched in a “pro-immigration” position after WWII, this period of pro-immigration legislation did not last long. By 1954, the last remnants quickly vanished under the leadership of Herbert Brownell, Jr., the U.S. Attorney General. The pendulum took another drastic swing in the anti-immigration direction when Brownell introduced “Operation Wetback.”⁶⁶ This program was a “two-fold plan that coordinated the border patrol to prevent undocumented aliens from getting into the United States while rounding up and deporting those who were already here.”⁶⁷ If the government had applied a similar policy to American citizens, it would have been met with complaints about gross violations of the due process and equal protection rights citizens are guaranteed by the U.S. constitution. However, the Supreme Court has consistently ignored such violations when the federal government has acted under immigration law.⁶⁸

C. “The Border Crossed Us”

Some modern Hispanic scholars believe that southwestern U.S. rightfully belongs to Mexico. The history of the land does provide some merit to this proposition: “Almost all of Texas, New Mexico, Arizona, California, Nevada, and Utah [were] part of Mexico until Mexico lost them as a result of the Texan War of Independence in 1835-1836 and the Mexican-American War of 1846-1848. . . . Mexicans do not forget these events.”⁶⁹ Although the Treaty of Guadalupe Hidalgo shaped the Mexico-U.S. border, some modern scholars proclaim that the line of demarcation is arbitrary. Dr. Charles Truxillo, a professor at New Mexico University, proposes that in the near future a new nation will form at the border of the U.S. and Mexico called Republica del

⁶⁵ See Carrasco, *supra* note 3, at 317 (for an understanding of how “permanent” status is a misnomer because Congress can revoke that status at any time, see *Fong Yue Ting v. U.S.* 149 U.S. 698 (1883) and *Wong Wing v. U.S.* 163 U.S. 228 (1886)).

⁶⁶ *Id.*

⁶⁷ *Id.* (Carrasco explains that the program led to the deportation of 3.7 million Latinos with only 63,500 receiving any formal deportation proceedings).

⁶⁸ There are several cases during the Chinese Exclusion period that establish this doctrine. The seminal cases are *Fong Yue Ting v. U.S.* 149 U.S. 698 (1883) and *Wong Wing v. U.S.* 163 U.S. 228 (1886); for an attack on Congress incorrectly assuming the power to legislate immigration law, see Louis Henkin *The Constitution and the U.S. Sovereignty: A century of Chinese Exclusion and its Progeny* 100 HARV. L. REV 853, 862-63 (1987) (explaining that the assumed Congressional power to control immigration is unenumerated, not assuredly within a sovereigns power, and should not be considered an extra-constitutional power).

⁶⁹ Huntington, *supra* note 16, at 229-30.

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Norte.⁷⁰ This new nation would occupy most of the current southwest of the U.S. and some northern, industrial cities of Mexico, and would be a nation that is not quite Mexico and not quite America.⁷¹

Truxillo and others argue that “the border crossed us” and that the land is a Mexican’s birthright.⁷² This position is not only held by scholars, but throughout Mexico as well. Fifty-eight percent of Mexican citizens believe that “the territory of the United States’ southwest justly belongs to Mexico.”⁷³ Any number of modern Chicano scholars would argue that the southwest is indeed the rightful territory of the Mexican people which was wrongfully taken away by a manipulative and an overpowering U.S. government.⁷⁴ Sociologists would explain that the root of the Chicano desire to form a Republica del Norte at the U.S.-Mexican border goes far beyond nostalgia. When a group of people have a common ancestry, origin, and culture, they are also linked to a specific territory, and the sense of solidarity can override other arbitrary distinctions as they work toward a common goal.⁷⁵

With the ever-growing Mexican population along the southern border, the concept of a Republica del Norte is not entirely impossible. The connection between Mexicans living in the U.S. and their native country is strong. Millions vote in Mexico’s elections while living in the U.S.⁷⁶ The border town of El Cenizo, Texas established Spanish as its official language.⁷⁷ With many Mexicans venturing back and forth from one country to the other, the border is virtually nonexistent to some. Americans tend to assume that Mexican immigrants come to the U.S. with the intention of becoming Mexican-

⁷⁰ See Brent Nelson, *La Republica del Norte: The Next American Nation*, available at http://www.unm.edu/~ecdn/social_contract.html (last visited Jan. 11, 2007).

⁷¹ *Id.*

⁷² See Hanson, *supra* note 16, at 32.

⁷³ *Id.*

⁷⁴ See DAVID LAVENDER, *THE SOUTHWEST, The Anvil of American Indian Policy* (University of New Mexico Press 1980) (depicting the story of how the 1848 Treaty was formed as one between an overcome and intimidated Mexican government and the more powerful U.S. government.) For a brief but critical look at Mexico’s history, see Hanson, *supra* note 16, at 76-77 (explaining that Mexico’s nostalgic look at history is laced with inaccuracies: “Terrorist organizations of the late nineteenth century are romanticized. The everyday killer Joaquin Murrieta becomes a modern-day Robin Hood... [And] commentators who have resurrected Tijerina for their pantheon of brown heroes point out that his broadsided were racist to the core and laced with anti-Semitism.”).

⁷⁵ See Nelson, *supra* note 70.

⁷⁶ *Id.*; see also, Sam Dillon, *Mexico Weighs Voting by its Emigrants in U.S.*, N.Y. TIMES, Dec. 7, 1998, at A3.

⁷⁷ *Id.*, see also, Joyce Howard Price, *Officially, They Speak no Ingles; Its Spanish Only for Town in Texas*, WASH. TIMES, Aug. 14, 1999, at A1.

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Americans; instead, many Mexican immigrants merely intend to become a Mexican *in America*.⁷⁸

Unlike previous generations of immigrants who assimilated into U.S. culture out of necessity, Mexican immigrants receive steady waves of compatriots from Mexico to reaffirm their connection to their home country.⁷⁹ Europeans entered and blended into the proverbial “melting pot” by fire; if they did not assimilate, they would be unemployed and unlikely to survive.⁸⁰ Conversely, the modern Mexican immigrant can find employment without integrating into the U.S. culture at all.⁸¹ When this type of cultural seclusion exists, the image of a melting pot is replaced with the concept of a “salad bowl” with various ingredients touching but never becoming one.⁸² This is more likely to occur where there is a high concentration of immigrants in one area, such as in Los Angeles, where it has been estimated that the city will be 60% Hispanic by 2010.⁸³

California is experiencing a “chain migration” where those immigrants who are established in the U.S. are assisting future generations of Mexicans to come into the U.S. When this occurs, “[m]igrants enable their friends and relatives back home to migrate by providing them with information about how to migrate, resources to facilitate movement, and assistance in finding jobs and housing.”⁸⁴ If this self-perpetuating “migration chain” continues, many immigration critics worry the border will only be known to cartographers, and a *de facto* new nation will arise.⁸⁵ Pat Buchanan, American politician who served as senior advisor to three American presidents, Nixon, Ford and Reagan, analogizes the southwest to Kosovo, and predicts that the southwest will eventually secede from the U.S.⁸⁶ Others posit that the millions who have come to the U.S. from Mexico have caused a “blurring of the border between Mexico and America, introducing a very different culture, while also promoting the

⁷⁸ See Hanson, *supra* note 16, at 86.

⁷⁹ *Id.* at 21-25.

⁸⁰ *Id.* at 23.

⁸¹ See Huntington, *supra* note 14, at 248 (the large Cuban society in Miami is often used as a comparison city for Los Angeles).

⁸² See Lamm, *supra* note 4 (explaining this the transformation of the melting pot image to a salad bowl image is destructive to making a unified nation).

⁸³ See Huntington, *supra* note 14, at 227.

⁸⁴ *Id.* at 228 (explaining “If there is a single ‘law’ in migration, it is that a migration flow, once begun, induces its own flow.”).

⁸⁵ See *MSNBC: Hardball with Chris Matthews* (MSNBC television broadcast, June 5, 2006) available at <http://mediamatters.org/items/200606060011> (last visited on 12/15/06).

⁸⁶ *Id.*

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emergence, in some areas, of a blended society and culture, half-American and half-Mexican.”⁸⁷

II. ECONOMICS OF ILLEGAL MEXICAN IMMIGRATION: CALIFORNIA AS A CASE STUDY

A. Sheer numbers and Mexifornia

California highlights both the economic advantages and pitfalls of Mexican immigration, both legal and illegal. Although most southwestern states have similar situations, the other states pale in comparison to what California is experiencing in terms of numbers.⁸⁸ When computing the economic costs of illegal immigration for California, one only needs to look at figures and statistics (see Table 1) to understand the expenses borne by the state’s taxpayers (i.e. with respect to hospitals, schools, and the judicial system).⁸⁹ On the other hand, many argue that despite those exorbitant costs, the U.S. would be unable to function if the millions of current illegal Mexican immigrants were not in the country.⁹⁰

Table 1
Illegal Immigrants: 2004 Outlays and Receipts (*in billions*)

Category	Outlays	Receipts	Net Cost
Education	\$7.7	—	\$7.7
Uncompensated Medical Care	\$1.4	—	\$1.4
Incarceration	\$1.4	—	\$1.4
Tax Payments		\$1.7	\$-1.7
Total	\$10.5 Billion	\$1.7 Billion	\$8.8 Billion

⁸⁷ Huntington, *supra* note 14, at 221. For more discussion on a possible Balkanization of the Southwest see also, *Media matters for America* <http://mediamatters.org/items/200606060011>.

⁸⁸ For the sake of simplicity and for the purposes of this section, California will serve as an example of both the costs and benefits of any state that has millions of Mexican immigrants in the state.

⁸⁹ See Federation for American Immigration (FAIR), *The Costs of Illegal Immigration to Californians*, (2004) available at http://www.fairus.org/site/PageServer?pagename=iic_immigrationissuecentersffec.

⁹⁰ See President Bush, 2006 State of the Union (Jan. 31 2006) (“We hear claims that immigrants are somehow bad for the economy, even though this economy *could not function without them*. All these are forms of economic retreat, and they lead in the same direction, toward a stagnant and second-rate economy.”) available at http://www.ontheissues.org/Celeb/George_W__Bush_Immigration.htm

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California not only highlights some of the complexities on the issue of Mexican immigration, but the state also can serve as an example for the rest of the country in how it advances in the coming decades.⁹¹ Professor Victor Davis Hanson urges anyone who believes this is a problem exclusively affecting California to think again. Illegal aliens are concentrated in select areas of the country now (i.e. Los Angeles, Miami) but the future of immigration could be quite different.⁹²

If you want your work done cheaply by someone else, you will welcome illegal aliens as [California] did. And if you become puzzled later over how to deal with the consequent problems of assimilation, you will also look to California and follow what [California] has done, slowly walking the path that leads to Mexisota, Utexico, Mexizona or even Mexichusetts – a place that is not quite Mexico and not quite America either.⁹³

It is estimated that Hispanics will constitute 25% of the U.S. population by 2040.⁹⁴

While an estimated 1.5 million Mexicans try to cross into the U.S. and are apprehended by Border Control every year, another 500,000 enter the U.S. undetected, and about one third of those immigrants go to California.⁹⁵ The growing number of foreigners has not only placed an economic burden on the state, but has also had the unsettling effect of leading millions of native-born Americans to flee from California.⁹⁶ Many claim that there is a Mexican immigration “problem,” but when a native U.S. citizen pays a Mexican gardener to mow his lawn for a lower price than an American gardener would charge, this transaction is socially acceptable—perhaps because it allows the American to save money. However, when the same U.S. citizen sees the same Mexican gardener waiting in line at the DMV, there is an immigration “problem.”⁹⁷

⁹¹ Hanson, *supra* note 16, at xii-xiii.

⁹² *Id.* at xiii.

⁹³ *Id.*

⁹⁴ Huntington, *supra* note 14, at 224.

⁹⁵ See Buchanan, *supra* note 2.

⁹⁶ *Id.*

⁹⁷ See Hanson, *supra* note 16, at 61.

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B. Economic Principles

Two basic theories have been proposed to explain how the migrant worker affects the native worker. The two theories may not be mutually exclusive, depending on the surrounding circumstances, such as the degree to which there is a disparity in wealth among citizens in the same area. In California, for example, both theories are applicable.

The segmented labor market theory attempts to explain the effect that immigrant workers have on native workers as if the two groups exist independently of each other.⁹⁸ Immigrant workers do not have substantial effect on native workers because the two work forces pursue entirely different forms of employment.⁹⁹ Mexican immigrant workers, for example, take low-paying, backbreaking employment opportunities (i.e. janitor, landscaper, crop picker), and do not compete with native workers seeking blue- and white-collar employment.¹⁰⁰ Moreover, immigrant workers who take those manual labor jobs are actually providing native U.S. workers with a greater opportunity to seek higher forms of employment.¹⁰¹ This theory would only apply if immigrant workers do not eventually climb the social ladder into high-paying jobs, and if the number of immigrant workers is lower than the number of jobs available to prevent them from creating labor surpluses or from turning to social welfare programs.

The one-to-one displacement theory suggests that every employed foreign worker is currently taking a job opportunity away from a native worker.¹⁰² Advocates of this approach argue that if the U.S. deported illegal immigrant workers, opening job opportunities for unemployed native workers, then unemployment in this country would be eliminated.¹⁰³ In other words, every job vacancy left by a deported immigrant would automatically be filled by unemployed native workers. Economist Paul Samuelson offers another explanation:

By keeping labor supply down, immigration policy tends to keep wages high. Let us underline this basic principle: Limitation of the supply of any grade of labor relative to all other productive factors can be expected to raise its wage rate;

⁹⁸ DAVID E. SIMCOX, U.S. IMMIGRATION IN THE 1980'S: REAPPRAISALS AND REFORM 67-88, (Westview Press) (1998).

⁹⁹ *Id.*

¹⁰⁰ *Id.* at 67-69.

¹⁰¹ *Id.*

¹⁰² *Id.* at 67.

¹⁰³ *Id.*

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an increase in supply will, other things being equal, tend to depress wage rates.¹⁰⁴

This theory was realized, at least in part, during “Operation Wetback.” Thousands of immigrant laborers were deported, and the shortage in labor supply led to higher employment rates among natives and higher salaries.¹⁰⁵

When considering the costs and benefits of the presence of illegal Mexican immigrants in California, each of these theories, if implemented could support either a pro-immigration stance or an anti-immigration stance. However, a change in circumstances – in the form of an economic depression, for example – could make either theory appear meritless.

What benefits and costs would be involved if the U.S. were to severely restrict immigration? Would the benefits of immigration affect the entire country, or just particular segments of society? If the costs outweigh any potential benefits, are some American burdened more than others? Finally, where do we go from here?

C. Costs of Mexican Immigrants

President Bush explained the costs of illegal immigration in his May 15, 2006 Address to the Nation: “Illegal immigration puts pressure on public schools and hospitals, it strains state and local budgets, and it brings crime to our communities.”¹⁰⁶ The costs borne by California can be divided into two categories: (1) the government spending that is required to provide access for immigrants to governmental resources like schools, hospitals, and other similarly government funded projects; and (2) the adverse effect of immigration on crime rates and law enforcement expenditures.

Governmental Resources: Education, and Health

In the 1880s, the Supreme Court established that aliens would have as many rights as Congress permitted them to have, and that those rights would be

¹⁰⁴ See Center for Immigration Studies, *Increasing the Supply of Labor Through Immigration: Measuring the Impact on Impact on Native-born Workers* (quoting Paul Samuelson, Economics (1964).) available at <http://www.cis.org/articles/2004/back504.html> (May 2004).

¹⁰⁵ See Hanson, *supra* note 16, at 13.

¹⁰⁶ President George W. Bush, *President Bush Addresses the Nation on Immigration Reform*, available at <http://www.whitehouse.gov/news/releases/2006/05/20060515-8.html> (May 2006). The rest of the quote is as follows: “These are real problems. Yet we must remember that *the vast majority of illegal immigrants are decent people* who work hard, support their families, practice their faith, and lead responsible lives. They are a part of American life, but they are beyond the reach and protection of American law.” (Emphasis added).

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revocable at any time.¹⁰⁷ Until a few decades ago, Congress' authority over immigration law went virtually unchecked.¹⁰⁸ This judicial approach allowed statutes to infringe upon constitutional rights given to lawful permanent residents.¹⁰⁹ However, *Afroyim v. Rusk*, 387 U.S. 253 (1967) brought Congress' free rein over the matter to an end.¹¹⁰ In that case, the Court struck down a congressional statute that revoked the plaintiff's U.S. citizenship for voting in a foreign election.¹¹¹ This decision represented the beginning of a change in the Court's deference to Congress with matters of immigration and naturalization. By the 1980s, it became clear that federal courts had abandoned the Chinese Exclusion cases, which allowed Congress to discriminate against the Chinese, after a string of decisions that gave aliens the government benefits such as education and healthcare.¹¹²

Public education is a benefit that federal courts have allowed illegal aliens to enjoy. In the landmark case of *Plyler v. Doe*, 457 U.S. 202 (1982), children of illegal aliens were assured free public education under principles of Equal Protection and the 14th Amendment.¹¹³ The Court explained:

Every citizen or subject of another country, while domiciled here, is within the allegiance and the protection, and consequently subject to the jurisdiction, of the United States. No plausible distinction with respect to Fourteenth Amendment jurisdiction can be drawn between resident aliens whose entry into the United States was lawful, and resident aliens whose entry was unlawful.¹¹⁴

Although this opinion was criticized by later Supreme Courts and other federal courts, the case serves as a classic example of how policy has changed from the Chinese Exclusion period to present day. In the abstract, the *Plyler*

¹⁰⁷ *E.g.* *Chae Chan Ping v. U.S.* 30 U.S. 581, 609 (1889) (this case is also known as the Chinese Exclusion Case.).

¹⁰⁸ *See* *Fong Yue Ting v. U.S.* 149 U.S. 698, 724 (1893).

¹⁰⁹ *See* *Wong Wick v. U.S.* 163 U.S. 228, 237 (1896) (Due Process would only be required where the sentence for violating immigration law was a sentence of hard labor in prison).

¹¹⁰ *See* Nelson, *supra* note 70 (citing *Afroyim v. Rusk*, 387 U.S. 253 (1967) (invalidating §401 (e) of the Nationality Act of 1940).).

¹¹¹ *Id.*

¹¹² Critics of expanding alien right's disdain rulings of this nature and discard them as misinterpretations of law by "activist" judges. The argument continues that each benefit given to an illegal immigrant represents millions in additional expenses that need to be paid with tax dollars: the very same tax system that illegals do not participate in.

¹¹³ *See* *Plyler v. Doe*, 457 U.S. 202 (1982).

¹¹⁴ *Id.*

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court's assertion that everyone should be entitled to receive a public education, regardless of legal residence status, is admirable. However, in practice, there have been tremendous downsides to this approach, particularly in California.¹¹⁵

The Mexican population is so apparent in Los Angeles, that sociologists Katrina Burgess and Abraham Lowenthal declared "The schools of L.A. are becoming Mexican."¹¹⁶ The city of Santa Ana, which is 40 miles south of Los Angeles, has a student population that is 92 percent Hispanic.¹¹⁷ Mexican immigrants in public schools are an extra expense for taxpayers—not just because of their presence, but also because they rarely graduate on schedule.¹¹⁸ Studies suggest that as many as 40 percent of "both Hispanic aliens and Hispanic citizens of immigration background do not graduate from [California's] high schools within the normal four years, while over 90 percent of Mexicans of all statuses have no B.A. degree."¹¹⁹ Only 59.6 percent of Hispanics had completed high school in 2000.¹²⁰ While academic failures lead to more and more tax dollars being poured into schools,¹²¹ generalizations about "all immigrants" or "all schools" are always subject to exceptions.¹²²

Several other federal court decisions in the 1980s expanded the benefits an alien could receive. The Second Circuit allowed illegal aliens to receive supplemental security income in 1985 – a case later used to expand their eligibility to other forms of welfare.¹²³ In 1986, the Eastern District of New York held that illegal aliens are entitled to Medicaid.¹²⁴ In 1987, the Fifth Circuit granted unemployment benefits to undocumented workers even though they were not permitted to work under the terms of the immigration law.¹²⁵ With each decision, millions of tax dollars were spent to supplement those who

¹¹⁵ See Huntington, *supra* note 14, 226-230.

¹¹⁶ *Id.*, at 227 (this quote is from Katrina Burgess and Abraham Lowenthal in their scholarly study of Mexico-California ties).

¹¹⁷ See Reuters, *California Schools Extend Break For Immigrants*, Dec. 19, 2006, available at <http://www.msnbc.msn.com/id/16287485/>. (accessed Jan 20, 2007).

¹¹⁸ See Huntington, *supra* note 14, at 232-33.

¹¹⁹ Hanson, *supra* note 16, at 68.

¹²⁰ See Huntington, *supra* note 14, at 233-34 (explaining that other academic woes for Mexican immigrants includes a drop out rate of 30 percent as compared to their white counter part whose dropout rate is only 7 percent).

¹²¹ See FAIR, *supra* note 89.

¹²² For an article on how many Mexican immigrants and their children have achieved academic success in Californian schools, see Richard Rothstein, *True or False: Schools Fail Immigrants*, available at http://www.epinet.org/content.cfm/webfeat_lessons20010704 (July 4, 2001).

¹²³ See *Berger v. Heckler*, 771 F.2d 1556 (2nd Cir. 1985).

¹²⁴ See *Lewis v. Gross*, 663 F. Supp. 1164, No. CV-79-1740 (1986).

¹²⁵ See *Ibarra v. Texas Unemployment Commission*, 823 F.2d 873 (1987).

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had contributed a minimal amount of money to the tax system.¹²⁶ The courts appeared to be going beyond Constitutional protections to reach their decisions, instead balancing the cost the state would bear as a result of expanding the rights afforded to liens against the benefits that segment of society could provide to the state.¹²⁷

Crime

The streets of Los Angeles can be analogized to the lawless streets of Wild West frontier town.¹²⁸ The same young men who work hard in the crops to help the country run are the same young men who participate in crime and violence.¹²⁹ Mexican immigrants are surrounded by crime in their native country,¹³⁰ and the situation does not change when they arrive in the U.S. Arriving into America may be the realization of a lifelong dream for some, but they have not reached a place free of crime.

An immigrant may arrive in the U.S. by crossing the border against U.S. immigration law, but he or she is ready to work hard for low wages to avoid being, so the law is not enforced. He or she will be paid in cash by an employer, and neither the employer nor the immigrant will pay taxes on the employment, breaking laws pertaining to taxation. The immigrant may live in an overcrowded dump run by his or her slumlord; this time, its property and health laws that are broken.¹³¹ Since he or she cannot open a bank account as an illegal alien, the immigrant walks the streets with hundreds of dollars in his or her pockets, and may be robbed by a gang of optimistic youths hoping for a big score.¹³²

In this context, it is unsurprising that “an entire species of predatory criminals exists in California that simply cruises cheap apartment buildings, corner liquor stores and rural markets, always on the prowl for industrious Mexican laborers.”¹³³ The individual is likely affected on a personal level by witnessing laws being broken on a daily basis. From the moment an illegal

¹²⁶ See FAIR, *supra* note 89. Undoubtedly, money spent by aliens in the U.S. does often indirectly go toward taxes (i.e. when one pays rent, their landlord uses that money to pay property taxes).

¹²⁷ The Courts may have been assuming the role of super-legislature in evaluating how society should address issues normally handled by the political process. By granting educational opportunity for illegal immigrants, for example, the Court assumed that would eventually benefit society in the long run when those children enter the work force.

¹²⁸ See Hanson, *supra* note 14, at 17.

¹²⁹ *Id.* at 39.

¹³⁰ A reference back to Section I, *supra* at A: 2 “Mexico City.”

¹³¹ See Hanson, *supra* note 16, at 48-49.

¹³² *Id.* at 40, 49.

¹³³ *Id.* at 40.

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immigrant enters the country from Mexico, he or she is surrounded by an entire universe accustomed to breaking U.S. laws.¹³⁴

The agricultural leeches are only the alpha, not the omega that surrounds the unskilled laborer. Beyond them is a virtual army of parasites. The coyote who smuggled him in. . . The forger who gives him the false identification. . . The landlord who rents him. . . The woman who provides him sex, the local market that cashes his check for a cut [and so on].¹³⁵

These types of crimes are witnessed every day by illegal immigrants. When anyone sees the laws go unenforced on a daily basis, a sense of complete lawlessness is created, leading to the perception that anything and everything will go unpunished.¹³⁶ Author Deanna Spingola succinctly explains: "If an individual breaks the law, there should be consequences or others will follow the example of the unfettered lawbreaker."¹³⁷ The combination of the culture of crime surrounding Mexican immigration in Los Angeles and the accompanying sense that most crimes will go unpunished may explain why almost one-quarter of California's inmate population are Mexican.¹³⁸

Although the types of crimes discussed above are abundant, those crimes do not often lead to the incarceration of Mexican immigrants. Drug crimes are much more common.¹³⁹ Because the border between the U.S. and Mexico is easily crossed, illegal drugs also cross over; for example "[m]ore cocaine, heroin, methamphetamine, and marijuana flood across the Mexican border than from any other place[.]"¹⁴⁰ John Walters, the Drug Czar of the Drug Enforcement Agency, claimed that prior to the implementation of the Methamphetamine Epidemic Act in 2006, illegal immigrants were the largest methamphetamine distributors in the country.¹⁴¹

¹³⁴ *Id.* at 48.

¹³⁵ *Id.*

¹³⁶ See Deanna Spingola, *Illegal Immigration and the Law*, available at http://www.spingola.com/illegal_immigration.htm (May 2005).

¹³⁷ *Id.*

¹³⁸ See Heather Mac Donald, *The Illegal-Alien Crime Wave*, CITY JOURNAL (Winter 2004), available at http://www.city-journal.org/html/14_1_the_illegal_alien.html; but see Ruben G. Rumbaut, *Debunking The Myth Of Immigrant Criminality*, available at <http://www.ilw.com/articles/2006,0925-rumbaut.shtm> (2005) (explaining how crime rates and immigration rates are not linked).

¹³⁹ *The Situation Room* (CNN television broadcast Jan. 18, 2007).

¹⁴⁰ *Id.*

¹⁴¹ See *Scarborough Country*, (MSNBC television broadcast Jan. 10, 2007).

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To deal with the problem of drug trafficking by illegal aliens, Californians took matters into their own hands when a majority of California voters passed the controversial Proposition 187 in 1994.¹⁴² The Act “found and declared” that California had “suffered. . . economic hardship caused by the presence of illegal aliens in the state” and that the state had “suffered. . . personal injury and damage by the criminal conduct of illegal aliens in the state.”¹⁴³ The purpose of this Act was to facilitate state and federal governments in working together to “establish a system of required notification by and between such agencies to prevent illegal aliens in the United States from receiving benefits or public services in the State of California.”¹⁴⁴

The costs of Mexican immigration in California are clear, with regard to education and crime. Schools are noticeably influenced by Spanish-speaking students, and crimes of all sorts are being committed by Mexican immigrants or on their behalf. However, it is important to weigh the costs borne by American taxpayers against the potential benefits provided by Mexican immigrants.

D. Benefits: Fact or Fiction?

A Day Without a Mexican

Sergio Arau’s 2004 film *A Day Without A Mexican* suggests that California is utterly dependent on the Mexican immigrants who reside in the state.¹⁴⁵ In the movie, the Mexican population in California mysteriously disappears from the state, depicting the desired effect of “Operation Wetback” and similar proposals to deport all illegal aliens.¹⁴⁶ All of the jobs “Americans won’t do” are often performed almost exclusively by Mexican immigrants.¹⁴⁷ Jobs that many Americans refuse to do (i.e. pick vegetables), or those demanding “any physical labor that requires little skill or education but a great deal of physical strength and stamina and some courage . . . is now done by people born in Mexico.”¹⁴⁸ American youths are said to consider such service jobs demeaning.¹⁴⁹

¹⁴² *Id.* Proposition 187 was later found unconstitutional by the 9th Circuit.

¹⁴³ *League of United Latin Am. Citizens v. Wilson*, 131 F.3d 1297, 1300; 131 F.3d 1297, 39 Fed. R. Serv. 3d 1336 (1997).

¹⁴⁴ *Id.* at 1300.

¹⁴⁵ *See* DAY WITHOUT A MEXICAN, (HBO April 2007).

¹⁴⁶ The movie does not make a distinction between legal or illegal Mexican residents. Instead, all characters with Mexican ancestry “disappear.”

¹⁴⁷ *See* George W. Bush, *supra*, note 90.

¹⁴⁸ *See* Hanson, *supra* note 16, at 35.

¹⁴⁹ *See* Hanson, *supra* note 34.

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Arau's film brings to life the claim that "immigrants are somehow bad for the economy, even though this economy could not function without them."¹⁵⁰ As the Mexicans disappear from California, the houses remain unclean, the crops unpicked, and every other service sector of the economy comes to a screeching halt.¹⁵¹ The void left by the unwillingness of Americans to assume those jobs is often filled by Mexican immigrants; for example, "California needs workers of a certain type – muscular, uneducated, and industrious – to cut our lawns, harvest our food, cook and serve meals, baby-sit kids, build homes, clean offices, and make beds in motels and nursing homes."¹⁵² The working Mexican immigrant does appear to provide some benefits to the U.S. and to California. However, critics have challenged the claim that these benefits make up for the costs.¹⁵³ In fact, the cost of the estimated 12 million undocumented illegal aliens living in the U.S. is estimated to be approximately \$20 billion.¹⁵⁴

Assessing the overall effect of Mexican immigrants in the U.S. is more complicated than adding up the benefits Mexican immigrants provide to the state and then simply subtracting the tax dollars allocated to the immigrants.¹⁵⁵ The effect immigrants have on a particular area may be different for the affluent than for the lower class.¹⁵⁶ In Southern California, a resident may have his gardening done cheaply by an illegal immigrant willing to do the work for less pay than a native U.S. worker, while a native construction worker cannot find work for the same reason.¹⁵⁷

IRCA and AgJOBS

The benefit provided by the illegal Mexican immigrant to California is greater in the field of agriculture than in any other area. Hanson claims that a

¹⁵⁰ See President Bush, *supra* note 90.

¹⁵¹ See Arau, *supra*, note 145; see also, Hanson, *supra*, note 16, at 37 ("Ban our yearly contingent of tough, lean Mexican Immigrants completely from California tomorrow, and I think within a year or two the state would be almost paralyzed- much of its food decaying, its hotels dirty, its dishes unwashed, its lawns and shrubs weedy and unkempt.").

¹⁵² See Hanson, *supra* note 16, at 158.

¹⁵³ See Center for Immigration Studies, *Costs* at <http://www.cis.org/topics/costs.html> (last accessed April 27, 2007).

¹⁵⁴ *Id.*

¹⁵⁵ See Center for Immigration Studies, *supra* note 104.

¹⁵⁶ See Peter Elstrom, *Fresh Ideas for the Immigration Debate*, available at http://www.businessweek.com/bwdaily/dnflash/content/feb2007/db20070226_045720.htm (Feb. 27, 2007).

¹⁵⁷ *Id.*

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prime example of the “type” of job Americans refuse to do is picking crops.¹⁵⁸ The reason might be that “[f]armwork is among the most dangerous professions in the U.S., and many farmworkers suffer job related injuries or from the effects of poisonous pesticides.”¹⁵⁹ As a result, this void is filled by undocumented workers.¹⁶⁰ These workers lack any bargaining power and are often exploited with unfair wages and dangerous working conditions.¹⁶¹

Congress attempted to address this issue in 2005 with the Agricultural Jobs, Opportunity, Benefits, and Security Act (“AgJOBS”).¹⁶² The bill modifies the H-2A visa application by streamlining the process and by providing various worker protections.¹⁶³ The most significant improvements for laborers under AgJOBS are as follows: (1) free housing is provided to nonlocal employees by employer; and (2) wages will be paid that match the highest of either federal minimum income, state minimum income, or the prevailing wage for that job.¹⁶⁴ In addition, the bill gives the guest worker the power to enforce these rights in federal court.¹⁶⁵

The working conditions of laborers will improve under this and similar laws when enforced, but the agricultural employers may receive the greatest benefit. With recent raids on employers suspected of hiring illegal aliens,¹⁶⁶ this legislation allows agricultural employers to avoid the dilemma of breaking the law or letting their crops spoil.¹⁶⁷ Understanding AgJOBS as an effort by Congress to advance and protect the needs of agricultural farmers is par for the legislative course. In the 1950s, laws were enacted to forbid the harboring or

¹⁵⁸ See Hanson, *supra* note 16, at 38-39

¹⁵⁹ See National Council of La Raza, available at <http://www.nclr.org/content/publications/download/2609>

¹⁶⁰ *Id.* (“The majority of migrant and seasonal farmworkers in the U.S. are currently undocumented, and 70% of U.S. farmworkers are Latino.”)

¹⁶¹ *Id.*

¹⁶² The discussion of AgJOBS is limited to how “illegal” immigrants will be authorized to pick crops in the U.S. and how that will benefit California. There is a second component of this bill which would allow illegal workers to earn a path toward citizenship. However, this aspect of immigration reform was not included in the 2006 immigration reforms that were enacted into law. This issue of earned citizenship is addressed in Section III, B:3 “The debate over ‘Amnesty’”

¹⁶³ See NCLR, *supra* note 159.

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* (recall the line of cases after Plyler, *supra* Section II:3, that expanded alien rights. This bill is a continuation in that expansive direction).

¹⁶⁶ *E.g.*, Robert Longley, *Immigration Raid Vacates Texas Town*, available at <http://usgovinfo.about.com/b/a/217518.htm> (Feb, 14, 2007)

¹⁶⁷ See Gaouette, *supra* note 55 (quoting California Senator Dianne Feinstein who explained that efforts to curb illegal border crossing resulted in an entire agricultural season being lost because not enough workers were available to pick the crops.).

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transporting of illegal immigrants, but those laws without any teeth, as the law did not forbid actually employing illegal workers.¹⁶⁸ In 1972 and 1973, the House of Representatives passed employer sanctions on hiring illegal workers in successive years, only to have the sanctions rejected by the Senate.¹⁶⁹

In 1986, less than thirty years after “Operation Wetback,” Congress authorized the Mazzolli-Simpson Immigration Reform and Control Act (“IRCA”) as part of a campaign called “Operation Jobs” to fill the labor shortage.¹⁷⁰ Like AgJOBS, IRCA also contained provisions that would extend earned citizenship to illegal aliens who met certain qualifications.¹⁷¹ Even though many immigrants were given U.S. citizenship under IRCA, a long-awaited dream come true for most, the true winners under this 1986 Act may have been the agricultural farmers. The Act appeared to establish firm guidelines for employers to follow when employing foreign laborers, but there were several concessions made in the employers’ favor, including “the right to ‘replenish’ the supply of agricultural workers[;] a two year moratorium on enforcement of employer sanctions in agricultures[;] and a further curb on INS operations against field workers.”¹⁷²

Over twenty years ago, author David E. Simcox made a prescient observation: the agricultural growers’ constant demand for cheap laborers would continually impact how Congress addressed immigration reform. Simcox wrote:

[on] one side is a congeries of determined special interests [of agricultural growers] that, though representing a minority, press effectively for more immigration. On the other side is a sizable but unfocused majority of the electorate that favors restricting immigration and harnesses it more rationally to agreed national needs. This deep division will continue to roil policymaking.”¹⁷³

¹⁶⁸ See Simcox, *supra* note 98, at 4-6

¹⁶⁹ *Id.* at 6 (particularly important legislative reforms and their specific details and effects are addressed more fully in Section III, *infra.*).

¹⁷⁰ *Id.* at 4 (Important to note, IRCA was enacted under great political pressure in the November before a mid-term election. As early as 1981 there was a strong public outcry for immigration reform when the country’s unemployment level approach 10% and William French Smith, US Attorney General, admitted that the country “[had] lost control of [its] borders.”).

¹⁷¹ *Id.* at 4-12.

¹⁷² *Id.* at 11.

¹⁷³ Simcox, *supra* note 98, at 59

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Although theirs is a minority voice, farmers have significant pull in the political process in a state like California, which produces nearly half of the country's fruits, vegetables, and nuts.¹⁷⁴

III. A LEGISLATIVE PERSPECTIVE: THE SECURE FENCE ACT OF 2006 AND OTHER MODERN IMMIGRATION REFORM

A. Politics As Usual

Few issues in current U.S. politics are as likely to incite emotional reactions as the topic of immigration. Extremists line up on each side, generally along political lines, and offer their opinions about the appropriate Congressional response to the recent influx of immigrants from Mexico.¹⁷⁵ The clashing viewpoints which form the landscape of the immigration debate are firmly entrenched, which makes the pursuit of a popular consensus through a moderate alternative nearly impossible.¹⁷⁶

Politicians often handle the immigration issue in a superficial manner in order to garner votes. Democrats, who largely resist the imposition of draconian measures to stem the rising tide of immigration, face criticism for their perceived weakness with regard to national security at the borders—which has become a hot-button issue for U.S. voters in a post-9/11 world.¹⁷⁷ Conversely, Republicans, who are generally in favor of such measures, face criticism for politicizing the issue in a ploy to win votes from their conservative base, instead of acting in the nation's best interests.¹⁷⁸ When it comes to issues such as immigration about which voters are deeply divided, competing politicians often polarize themselves by exaggerating the shortcomings of the

¹⁷⁴ See Gaouette, *supra* note 55.

¹⁷⁵ See *Immigration Agenda: Republicans vs. Democrats*, available at <http://immigration.about.com/od/ussocioeconomicissues/a/GOPvLiberalView.htm> (explaining that from a philosophical standpoint, republicans generally advocate for measures that would close US borders, while Democrats advocate for open immigration policies.) (last accessed Nov. 5, 2006).

¹⁷⁶ See *Moral Issues*, available at <http://www.cnn.com/ELECTION/2006/special/issues/moral.issues/> (accessed Nov. 15, 2006) (explaining how these three moral issues play a factor in close election races).

¹⁷⁷ See *House Aims to Crack Down on Illegal Immigrant Smugglers*, Sept. 21, 2006, available at <http://www.foxnews.com/specialsections/immigration/index.html> (accessed Nov. 19, 2006) (quoting James Sensenbrenner, Republican Senator from Wisconsin, "The American people say border security first.").

¹⁷⁸ Nicole Gaouette, *Border Bills Come Down to Last Minute*, L.A. TIMES, Sept. 25 2005, at A1.

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opposing position. As a result, they continue to move further away from possible solutions.¹⁷⁹

The intense emotions evoked by the issue of immigration may be the source of this superficial treatment in the U.S., which has been termed “a nation of immigrants[.]”¹⁸⁰ Many Americans become nostalgic about how their ancestors were intimately involved in the construction of this country’s infrastructure during its developmental years.¹⁸¹ Millions of those immigrants in the early 1900s were greeted on Ellis Island by the kind words of Emma Lazarus which begged for Europe’s poor “huddled masses.”¹⁸² Many current immigrants, most notably those from Mexico, are seeking the same supportive welcome to America as they pursue their “American Dream.”

B. Recently Enacted Legislation

Security Fence Act of 2006

Since 9/11, national security has become a governmental priority. There is a general consensus among the nation’s representatives that the country’s borders must be patrolled closely, but finding an appropriate means for doing so has proven to be a difficult task. On September 29, 2006, after months of debate, the Senate approved the construction of a 700-mile fence along the southern border of the U.S., under the Secure Fence Act of 2006 (the “Secure Fence Act”).¹⁸³ The Secure Fence Act specifies that the fence will be built in choice locations between the US and Mexico, including Tecate and Calexico, California, as well as several border towns throughout New Mexico,

¹⁷⁹ *Immigration Reform, in Pieces*, N.Y. TIMES, Sept. 26, 2006, at A22, (“The House’s election hunt for border-security sound bites shows how susceptible to demagoguery the debate can be.”).

¹⁸⁰ For the actual numbers of foreign born U.S. population, see U.S. Citizen and Immigration Services, *Pew Hispanic Center March 2005 Current Population Survey*, <http://www.cnn.com/2006/EDUCATION/04/25/extra.immigration.terms/index.html>

(This phrase appears to be a misnomer as only approximately 13% of the country’s populous are actually foreign born. However, this does not prevent politicians from conjuring up the nations’ history for political leverage), see also, Bush, *supra* note 106 (“We’re also a *nation of immigrants*, and we must uphold that tradition, which has strengthened our country in so many ways.” (emphasis added)).

¹⁸¹ See DENNIS CLARK, *THE IRISH RELATION: TRIALS OF AN IMMIGRANT TRADITION*, 46-58 (Fairleigh Dickinson University Press) (January 1982) (explaining the pride Irish-American should have for their immigrant forefathers who often took dangerous jobs such as construction of tunnels and skyscrapers during the nation’s formative years).

¹⁸² But see Waters, *supra* note 9 (“Despite the noble and compassionate words of Emma Lazarus inscribed on the pedestal of the Statue of Liberty in 1903, Americans have not always reflected that spirit for the immigrant even in the early years of our country’s development.”).

¹⁸³ See Gaouette, *supra* note 178.

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Arizona, and Texas.¹⁸⁴ In 2007, the Department will use “state-of-the-art” security systems to better detect illegal crossing and always with an eye to prevent potential terrorist attacks, in accordance with the provisions of the Secure Fence Act.¹⁸⁵

The proposed use of a fence as a solution for illegal immigration was hotly contested during the summer of 2006. One outspoken proponent of the Secure Fence Act was Republican Senator Jeff Sessions from Alabama; Democratic Senator Edward Kennedy from Massachusetts argued vehemently against it. Senator Sessions continually stressed that the Secure Fence Act would be “absolutely effective” in deterring illegal immigration and avoiding its detrimental side effects.¹⁸⁶ He cited the 56% decrease in crime San Diego experienced after building a fence around certain parts of its border with Mexico.¹⁸⁷ Senator Kennedy was quick to discard any statements in support of the Secure Fence Act as “a crass political effort by those more interested in saving their [Senate] seats than securing the border.”¹⁸⁸ He suggested that the real issue was the system that permitted people to overstay their visas.¹⁸⁹ Democratic Senator Harry Reid from Nevada explained that no barrier could solve the current immigration reform issues: “You build a fence 10 feet high, 20 feet high, 100 feet high, it won’t solve our problems.”¹⁹⁰ The use of a fence was also criticized by Republican Senator Arlen Specter from Pennsylvania, who rejected the concept due to its failure to address other aspects areas that need immigration reform.¹⁹¹

During the debate over the *Secure Fence Act*, critics pointed out that Republicans seemed to be exploiting this issue to gain some political advantage among their base. After the Act became law, critics attacked it from a different angle, by speculating about its practical effect. Some argued that by blocking known trails across the border, the fence would not deter immigrants from trekking across the desert as much as it would force them to take more

¹⁸⁴ See Nicole Gaouette, *Senate Moves Toward Action on Border Fence*, L.A. TIMES, Sept. 29 2006, at A18.

¹⁸⁵ *Id.*

¹⁸⁶ See Nicole Gaouette, *Border Bill Takes a Detour*, L.A. TIMES, Sept 29, 2006 at A16-A17.

¹⁸⁷ *Id.* at A16.

¹⁸⁸ *Id.*

¹⁸⁹ *Id.* (Kennedy pointed out that approximately 40% of illegal immigrants in the US entered legally but have overstayed their visa.)

¹⁹⁰ See Gaouette, *supra* note 178.

¹⁹¹ *Id.* (Specter is quoted as saying “I don’t see how we can deal with immigration on a piecemeal basis.” In context, he was expressing the need for comprehensive immigration reform that dealt with various aspects of illegal immigration. In other words, building a fence to thwart individuals from illegally crossing the border is only a “piece” of the puzzle needed for a solution.).

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dangerous routes.¹⁹² Others expressed concern that the ecosystem would be adversely affected by the construction of a fence that stretched hundreds of miles.¹⁹³ Senator Biden, Democrat from Delaware, argued that the provisions of the Secure Fence Act conditioned the construction of the proposed fence on so many factors that it could never be completed, and that the proposal was simply a “sham” by Congress in an effort to deceive the American people.¹⁹⁴ In addition, it appears to some to be a foregone conclusion that the fence between the border will never be built.¹⁹⁵ This further supports earlier contentions that this Act served a Republican political needs to appear tough on national security, rather than as an effective solution to a practical concern.

Department of Homeland Security and Border Patrol

After the creation of the Department of Homeland Security (DHS) by the Homeland Security Act of 2002, the bureaucratic organizations responsible for enforcing immigration policy were reorganized. On March 1, 2003, the Natural Immigration Service was moved into the DHS, and renamed Citizenship and Immigration Services (CIS).¹⁹⁶ CIS handles U.S. immigration services and benefits: citizenship and visa applications, asylum, and refugee services.¹⁹⁷ The Border Patrol is the responsibility of a different bureaucratic department known as the Department of U.S. Immigration and Customs Enforcement.¹⁹⁸

In September of 2006, the House and Senate agreed to provide DHS with a budget of \$34.8 billion, with \$21.3 billion earmarked for border security and immigration enforcement.¹⁹⁹ Of that allotment, \$1.2 billion is for border security and will be used in an effort referred to as Hold The Line “to hire “1,500 new Border patrol agents, increasing the force to 14,800, and add 6,700 detention beds.”²⁰⁰ The increased number of agents will ensure greater coverage along the 2,000-mile southern border, but the beds also provide a

¹⁹² See Gaouette, *supra* note 186.

¹⁹³ *Id.*

¹⁹⁴ See Lou Dobbs Reports, (CNN Oct. 10, 2006).

¹⁹⁵ See Gaouette, *supra* note 55 (quoting Frank Sharry, executive director of National Immigration Forum, “I’m going to go out on a limb and say we’ll never see a 700-mile wall along the southern border”; “This is about incumbent protection, not border protection.”).

¹⁹⁶ See Immigration: Key Dates, available at <http://www.cnn.com/2006/POLITICS/09/27/elec.keydates.immigration/index.html> (Sept. 27, 2006)

¹⁹⁷ See History of Immigration, <http://www.rapidimmigration.com/usa>

¹⁹⁸ *Id.*

¹⁹⁹ See Eric Lipton, *Lawmakers Agree to Spend \$1 Billion on Tightening Border*, N.Y. TIMES, Sept. 26, 2006 at A21.

²⁰⁰ *Id.*

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place to keep individuals who are apprehended.²⁰¹ The Border Patrol's former "catch and release" cycle did not prevent those who attempted to cross the border from trying again, and the process was heavily criticized.²⁰² Bush outlined the problem:

For many years, the government did not have enough space in our detention facilities to hold [apprehended border crossers] while the legal process unfolded. So most were released back into our society and asked to return for a court date. When the date arrived, the vast majority did not show up. This practice, called "catch and release," is unacceptable, and we will end it.²⁰³

It is interesting to note that although Mexican immigrants come to the U.S. in the largest numbers, this aspect of immigration reform does not affect them as much as it affects immigrants from other countries.²⁰⁴

In an active effort to better protect the borders, Congress has enacted another piece of legislation which requires all air travelers—even American citizens—to present a passport at the border.²⁰⁵ The primary problem presented by the Act was its effect on U.S. citizens and Canadians who were currently abroad without their passports.²⁰⁶ The law provides for exceptions, however; officers are empowered to make discretionary judgments regarding the admittance of individuals into the U.S. without a passport. In early 2008, the Act, which currently only applies to air travelers, will also apply to land and sea travelers.²⁰⁷

²⁰¹ Without a place to keep the attempted illegal crossers, agents are forced to release those apprehended. Thus, the heavily criticized policy of "catch and release" took form.

²⁰² For a critical look at the flaws in previous immigration policy handled apprehended illegal border crossings, see Spencer S. Hsu, *Backlogs at the Borders, Cracks in the System*, WASH. POST, May 14, 2006 at A1 available at http://www.washingtonpost.com/wp-dyn/content/article/2006/05/13/AR2006051301173.html?nav=rss_world/centralamerica

²⁰³ See Bush, *supra* note 106.

²⁰⁴ *Id.* (explaining that because the U.S. is able to return those apprehended with relative ease, "catch and release" was used for natives of more distant countries.)

²⁰⁵ See Beverley Lumpkin, *New Rules Requiring Passports for Americans*, <http://travel.msn.com/Guidelines/article.aspx?cp-documentid=380528&page=2>; (explaining that these new rules "were mandated by Congress in 2004 following the terrorist attacks of Sept. 11, 2001, and were recommended by the 9/11 Commission.); see also, The State Department's website at http://travel.state.gov/travel/cbpmc/cbpmc_2223.html

²⁰⁶ *Id.*

²⁰⁷ *Id.*

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The discretion afforded to Border Patrol agents in enforcing the passport requirement appears to be a necessary delegation of enforcement responsibility, in the interest of promoting efficiency. If U.S. citizens were able to prove their identity and legal citizenship without a passport, then a time-consuming judicial hearing could be avoided. However, the discretionary powers of Border Patrol agents and other law enforcement officers in other circumstances may come dangerously close to violating traditional notions of due process. Under the Illegal Immigration Reform and Immigrant Responsibility Act (IIRIRA), the discretion of Border Patrol agents charged with determining whether an individual is an illegal alien is virtually unchecked.²⁰⁸ Prior to the IIRIRA, the law provided that an individual suspected of illegally crossing the border could have the benefit of judicial intervention prior to his or her deportation.²⁰⁹ After the IIRIRA, however, an officer is empowered to exercise his or her discretion in enforcing immigration laws.²¹⁰ Critics are fearful of allocating this responsibility to Border Patrol agents merely to improve efficiency, because “to allow officers of such low grade, who are not lawyers, to have such a sweeping authority regarding the admission or removal of aliens appears to . . . greatly diminish the notion of due process.”²¹¹

The Debate over “Amnesty”

The most controversial aspect of recent legislative reform has involved the question of how to deal with the estimated millions of undocumented immigrants currently residing in the U.S. Some advocate the deportation of everyone living in the U.S. who entered the country illegally. This approach is analogous to “Operation Wetback” from 1954, but this time politicians have characterized it as an “enforcement only approach.”²¹² This stance is grounded in the belief that amnesty is the equivalent of rewarding criminal behavior and would even encourage more immigrants to cross the border illegally.²¹³

Others are in favor of giving amnesty to every undocumented alien currently living in the U.S. The illegal alien’s method of entry into the country would be forgiven, and he or she would be given a legal status. Benefits of this strategy could be as follows: an increased number of taxpayers reduced social

²⁰⁸ See Waters, *supra* note 9.

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² See Gaouette, *supra* note 186.

²¹³ See Jennifer and Peter Wipf, *Amnesty: Both Sides of the Issue*, available at http://immigration.about.com/od/ussocialeconomicissues/i/AmnestyIssue_2.htm.

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costs related to illegal immigration, and the advancement of greater diversity.²¹⁴ Amnesty would allow illegal immigrants to come out from their “underworld,” join the American culture, and benefit from social programs which could help reduce crime rates.²¹⁵ The closest this country has come to embracing this position was the Mazzoli-Simpson Act IRCA of 1986, which provided amnesty for illegal aliens who met certain qualifications, such as residing in the U.S. for 5 years.²¹⁶

By spring of 2007, Senators John McCain, republican from Arizona, and Ted Kennedy are expected to propose legislation resembling that of AgJOBS and Mazzoli-Simpson.²¹⁷ Illegal immigrants currently residing in the U.S. could become eligible to obtain legal status through a temporary worker program.²¹⁸ This view was endorsed in the 2004 presidential election race by Senator John Kerry, Democrat from Massachusetts:

[W]e need an earned-legalization program for people who have been here for a long time, stayed out of trouble, got a job, paid their taxes, and their kids are American. We got to start moving them toward full citizenship, out of the shadows.²¹⁹

Kerry’s stance is similar to the McCain-Kennedy proposal. No matter what conditions might be imposed on the grant of citizenship status, conservatives are steadfastly opposed to providing any kind of benefits to undocumented workers.²²⁰ Republican Senator Bill Frist from Tennessee explains his opposition as follows: “[G]ranting amnesty now will only encourage future and further disrespect for the law.”²²¹

Supporters of the anticipated McCain-Kennedy proposal and President Bush’s stance on immigration reform are quick to declare that they are not in favor of amnesty; even though the distinction appears to be strictly semantic. On the campaign trail in 2003, Bush unequivocally opposed amnesty: “I don’t believe we ought to have amnesty. I don’t think we ought to reward illegal

²¹⁴ *Id.*

²¹⁵ *Id.*

²¹⁶ See JAMES KILLORAN, *THE KEY TO UNDERSTANDING U.S. HISTORY AND GOVERNMENT* 182 (Jarrett Publishing Company) (2000).

²¹⁷ See Elstrom, *supra* note 156.

²¹⁸ *Id.*

²¹⁹ *George Bush on Immigration*, (quoting Bush-Kerry Debate in Tempe Arizona, Oct. 13, 2004, available at http://www.ontheissues.org/International/John_Kerry_Immigration.htm

²²⁰ See *Frist Fires Opening Shot on Immigration*, *supra* note 36.

²²¹ *Id.*

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behavior . . . If they want to become . . . citizen[s], they can stand in line.”²²² In his recent Address to the Nation of Immigration Reform, Bush reiterated his belief that amnesty was an unfair practice.²²³ Nevertheless, his proposal for permitting some of the 12 million illegal aliens currently in the U.S. to become citizens parallels the concept of amnesty.

Under Bush’s approach, there are two types of illegal aliens: those who may be eligible for earned citizenship, and those who are ineligible.²²⁴ The problem with this approach, beyond determining what qualifications should exist and how they are to be met, is that the most important question remains unresolved: what happens to the illegal immigrants who are ineligible for earned citizenship? No real effort to deport all illegal aliens is likely to be made; therefore, the distinction between those who are entitled to a change of status and those who are not entitled appears to be a mere change in form without much substance. Under immigration rights’ cases in the 1980s, illegal aliens are already privy to many public benefits; the rest of the illegal immigrants in this country would remain in the same position after the enactment of the immigration reform as the position they were in prior to its enactment. The immigration debate will continue to progress on a piecemeal basis until legislation can deal with all of the illegal immigrants, and not just those who would qualify for amnesty.

CONCLUSION: WHERE DO WE GO FROM HERE?

Over the past few decades, Congress has swayed from one extreme to the other in its immigration policy. The effects of any legislation proposed to restructure immigration law are unlikely to last for any significant period of time. If history continues to repeat itself, then even if an impenetrable wall were built around the entire U.S. border, only a decade or two would pass before the wall was torn down. Legislation will have to be constantly modified to fit the needs of an ever-evolving world. Congress must be aware that the immigration policies that once helped the U.S. thrive may eventually damage its growth. The same can be said for policies currently considered to be detrimental to the U.S. may promote economic growth in the future.

There are two possible answers to the initial question, “where do we go from here?” First, it is important to remain flexible as a nation with regard to

²²² See Bush-Kerry, *supra* note 219.

²²³ See Bush, *supra* note 106, (“We must face the reality that millions of illegal immigrants are here already. They should not be given an automatic path to citizenship. This is amnesty, and I oppose it. Amnesty would be unfair to those who are here lawfully, and it would invite further waves of illegal immigration.”)

²²⁴ *Id.*

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society's needs and demands. Second, with regard to how we get to our eventual destination, it will be important to recognize that although intense emotions surround the immigration debate, public sentiment must not be permitted to outweigh the country's needs.

The future may be bright or bleak, depending on one's perspective, but here is one way to consider the issue of Mexican immigration into the U.S.:

Our new immigrants are just what they've always been—people willing to risk everything for the dream of freedom. And America remains what she has always been: the great hope on the horizon, an open door to the future, a blessed and Promised Land. We honor the heritage of all who come here, no matter where they come from, because we trust in our country's genius for making us all Americans—one nation under God.²²⁵

²²⁵ See Bush, *supra* note 106.

CARNERO V. BOSTON SCIENTIFIC CORPORATION: AN ANALYSIS

*Daniel Allen Cohn**

INTRODUCTION

Circuit Court's refusal to extend Section 806 whistleblower protection to employees of publicly-traded American businesses operating abroad undermines the effectiveness of the Sarbanes-Oxley Act

On January 7, 2004, Ruben Carnero ("Carnero") filed a complaint in United States District Court alleging that his employment with a Latin American subsidiary of Boston Scientific Corp. ("BSC") had been terminated in retaliation for "whistleblowing."¹ Carnero had informed BSC that the subsidiary inflated sales figures and created false invoices.² The district court determined that Carnero, an Argentinean citizen, residing in Brazil, could not sue BSC under the "whistleblower protection provision" contained in the Sarbanes-Oxley Act of 2002³ as the provision is without extraterritorial effect.⁴ The U.S. Court

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¹ Carnero v. Boston Sci. Corp., 433 F.3d 1, 2-3 (1st Cir. 2006) (In accordance with the procedural provisions of the Sarbanes-Oxley whistleblower statute, Carnero first sought a judgment from the Department of Labor. It was the Department of Labor that initially concluded that (a) Boston Scientific Corp. was covered by the Sarbanes-Oxley whistleblower provision— because it is a publicly traded company on the New York Stock Exchange, and (b) that "the whistleblower protection provision of the Act did not apply to employees of covered companies working outside of the United States." The United States District Court for the District of Massachusetts then engaged in a de novo judicial review of these findings on January 7, 2004 when Carnero filed a complaint in accordance with 18 U.S.C. § 1514A(b)(1)(B), providing that claimant may bring federal court action if the Secretary of Labor has not issued a final decision within 180 days of filing the complaint and if there is no showing that the delay is due to the claimant's bad faith); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

² *Id.*

³ Sarbanes-Oxley Act of 2002, tit. VIII, § 806 (codified as amended in 18 U.S.C. § 1514A); Carnero, 433 F.3d at 2.

⁴ Carnero, 433 F.3d at 1.

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of Appeals for the 1st circuit affirmed the judgment,⁵ and Carnero's petition for a Writ of Certiorari to the U.S. Supreme Court was denied in June of 2006.⁶

The Court began by taking Carnero's satisfaction of the statute's basic elements as a given⁷— and further, acknowledged that the whistleblower protection provision of the Sarbanes-Oxley Act extends to alleged retaliation against an employee of a *subsidiary* of a publicly traded domestic company.⁸ Nevertheless, the court concluded that Carnero was not entitled to whistleblower protection because Section 806 of the Sarbanes-Oxley Act does not expressly indicate extraterritorial application.⁹ Therefore, even though BSC was covered by the Sarbanes-Oxley Act (as a publicly traded company on the New York Stock Exchange), and subject to its provisions, the Court concluded that Section 806 “would not apply to employees of covered companies working outside of the United States.”¹⁰ In formulating this interpretation, the court considered the text, structure, context and legislative history of the statute in order to uncover the nature of Congress's intended application.¹¹

This case note will examine the 1st Circuit's decision in *Carnero v. Boston Scientific Corp.*, holding the “whistleblower protection provision” of the Sarbanes-Oxley Act to be without extraterritorial application. What follows, is a recapitulation of the methodology used, and an evaluation of the conclusions drawn, by the Court, in surmising congressional intent regarding the whistleblower provision housed in Section 806. This note will then briefly take stock of the legal precedent set by *Carnero*, and how it has been utilized in recent cases. Finally, the note will conclude with a discussion of the likely policy repercussions of the *Carnero* holding and its ultimate imprudence.

THE COURT'S RATIONALE

The Court in *Carnero* uses a traditional canon of statutory interpretation as the essential foundation for its rationale in limiting Section 806 to domestic application.¹² Citing the language of an important 1949 Supreme Court decision in *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, the *Carnero* court

⁵ *Id.*

⁶ *Carnero v. Boston Sci. Corp.*, *cert. denied*, 2006 U.S. LEXIS 4956 (U.S., June 26, 2006) (mem.).

⁷ See 18 U.S.C.A. § 1514A(a)

⁸ *Carnero*, 433 F.3d at 6.

⁹ *Id.* at 7 (Here, the Court employs a canon of statutory construction set forth in *Foley Bros., Inc. v. Filardo*, 336 U.S. 281 (1949)).

¹⁰ *Id.* at 3 (citing *Carnero v. Boston Scientific Corp.*, 2004-SOX-22 (OSHA Reg'l Adm'r) (Dec. 19, 2003)).

¹¹ *Id.*

¹² See *Id.* at 3.

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declares “it is a longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.”¹³ Since Congress does not explicitly state that Section 806 is to be applied extraterritorially and because no contrary intent seems detectable, the Court concludes that the provision ought to be constricted to domestic application.¹⁴ Moreover, the Court finds that the strength of this “Foley-presumption”¹⁵ offsets whatever value overseas application of Section 806 would have for investors.¹⁶

In searching for a manifestation of congressional intent beyond the plain-language of Section 806, the Court looks to the context and legislative history of the statute.¹⁷ It finds that other provisions in Sarbanes-Oxley, as well as unrelated statutes, clearly evince Congress’s consideration of extraterritorial application, whereas no such lucid indication appears in Section 806.¹⁸ Furthermore, by placing the responsibility of enforcement in the hands of the Department of Labor (“DOL”), a domestic agency, Congress has shown a lack of concern for the problems that would arise should that agency seek to regulate employment relationships abroad.¹⁹ For the Court, these considerations (or lack thereof) buttress its initial presumption against extraterritoriality.²⁰

¹³ *Carnero*, 433 F.3d at 3.

¹⁴ *Id.*

¹⁵ The question of whether “contrary intent appears,” is an integral part of the rule set forth in Foley. Indeed, the presumption itself is conditioned upon the Court’s inability to find evidence of such intent. Where this note refers to the Foley-presumption, it means only the presumption itself, and not the rule as a whole.

¹⁶ *Carnero*, 433 F.3d at 7 (“In the present case, whatever help to investors its overseas application might in theory provide is offset ... by the absence of any indication that Congress contemplated extraterritoriality...” The Court seems to have concluded here that the strength of the Foley-presumption outweighs, in a sort of balancing test, whatever value would derive from protection of foreign whistleblowers under Section 806. This is a highly contentious point, and one which lies at the crux of the decision, and its imprudence. As will be discussed further in this note, the facts of Foley so drastically differ from *Carnero*, that the presumption, whatever its value, is misplaced here. Moreover, the value that extraterritorial application of Section 806 would provide investors is, in fact, profound; and underappreciated by the Court in *Carnero*. This important point will also be examined more closely as the note proceeds.).

¹⁷ *Id.* at 8.

¹⁸ *Id.* (“Not only is the text of 18 U.S.C. § 1514A silent as to any intent to apply abroad, the statute’s legislative history indicates that Congress gave no consideration to either the possibility or the problems of overseas application. In sharp contrast with this silence, Congress has provided expressly elsewhere in the Sarbanes-Oxley Act for extraterritorial enforcement of a different, criminal, whistleblower statute. By so providing, Congress demonstrated that it was well able to call for extraterritorial application when it so desired.”).

¹⁹ *Id.* at 9.

²⁰ *Id.* (“Where Congress includes particular language in one section of a statute but omits it in

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The mechanics of the *Carnero* court's statutory interpretation seem appropriate, but the substance of its inspection is lacking. The Court first looks to the plain language of Section 806 and concludes, properly, that it makes no mention of territorial application.²¹ As such, the Court finds that there exists a presumption against any congressional intention to enforce the provision abroad.²² The Court then proceeds to consider the context of Section 806, in search of "contrary intent" that would effectively rebut the presumption it has adopted.²³ It finds no such intent on the part of Congress.²⁴

It is still an accepted maxim of statutory interpretation, that absent plain language to the contrary, legislation of Congress is presumed to apply only domestically.²⁵ However, this presumption does not apply where the legislation pertains to concerns that are not inherently domestic.²⁶ As will be explicated as this note proceeds, Section 806 and the Sarbanes-Oxley Act itself are an effort to protect the American securities market, and its investors, from fraudulent financial activity— both at home and abroad.²⁷ This fact ought to have rendered the Court's initial presumption inapplicable.

Furthermore, the Court engages in an unprogressive investigation of contrary intent— which would rebut the presumption it mistakenly adopted. In proceeding to make its contextual considerations, the Court really remains transfixed by the lack of any plain language specifying the extraterritorial applicability of Section 806. With the exception of its concerns regarding the DOL, the Court refuses to divert its attention from the text itself to consider the statute's broader context. This failure to adequately explore other indicia of congressional intent, particularly the environment surrounding the Sarbanes-Oxley Act itself and the substantial value the Section 806 provision has

another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." citing *Russello v. United States*, 464 U.S. 16, 23 (1983); "No reference is made to providing for interpreters, for coordinating with the Department of State, or for the utilization of foreign personnel. Significantly, the DOL is given only sixty days to complete its entire investigation of a complaint and to issue findings under the procedure mandated by 49 U.S.C. § 42121(b)(2)(A). This short time frame seems unrealistic if the DOL were expected to conduct investigations overseas. Moreover, if an administrative hearing is held, the hearing 'shall be conducted expeditiously' under 49 U.S.C. § 42121(b)(2)(A). There is no provision either for the resources or the flexibility that might be needed in dealing with foreign matters.").

²¹ *Carnero*, 433 F.3d at 7.

²² *Id.*

²³ *Id.*

²⁴ *Id.* at 8.

²⁵ See *Small v. United States*, 544 U.S. 385 (2005).

²⁶ *United States v. Bowman*, 260 U.S. 94, 98 (1922).

²⁷ See *Bechtel v. Competitive Technologies, Inc.* 448 F.3d 469, 484 (2nd Cir. 2006) (Straub, J. dissenting).

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regarding its application, leads to an unsatisfactory judicial conclusion.

Of paramount concern is that the *Foley*-presumption is misplaced. There are essential differences in both areas of the law and the politics at issue between 1949 *Foley*, and here, in 2006 *Carnero*— which the First Circuit failed to recognize.²⁸ Such oversight led to a holding that is contrary to the goals of Congress and which undermines the effectiveness of the Sarbanes-Oxley Act. Furthermore, in its contextual investigation for “contrary intent,” the court fails to give adequate weight to the overarching context of the Act, and the mechanisms in place to further its ends. It places superior emphasis on the context of Section 806, as it appears within the confines of Sarbanes-Oxley, and undermines the essential legal and political circumstances under which Sarbanes-Oxley, itself, was enacted. The contextual arguments made by the Court seem purposed toward supporting its initial conclusion that the *Foley*-presumption apply.

Indeed, the limited scope of this investigation reflects an essential bias toward substantiating a conclusion the Court has already drawn. Had the *Carnero* court recognized the important differences between *Foley* and the case before it, and avoided so abruptly applying the precedent set forth in the former case, it would have probably engaged in a more full-bodied and impartial analysis of the context of Section 806. Such consideration would have revealed the intention and importance of providing whistleblower protection to employees of American companies operating beyond our borders.²⁹

A. The Difference with *Foley*: Misplaced Presumption

The *Foley* case concerned the applicability of the Eight Hour Law³⁰ to a contract between the United States and a private contractor it had hired to work on construction projects in Iraq and Iran.³¹ The Eight Hour Law provides that every contract made, to which the United States is a party, shall contain a provision that no laborer doing any part of the work contemplated by the contract, in the employ of the contractor or any subcontractor, shall be required or permitted to work more than eight hours in any one calendar day without specific restitution.³²

²⁸ Examples of these differences will be dealt with in greater specificity as the note proceeds, but in this instance it refers to the difference between labor law and securities law, as well as, the great progressions in global economics with regard to interconnectedness.

²⁹ As will be later revealed in greater detail, it is the position of the author that Section 806 whistleblower protection ought to be provided to *all* employees of companies subject to the Sarbanes-Oxley Act— not just those individuals employed by American corporations.

³⁰ 40 U.S.C.A. §§ 321-326 (2007).

³¹ *Foley Bros., Inc. v. Filardo*, 336 U.S. 281 (1949).

³² *Id.* at 283 (citing 40 U.S.C. § 324 (2007); 40 U.S.C § 325(a) (2007)).

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In 1941, *Foley Bros., Inc.* contracted with the United States to build certain public works in the Middle East.³³ When *Foley Bros.* failed to compensate one of its employees, in accordance with the provisions of the Eight Hour Law, the employee filed suit to recover his unpaid wages.³⁴ The case made its way up through the New York State Courts before the U.S. Supreme Court granted a Writ of Certiorari; and considered whether Congress intended to extend the Eight Hour Law to work performed in foreign countries.³⁵ It concluded that no such intent existed.³⁶

The *Foley* court begins its investigation of congressional intent by recognizing that, unless a contrary intent appears, legislation of Congress is meant to apply only within the territorial jurisdiction of the United States.³⁷ So, even though the *Carnero* court uses the *Foley* decision as the backbone of its presumption against extraterritoriality, it must be noted that the *Foley* case did not establish that maxim of interpretation.³⁸

The *Foley* court references the language of the Supreme Court in *Blackmer v. United States* which, in turn, refers back to an earlier decision in *American Banana Co. v. United Fruit Co.*³⁹ The *American Banana* holding of 1909 was probably the first to clearly establish the presumption that when Congress legislates, it intends to restrict its laws to domestic application.⁴⁰ The *Carnero* court's decision to reference *Foley*, and not *American Banana* (or its closer progeny⁴¹), is important because it reflects the Court's conception of Section 806 in terms of employment, and not in terms of market security.⁴² This distinction is of the utmost importance, as the presumption is probably not applicable to cases of the later sort.⁴³

American Banana dealt with the applicability of the Sherman Anti-Trust Act to conduct beyond the territorial limits of the United States. There, the Plaintiff, a domestic corporation, asserted that Defendant, its competitor and

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.* at 284.

³⁶ *Foley Bros.*, 336 U.S. at 285.

³⁷ *Id.* (citing *Blackmer v. United States*, 284 U.S. 421, 437 (1932)).

³⁸ See *Blackmer v. U.S.*, 284 U.S. 421, 436 (1932); *American Banana Co. v. United Fruit Co.*, 213 U.S. 347, 357 (1909).

³⁹ *Foley Bros.*, 336 U.S. at 285.

⁴⁰ See *American Banana*, 213 U.S. at 357

⁴¹ Such as *Continental Ore Co. v. Union Carbide & Carbon Corp.* 370 U.S. 690 (1962); which, like *American Banana*, also dealt with the territorial scope of the Sherman Anti-Trust Act.

⁴² The *Foley Bros.* case dealt with foreign application of the Eight Hour Law, whereas the *American Banana* case concerned enforcement of the Sherman Anti-Trust Act abroad.

⁴³ See *Continental Ore*, 370 U.S. at 704-705.

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also a domestic corporation, had engaged in monopolistic practices in Panama⁴⁴ which were forbidden by the Act.⁴⁵ The Supreme Court held that it would not apply the Sherman Anti-Trust provisions extraterritorially.⁴⁶

The Court concluded that “the general and almost universal rule is that the character of an act as lawful or unlawful must be determined wholly by the law of the country where the act is done.”⁴⁷ For another jurisdiction, if it should happen to lay hold of the actor, to treat him according to its own notions rather than those of the place where he did the acts, not only would be unjust, but would be an interference with the authority of another sovereign, contrary to the comity of nations, which the other state concerned justly might resent.”⁴⁸ Further, the Court declared that “all legislation is prima facie territorial.”⁴⁹

The presumption set forth in *American Banana*, and referenced by the *Foley* court⁵⁰ (as well as countless others over the last century) still has precedential value.⁵¹ But, in the realm of international relations and the laws that govern those relations, much has changed since 1909. *American Banana*, itself, has been overturned⁵² by *Continental Ore Co. v. Union Carbide & Carbon Corp.* In that case, the Supreme Court held that “a conspiracy to monopolize or restrain the domestic or foreign commerce of the United States is not outside the reach of the Sherman Act just because part of the conduct complained of occurs in foreign countries.”⁵³

That decision, as well as others that have followed suit, recognize the increasing interconnectedness of Nations, particularly with regard to economics.⁵⁴ In 1909, America’s interest in regulating business operations

⁴⁴ *American Banana*, 213 U.S. at 357 (at the time of the contentious actions, a border dispute existed between Panama and Costa Rica. Let it suffice to say that the defendant was operating in one of these two nations, clearly beyond the borders of the United States).

⁴⁵ *Id.* (defendant had intentionally manipulated shipping routes and trade agreement to favor its own interests. There was no question that such action, had it taken place inside the borders of the United States would have been illegal.).

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.* at 357.

⁴⁹ *Id.*

⁵⁰ *Foley Bros.*, 336 U.S. at 285 (citing to *Blackmer*, 284 U.S. at 437; which in turn cites to *American Banana*, 213 U.S. 347).

⁵¹ See *Small v. United States*, 544 U.S. 385 (2005).

⁵² *Continental Ore*, 370 U.S. at 704-705.

⁵³ See *United States v. American Tobacco Co.*, 221 U.S. 106 (1911); *United States v. Pacific & Arctic R. & Navigation Co.*, 228 U.S. 87 (1913); *United States v. Sisal Sales Corp.*, 274 U.S. 268 (1927).

⁵⁴ See *Harford Fire Ins. Co. v. California*, 509 U.S. 764 (1993) (holding that notions of comity do not require that foreign insurers be granted jurisdictional immunity from the Sherman Act). See also

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abroad was minimal. Such conduct simply did not have a substantial enough effect on our economy to warrant proscribing applicable laws abroad. Doing so would have been insulting to the sovereignty of other States, and would violate our nation's duty of comity toward them. But, as courts and nations have begun to recognize, this is no longer the case. Indeed, the notion that a State may properly proscribe law to actions beyond its borders which have a substantial effect within its territory has been well-established both domestically and among the States.⁵⁵ This accepted rule of international law is known as the "effects principle," and has become a recognized element of comity among Nations.⁵⁶

The *Carnero* court conceives of Section 806 in terms of employment law—a traditionally domestic legal realm with minimal international influence. This is why the Court references *Foley*, and subscribes to the presumption against extraterritoriality adopted therein. But, unlike the Eight Hour Law at issue there, failure to apply Section 806 extraterritorially risks imposing and restricting the commerce of the United States. As such, *Carnero* fits more properly into the lineage of *American Banana* and *Continental Ore*; where the important exception to the presumption against extraterritorial application of laws has been duly recognized.⁵⁷

At the heart of the *Foley* decision was the Court's conclusion that it is not the intention of the American legislature to overthrow the labor law provisions of other nations, regardless of how dissimilar such foreign conceptions of proper employment may be from our own.⁵⁸ It held that the nature of labor and employment rights is principally a domestic matter.⁵⁹ To enforce our Eight Hour Law (and its embodiment of our own conceptions of just employment) abroad would be an inappropriate intrusion on the sovereignty of foreign nations.⁶⁰

Certainly, the aforementioned logic of the *Foley* court is sound. It would be wholly inappropriate, and profoundly poor politics, for America to force its laws on other nations where the action sought to be regulated has no direct bearing domestically.⁶¹ The manner in which Iran chooses to conduct its

United States v. Aluminum Co. of America, 148 F.2d 416 (1945).

⁵⁵ See RESTATEMENT (THIRD) OF FOREIGN REL. LAW OF THE U.S. §§ 401, 403 (1987).

⁵⁶ STEPHEN C. MCCAFFREY, UNDERSTANDING INTERNATIONAL LAW (Aspen Pub. Co. 2000).

⁵⁷ *Continental Ore*, 370 U.S. at 705.

⁵⁸ *Foley Bros.*, 336 U.S. at 286.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ See *U.S. v. Corey*, 232 F.3d 1166, 1176 (Hawaii 2000) ("For most legislation, the presumption against extraterritoriality makes perfect sense. First, 'Congress generally legislates with domestic concerns in mind,' *Smith v. United States*, 507 U.S. 197, 204 n. 5, (1993), so courts can infer from

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domestic labor environment is of no concern to the United States. As such, reason dictates that absent a clear expression to the contrary, our labor laws must reasonably be interpreted to have no effect upon Iranian employment. But, unlike the Eight Hour Law at issue in *Foley*, Section 806 is not really about labor and employment law. It is about securities law and the protection of American market integrity.

In 2002 Congress passed the Sarbanes-Oxley Act in direct response to a wave of financial scandals that undermined the dependability of the American securities market.⁶² Revelations of mass corporate fraud, most notably the Enron and WorldCom scandals, threatened to destroy investors' faith in the American financial markets and, in so doing, to jeopardize those markets and the American economy.⁶³ To combat this threat, Congress passed a large body of reporting regulations and oversight provisions, intended as tools to ferret out financial deceit on the part of publicly traded corporations. But Congress also recognized that in order for any of these tools to work, the law would have to protect whistleblowers from retaliation.⁶⁴

Enron Corporation's deceptive actions had cost its investors hundreds of millions of dollars by the time insider Sherron Watkins stepped forward and "blew the whistle" on its fraudulent practices.⁶⁵ The corporate deceit at WorldCom Inc. had taken a similar financial toll on investors when Cynthia Cooper pointed out the fraud that had been perpetuated by her employer.⁶⁶ Indeed, whistleblowers like Watkins and Cooper are responsible for bringing to light the very scandals that birthed the Sarbanes-Oxley legislation.

Congress recognized the substantial value of protecting such individuals, and encouraging their actions. In order for the regulations and reporting provisions of Sarbanes-Oxley to take effect, methods of enforcement must be in place. Section 806 was passed into law because Congress recognized

congressional silence that the legislature meant to regulate only activities within the nation's borders. Second, the rule ensures that we do not precipitate 'unintended clashes between our laws and those of other nations which could result in international discord.' *EEOC v. ARAMCO*, 499 U.S. 244, 248 (1991). The Supreme Court has invoked this territorial presumption in numerous cases involving the scope of broad regulatory statutes. *See, e.g., Sale v. Haitian Centers Council, Inc.* 509 U.S. 155, 173 (1993) (Immigration and Nationality Act); *Aramco*, 499 U.S. at 248 (Title VII); *Filardo*, 336 U.S. at 285 (federal overtime law); *American Banana*, 213 U.S. at 357 (Sherman Act)").

⁶² *Guyden v. Aetna, Inc.*, 2006 WL 2772695 at *3 (D. Conn., Sept. 25, 2006).

⁶³ *Id.*

⁶⁴ *Id.* (citing S.Rep. No. 107-146, at 10 (2002), "Often, in complex fraud prosecutions, insiders are the only firsthand witnesses to the fraud.").

⁶⁵ John Gibeaut, *Culture Clash: Other Countries Don't Embrace Sarbanes or America's Reverence of Whistleblowers*, 92-MAY A.B.A. J. 10 (May 2006).

⁶⁶ *Id.*

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two important truths: First, that corporate insiders are in the best (and often the only) position to uncover and witness corporate fraud; and second, that these insiders will be far more likely to report their discovery if they are assured that the law will provide them with financial protection.⁶⁷

The *Carnero* court does not challenge the fact that the vast reporting provisions of the Sarbanes-Oxley Act are intended by Congress to apply to any corporation, foreign or domestic, that chooses to list its securities on American exchanges.⁶⁸ Such a truth has been obvious to both the courts and corporations that have encountered the Act. Yet, in *Carnero*, Congress's intention to make use of the single most important tool of effectively ensuring compliance with these provisions is questioned.⁶⁹ And the 1st Circuit has concluded that no such intention exists.⁷⁰

The *Carnero* court seems to have decided that even though Congress intended for BSC to comply with the reporting procedures set forth in Sarbanes-Oxley, and to abstain from fraudulent accounting, it also found the cost of incidental infringement on employment relations abroad to be too high a political price of enforcement. This rationale simply does not follow from legal precedent, or from the context and history of Section 806 and Sarbanes-Oxley.

To apply the Eight Hour Law in *Foley* extraterritorially would have been to impose American values of individual rights, abroad, as *ends in themselves*. It would have, without legitimate concern for our nation's own well-being, mandated that our laws usurp the laws of Iran— and in so doing, belittle that nation's sovereignty. Alternatively, application of Section 806 to corporate operations abroad would serve only as a *means to an end*: to protect the American securities market by encouraging whistleblowers to report fraud that may substantially damage it. Thus, whatever infringement upon foreign labor and employment law that would follow from extraterritorial application of Section 806, would be the result of a legitimate domestic concern.

Indeed, the *Foley* court points out that the presumption against extraterritoriality “is based on the assumption that Congress is primarily concerned with domestic conditions.”⁷¹ While enforcement of the Eight Hour Law abroad would have almost no effect on such domestic conditions, application of Section 806 certainly would. As international commerce continues to grow, the effect that foreign business operations have on the

⁶⁷ See *Guyden*, 2006 WL 2772695 at *3.

⁶⁸ *Carnero*, 433 F.3d at 3.

⁶⁹ *Id.* at 4.

⁷⁰ *Id.* at 18.

⁷¹ *Foley*, 336 U.S. at 285.

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American economy becomes increasingly profound.⁷² This is precisely why all publicly traded companies, both foreign and domestic, have been made subjects of the Sarbanes-Oxley Act. Section 806 is a key tool in ensuring the effectiveness of the provisions contained therein.⁷³ Failure to apply its protections extraterritorially creates a serious risk of non-compliance abroad, and thus, financial injury at home.

The presumption against extraterritorial application is “based on the common-sense inference that, where Congress does not indicate otherwise, legislation dealing with domestic matters is not meant to extend beyond the nation’s borders.”⁷⁴ But the presumption does not apply where the legislation implicates concerns that are not inherently domestic.”⁷⁵

In *United States v. Bowman*, the Supreme Court held that the presumption against extraterritorial application of our laws does not govern the interpretation of statutes that, by their nature, implicate the legitimate interests of the U.S. abroad. The *Bowman* case concerned a fraud perpetuated upon a U.S. vessel, outside the territorial waters of the U.S.⁷⁶ Although the statute at issue there did not contain an extraterritoriality provision, the Court concluded that it covered the conduct in question.⁷⁷ If fraud against a single American ship operating abroad has an effect on domestic interests substantial enough to rebut the presumption against extraterritorial application of our laws, then surely the domestic interest in ensuring the propriety of foreign business operations having a multi-billion dollar presence in our markets⁷⁸ provides a rationale for extraterritorial application of Section 806 that is equally, if not much more, compelling.⁷⁹

⁷² See www.aftermarket.org/International/Foreign_Market_Reports/APAC99.pdf

⁷³ Guyden, 2006 WL 2772695 at *3.

⁷⁴ *Corey*, 232 F.3d at 1170.

⁷⁵ *Id.*

⁷⁶ *U.S. v. Bowman*, 260 U.S. 94 (1922).

⁷⁷ *Corey*, 232 F.3d at 1170. (See also *U.S. v. Vasquez-Velasco*, 15 F.3d 833, 839 n.4 (applying *Bowman* to violent crimes associated with international drug trafficking); *U.S. v. Felix-Gutierrez*, 940 F.2d 1200, 1204 (9th Cir.1991) (applying *Bowman* to accessory after the fact to the murder of a DEA agent in Mexico)).

⁷⁸ See Automotive Aftermarket Industry Association (AAIA), Foreign Market Reports, available at http://www.aftermarket.org/international/foreign_market_reports/foreign_market_reports.asp#APAC C (last visited April 25, 2007).

⁷⁹ *Carnero* did expressly refer the Court to the decisions in *Bowman*, and *Shoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968) (where civil antifraud provisions of the Exchange Act were given extraterritorial application to protect American investors who purchase foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities). The Court simply found the other factors— namely; the absence of any plain language to contradict the *Foley*-presumption, the decision to give the

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The purpose of applying whistleblower protection abroad has almost nothing to do with America imposing its labor and employment values on other countries, and everything to do with America protecting its legitimate interest in the integrity of its own domestic securities markets. The latter is a compelling and justifiable reason for extraterritorial application of Section 806—one which was wholly absent from the Eight Hour Law at issue in *Foley*, and which, given the Supreme Court decisions in *Bowman* and *Continental Ore*, effectively rebuts the presumption used therein.

B. The Court's Supplementary Contextual Considerations Are Inadequate

Once the *Carnero* court adopts the *Foley*-presumption, it proceeds by considering whether or not Congress manifested a “clear intent” to rebut it.⁸⁰ Such an investigation involves the Court's contextual consideration of Section 806. First, the Court takes into account the structural discrepancies between Section 806 and other related (as well as unrelated) Sarbanes-Oxley statutes.⁸¹ The fact that other provisions have expressly called for extraterritorial application, whereas Section 806 has not, demonstrates to the *Carnero* court that the presumption was meant to remain intact.⁸² Furthermore, the Court finds that this point gains increased support upon consideration of the enforcement context surrounding Section 806. Since the DOL is a domestic body and ill-equipped to deal with the enforcement problems likely to arise in an international setting, the Court finds it most likely that Congress intended to limit enforcement (and application) of Section 806 domestically.⁸³

In contrast to Section 806, which makes no express reference to foreign entities, Section 106 of the Sarbanes-Oxley Act deals directly with foreign accounting firms.⁸⁴ That provision requires such firms to register with the SEC⁸⁵ if they audit public companies.⁸⁶ It also carves out exceptions that are tailored to difficulties inherent in American regulation of overseas professionals.⁸⁷ The Court finds that this accounting provision “reflects

Department of Labor enforcement responsibility, and the fact that other provisions did expressly indicate congressional intention of application abroad, to be greater indications of Section 806's territorial scope.

⁸⁰ *Carnero*, 433 F.3d at 8.

⁸¹ *Id.*

⁸² *See id.* at 8.

⁸³ *Id.*

⁸⁴ *Id.* at 9.

⁸⁵ The firms are technically required to register with a Board appointed by the SEC.

⁸⁶ *Carnero*, 433 F.3d at 9.

⁸⁷ *Id.* (citing 15 U.S.C. § 7216(c), providing that the SEC or the Board may, as it “determines necessary or appropriate in the public interest or for the protection of investors,” exempt a foreign

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Congress's recognition that the application of domestic U.S. regulatory statutes to persons abroad presents problems in addition to those of purely domestic application, and of the need to address those problems specifically."⁸⁸

In drawing this comparison between the Sarbanes-Oxley accounting provision and the Section 806 whistleblower protection provision, the Court clearly establishes that, in drafting the Sarbanes-Oxley Act, Congress was mindful of its overseas application (and the problems which may arise there from). This seems, at least on its face, to suggest that the Sarbanes-Oxley Act is a body of legislation Congress intended to have an international personality—and indeed it is.

However, rather than placing contextual emphasis on the Act itself, the events which brought it about and the ends it sought to realize, the Court focuses its attention on Section 806 as it compares to other provisions within the confines of the Act. This myopic approach to contextual evaluation strengthened the Court's initial determination that a presumption against extraterritoriality, as it pertains to Section 806, remained in force; and that Congress had not evinced a clear intent to rebut that presumption.

In keeping with this method of internal contextual comparison, the Court then refers to the other whistleblower provision found in Sarbanes-Oxley.⁸⁹ Though the Court continues to mistakenly value the more immediate context of Section 806 over the broader circumstances surrounding the Act itself, comparison with a similar provision does seem a worthwhile investigation. Section 1107⁹⁰ provides criminal sanctions for retaliation against anyone giving truthful information to law enforcement officers relating to the commission of any federal offense.⁹¹ A subsection of that provision expressly provides for extraterritorial jurisdiction over such offenses.⁹²

The Court reasons as follows: "That Congress provided for extraterritorial reach as to Section 1107 but did not do so as to Section 806 conveys the implications that Congress did not mean Section 806 to have extraterritorial effect."⁹³ Though this conclusion does have an appreciable logic,

public accounting firm from the Act.).

⁸⁸ *Id.* (this perceived failure of Congress to specifically acknowledge difficulties inherent in extraterritorial enforcement also plays an important role in the Court's conclusion that the Department of Labor's enforcement role is indicative of Congress's intent to limit Section 806 to domestic application.).

⁸⁹ *Id.* at 10.

⁹⁰ 18 U.S.C. § 1513(e) (2007).

⁹¹ *Id.*

⁹² *Carnero*, 433 F.3d at 10.

⁹³ *Id.* at 10-11(citing *Russello v. United States*, 464 US 16, 23 (1983) ("Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is

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its appropriateness here is undercut both by persuasive legal precedent, and by practical considerations of context.

In *United States v. Corey*, the Court of Appeals for the 9th Circuit resoundingly rejected the notion that express statutory language, providing for the extraterritorial application of one provision, means that other provisions of the same act are intended, by Congress, to be without such application.⁹⁴ The question of whether or not Congress enacted the statute with extraterritorial concerns in mind is the vital consideration, and one which cannot be ascertained simply by looking to the express language of other provisions similarly situated to the one at issue.⁹⁵

Furthermore, it is important to take the practical circumstances surrounding Section 806 (and Sarbanes-Oxley) into just consideration. As the *Carnero* court points out, “the Sarbanes-Oxley Act itself is a major piece of legislation bundling together a large number of diverse and independent statutes, all designed to improve the quality of, and transparency in, financial reporting and auditing of public companies.”⁹⁶ The scandals that precipitated legislation of the Sarbanes-Oxley Act were both unexpected, and seriously harmful to the American economy. Congress properly decided to act quickly, and boldly, in drafting a comprehensive series of laws that would counter the threat, and provide redress, in the event of similar corporate deceit in the future.

Had the *Carnero* court placed proper emphasis on the broader contextual elements surrounding Section 806, it would have determined, not only that the statute is part of an encompassing protectionist Act, but also, that it was drafted in some haste—in the hope of providing immediate shelter from impending financial scandals. In fact, the *Carnero* court seems to have uncovered tangible evidence of the expeditious manner in which Sarbanes-Oxley was composed. In footnote 9 of the decision, the Court points out that “it appears that through a drafting error, Congress enacted two subsections (e).” Yet, this observation, and the statutory circumstance it tends to evince, is given no value in the Court’s contextual consideration of Section 806.

In its brief departure from the textual confines of the Sarbanes-Oxley Act, the *Carnero* court considers the manner in which Section 806 would be

generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.”)).

⁹⁴ *Corey*, 232 F.3d at 1176 (rejecting the holding in *United States v. Gatlin*, 216 F.3d 207 (2d Cir. NY 2000) where the Court concluded “that if Congress wanted to extend the jurisdiction of the federal courts beyond the borders of the collective states, it had to express its intent in *each* relevant subsection. ([S]ubsections like § 7(7) confirm that Congress knows how to legislate extraterritorially when it so desires.”). We see no reason to impose such a burden on Congress.).

⁹⁵ *Id.*

⁹⁶ *Carnero*, 433 F.3d at 9.

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practically enforced, if applied abroad. It raises the concern that “if the whistleblower protection provision is given extraterritorial reach in a case like the present one, it would empower U.S. courts and a U.S. agency, the DOL, to delve into the employment relationship between foreign employers and their foreign employees.”⁹⁷ Further, the court notes that “in enacting other laws that affect employment relationships extraterritorially, members of Congress have recognized ‘the well-established principle of sovereignty. . . that no nation has the right to impose its labor standards on another country.’”⁹⁸ The Court found that if Section 806 had been intended, by Congress, to apply abroad, “it would have said so; and certainly would have considered, before enacting the law, the problems and limits of extraterritorial enforcement.”⁹⁹

This concern, that Congress understands the enforcement of domestic labor laws abroad to constitute a threat to the sovereignty of foreign nations, and that it would have expressly dealt with those concerns if it had intended to apply Section 806 abroad, is simply a restatement of the rationale behind the Foley-presumption. The impropriety of that presumption, as applied to the *Carnero* case, has already been explicated. Furthermore, the Court’s apprehension regarding the lack of any explicit acknowledgement of the concern, by Congress, is given undue value. Had Congress explicitly dealt with the territorial scope of Section 806, the whole process of interpretation would essentially be rendered moot. The fact that it did not, represents to the Court an intention to limit its application domestically. This line of reasoning betrays the Court’s failure to move beyond the Foley-presumption and objectively consider contextual circumstances that evince an “appearance of contrary intent.”

This latter inquiry is an essential part of the rule set forth in *Foley*, and one upon which the presumption itself depends. The contextual investigation of contrary intent must be engaged separately from the presumption it would eviscerate. Thus, the Court ought to have framed the issue as follows:¹⁰⁰ *had* Congress considered extraterritorial application of Section 806, given the context in which the law was passed, what would its conclusion have been? Such a consideration would have probably revealed “contrary intent”— the search for which was the very purpose of the Court’s investigation of statutory context.

Finally, the Court explores the relevance of Congress’s decision to put

⁹⁷ *Id.* at 15.

⁹⁸ *Id.* at 15 (citing S. REP. NO. 98-467, at 27-28 (1984)).

⁹⁹ *Id.*

¹⁰⁰ As this note has already posited, the rule set forth in *Foley* was not appropriately applied to *Carnero* in the first place, and since the Court decided to apply *Foley*, it “ought” to have applied it properly.

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the DOL in charge of enforcing Section 806. It concludes that “further suggestive of Congress’s lack of extraterritorial intent is its failure to provide any mechanism for enforcing the whistleblower protections in a foreign setting.”¹⁰¹ Congress did not grant, or even discuss the granting of, extraterritorial investigatory powers to the DOL, the agency charged with administering whistleblower complaints.”¹⁰²

The idea that the DOL is a domestic agency¹⁰³ and that it has not been equipped with additional tools the Court perceives as necessary to do its job abroad, suggests to the Court that Congress did not expect the DOL to encounter the problem of extraterritorial application. The Court properly points out that the DOL has not been statutorily provided with interpreters, or with coordination procedures involving the Department of State.¹⁰⁴ Furthermore, the Court finds it significant that the DOL has only been given sixty days to complete its investigation and to issue findings under the procedure mandated by 49 U.S.C. § 42121(b)(2)(A).¹⁰⁵ For the Court, “this short time frame seems unrealistic if the DOL were expected to conduct investigations overseas.”¹⁰⁶ Moreover, the Court notes that if given extraterritorial scope, the “broad coverage [of the statute] would create an expansive class of potential whistleblowers by extending its protections to countless employees in countless areas around the world.”¹⁰⁷ The lack of any statutory provisions providing the DOL with a means of handling this increased administrative and logistical burden is, to the Court, “striking.”¹⁰⁸

The aforementioned considerations regarding the DOL and the

¹⁰¹ *Carnero*, 433 F.3d at 15.

¹⁰² *Id.*

¹⁰³ *Id.* at 15 n.13 (acknowledging that “the DOL has been charged with administering whistleblower complaints in a variety of employment contexts, even where another agency, having the technical expertise in the subject area of the complaints (such as the SEC here), has overall control.” This shows that, on occasion, Congress will use the DOL as a means of administering laws that are not essentially about employment. This is one of those circumstances. The Court’s failure to appreciate that the DOL is here enforcing a law pertaining to market security, and not labor values, is responsible for its misplaced *Foley*-presumption).

¹⁰⁴ *Id.* at 15.

¹⁰⁵ *Id.* at 15-16 (noting the following statutory language: “Not later than 60 days after the date of receipt of a complaint ... and after affording the person named in the complaint an opportunity to submit to the Secretary of Labor a written response to the complaint and an opportunity to meet with a representative of the Secretary to present statements from witnesses, the Secretary of Labor shall conduct an investigation and determine whether there is reasonable cause to believe that the complaint has merit...”).

¹⁰⁶ *Carnero*, 433 F.3d at 15.

¹⁰⁷ *Id.* at 16.

¹⁰⁸ *Id.*

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practical context of its enforcement duties pertaining to Section 806, is a legitimate interpretive exercise. Here, the Court seems to have finally put the Foley-presumption aside, and considered contextual evidence of intent, objectively. However, even though the Court's concern with the DOL's inability to get their job done abroad may be well-founded, Congress's failure to address the issue is not strongly indicative of its intention to limit Section 806 domestically.

Certainly, whatever intention is revealed by Congress's failure to provide practical measures of enforcement to the DOL, is dwarfed by the other contextual consideration surrounding the statute. The enormous scope of Sarbanes-Oxley itself (in terms of both statutory volume and to whom its regulatory procedures apply), Congress's express acknowledgement that whistleblower protection provisions are a necessary means of revealing transgressions against the Act's provisions, and the expeditious manner in which the Act was enacted are contextual considerations that, when taken together, evince a congressional intent to apply Section 806 of Sarbanes-Oxley extraterritorially. Such a conclusion is not offset by a perceived failure of Congress to provide for practical challenges that may or may not confront the DOL upon executing its statutory responsibilities. The theoretical possibility that the DOL would be unable to properly do its job is simply not, in itself, convincing evidence that it was never assigned the job in the first place.

The Court has essentially posited that if it were a legislative body, and it intended to apply Section 806 abroad, it would have addressed concerns that Congress did not. But, the Court is not a legislative body; and it should not place too much emphasis on what it concludes would be imprudence on the part of Congress. When the other contextual indicia are considered, what the Court perceives as intent to limit Section 806 domestically seems more likely to be legislative oversight.

CITING CARNERO

The First Circuit's holding in *Carnero* has already begun to safeguard potentially fraudulent financial operations abroad, and in so doing, undermine the security of American market integrity. On August 1, 2006, Thomas Beck ("Beck"), formerly of Citigroup, Inc., was denied whistleblower protection under Section 806.¹⁰⁹ His claim was dismissed for lack of jurisdiction by the Department of Labor.¹¹⁰ The decision relied heavily on *Carnero* and the

¹⁰⁹ Beck v. Citigroup, Inc., Case No. 2006-SOX-00003 (U.S. Dept. of Labor Aug. 1, 2006), http://www.hrpolicy.org/downloads/2006/DOL_2006-SOX-00003_080106.pdf.

¹¹⁰ *Id.*

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rationale contained therein.¹¹¹

Beck was a German national employed as an investment banker by a subsidiary¹¹² of Citigroup, Inc. He worked in the global mergers and acquisitions business.¹¹³ Though based in Frankfurt, the nature of Beck's employment required him to travel regularly to the United States, and communicate daily with Citigroup's New York headquarters.¹¹⁴ Approximately 60% of his business was generated outside of Germany, and his compensation included stock options in Citigroup, Inc.¹¹⁵

On or about February 1, 2005, Beck began providing Citigroup executives with information regarding what he reasonably believed to be his company's fraudulent business practices.¹¹⁶ On March 9, 2005, (the day before Beck was scheduled to meet with Citigroup's head of European Investments, to report his concerns) he was abruptly terminated.¹¹⁷ The decision to discharge him was made, or ratified, by officials of Citigroup, Inc. located in New York.¹¹⁸

As the world's largest company,¹¹⁹ the operations of Citigroup, Inc., both domestically and abroad, may have a more substantial impact on the American marketplace than any other single publicly traded entity. This is a corporation, traded publicly on our domestic exchanges, that generates billions of dollars in revenue abroad. As such, Citigroup, Inc. provides an ideal example of a multinational corporation whose global business operations have substantial market effects at home. Yet, the holding in *Carnero, Beck* and the progeny sure to follow, drastically hinders the U.S.'s ability to scrutinize those operations— a hindrance that compromises the very spirit of the Sarbanes-Oxley Act.

Congress has clearly recognized that whistleblower protection is an

¹¹¹ *Id.*

¹¹² *Id.* (The Citigroup subsidiary, Citigroup Global Markets Deutschland AG & Co. KGaA)

¹¹³ *Id.*

¹¹⁴ Beck v. Citigroup, Inc., Case No. 2006-SOX-00003 (U.S. Dept. of Labor Aug. 1, 2006), http://www.hrpolicy.org/downloads/2006/DOL_2006-SOX-00003_080106.pdf.

¹¹⁵ *Id.*

¹¹⁶ *Id.* (stating that the alleged violations included (1) misrepresentations of projected revenues of Citigroup, Inc.'s German investment banking business; (2) misrepresentations by certain senior employees of their credentials and employment histories; (3) misrepresentations concerning the value of a German company to a client based in the United States who was considering it as a potential acquisition; and (4) fraudulent attempts to obtain investment banking business and mislead investors by inflating Citigroup, Inc.'s market position.)

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ Scott DeCarlo, *The World's 2000 Largest Public Companies*, FORBES, March 30, 2006, available at http://www.forbes.com/2006/03/29/06f2k_worlds-largest-public-companies_land.html.

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important mechanism for bringing fraudulent business practices to light.¹²⁰ Given the significant effect that such practices abroad would likely have upon our domestic marketplace, it is illogical to suppose that Congress intended to deprive foreign whistleblowers of protection.

DANGEROUS POLICY REPERCUSSIONS

Ruben Carnero argued that limiting the protection afforded by the whistleblower statute, improperly insulates the foreign operations of companies subject to the Sarbanes-Oxley Act.¹²¹ In so doing, the basic purpose of the Act—to protect the integrity of U.S. securities markets and the interests of investors therein—is frustrated.¹²² The large corporations to whom Sarbanes-Oxley applies conduct a great deal of business abroad that substantially affects the American marketplace.¹²³ Indeed, there is evidence that such foreign operation has already increased in response to the demands of Sarbanes-Oxley.¹²⁴ Failure to extend whistleblower protection to those employed in these operations, is likely to stifle their willingness to come forward and report accounting improprieties.

The global presence of multinational corporations, such as the Defendant in *Carnero*, is profound—as is the effect their foreign operations have on the American investor.¹²⁵ It is the duty of our judicial system, and our citizenry, to protect the foreign employee who has the courage to risk his job for our financial security.

Carnero correctly pointed out that a failure to interpret Section 806 of Sarbanes-Oxley to have extraterritorial application, wrongfully insulates the foreign operations of corporations—and is contrary to the over-arching purpose of Sarbanes-Oxley itself. The Court underappreciated the significance of this point.

The financial burden of complying with the Sarbanes-Oxley reporting provisions is substantial.¹²⁶ Indeed, that burden has already proved too great for many publicly traded companies.¹²⁷ These corporations, both foreign and

¹²⁰ *Bechtel*, 448 F.3d at 484.

¹²¹ *Carnero*, 433 F.3d at 7.

¹²² *Id.*

¹²³ Maria Camilla Cardilli, *Regulation Without Borders: The Impact of Sarbanes-Oxley on European Companies*, 27 *FORDHAM INT'L L.J.* 785 (2004).

¹²⁴ See Silvia Ascarelli, *Citing Sarbanes, Foreign Companies Flee U.S. Exchanges*, *WALL STREET JOURNAL*, Sept. 20, 2004, at C1.

¹²⁵ Gibeaut, *supra* note 65.

¹²⁶ Ascarelli, *supra* note 124.

¹²⁷ *Id.*

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domestic, which had formerly listed securities on American exchanges, have been forced to delist as a result of an inability to make compliance economically viable.¹²⁸ The companies that *have* been able to shoulder the fiscal load of Sarbanes-Oxley, must compensate for the monetary loss they endure. The often-cheaper operational environments of South America, India, and other developing areas have already fueled an enormous surge in outsourcing and relocation. In an effort to maximize profits, domestic corporations are leaving the United States—taking the jobs and money they provide our economy with them. The policy repercussions of the *Carnero* decision will be to encourage this domestically-injurious process.

The *Carnero* holding will serve to dissuade potential whistleblowers, employed abroad, from stepping forward and reporting their employers' fraud. The financial liability these companies carry, pertaining to such fraud, is enormous; and they will inevitably seek to protect themselves from it by all available means. So, as progressions in education, communication, transportation and international law all make corporate operation abroad an increasingly desirable business option, the *Carnero* court has added yet another element to the lure of foreign operation. One which, when coupled with the monetary loss necessarily incurred through compliance with Sarbanes-Oxley itself, is sure to be actively considered by executives.

CONCLUSION

In *Carnero*, the Court begins by incorrectly applying the legal precedent set forth in *Foley*, as it fails to appreciate that Section 806 is a law that “involves concerns that are not inherently domestic;” and is therefore not subject to the presumption against extraterritorial application. Furthermore, upon applying the interpretive method set forth in *Foley*, the Court fails to properly uncover “contrary intent,” by engaging in a contextual investigation that remains influenced by the presumption and which fails to adequately value the context of the Sarbanes-Oxley Act. The result is a decision that, on its face, reeks of injustice— and which is likely to bring about undesirable repercussions in our domestic economy.

Ruben Carnero did us a service when he stepped forward and reported what he thought to be the fraudulent business practices of his employer. He risked (and eventually lost) his job for the security of our domestic markets and the financial welfare of its investors. Though Congress meant to protect Carnero, and to encourage his actions, our Court turned its back on him. Seeing the lack of appreciation our judiciary has shown for whistleblowers like Ruben

¹²⁸ *Id.*

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Carnero, what foreign employee will now step forward and risk their livelihood for our protection?

We are living in a world where transnational fraud is more common than it ever has been in the past.¹²⁹ Until the Courts extend Section 806 whistleblower protection extraterritorially, the efforts of Congress to protect America from the damage such fraud can do, will be undermined.

¹²⁹ Gibeaut, *supra* note 65.