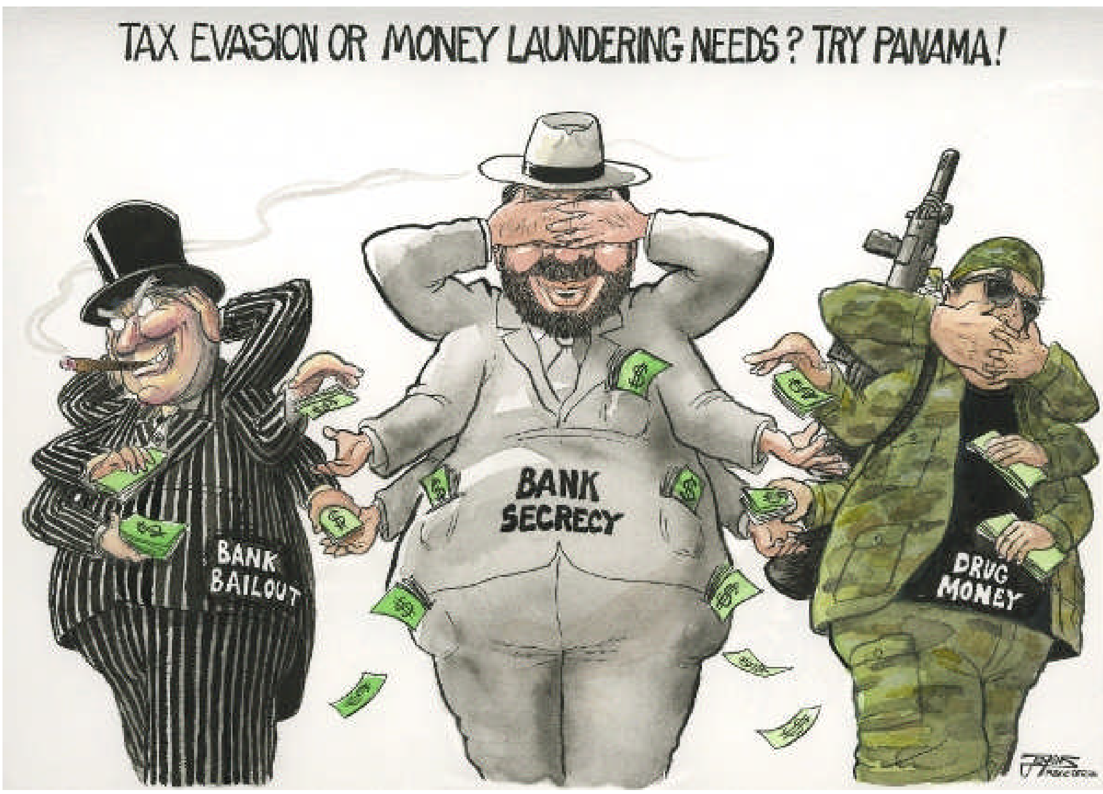
Panama FTA Would Undermine U.S. Efforts to Stop Offshore Tax-Haven Abuse and Regulate Risky Financial Conduct



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Executive Summary and Introduction

"We will restore a sense of fairness and balance to our tax code by finally ending the tax breaks for corporations that ship our jobs overseas."

- *President Barack Obama, Speech to Congress, Feb. 24, 2009*

One of President Barack Obama's most consistent pledges during the general election campaign was to eliminate tax breaks for corporations that offshore U.S. jobs – a commitment he reiterated during his February 24, 2009 speech to Congress.

Meanwhile, the Obama administration celebrated legislation introduced in early March 2009 to crack down on offshore tax havens. The Stop Tax Haven Abuse Act, which Obama himself co-sponsored while a senator, now has six Senate and 64 House cosponsors. Treasury Secretary Timothy Geithner welcomed the measure, which targets Panama and other jurisdictions, stating: "We fully support the legislation on offshore tax centers, and we look forward to working with you as part of the broader effort to address international tax evasion and close the tax gap."[1]

The congressional and administration support is not surprising, given the focus at the G-20 Washington and London Summits and by G-7 Finance Ministers to banking secrecy jurisdictions' contribution to global economic instability. The April London G-20 Summit especially honed in on the need to combat tax havens, while the Organisation for Economic Cooperation and Development report released in conjunction with the summit targeted Panama as a country that had long promised to clean up its act yet has failed to do so.

And, eliminating offshore tax loopholes could save U.S. taxpayers $210 billion over the coming decade, according to the Office of Management and Budget (OMB). Meanwhile, the Senate Homeland Security Committee estimates a savings five times as great. These funds would assist greatly in helping put people back to work amidst the deepest recession in the post-war period.

Yet the Office of the U.S. Trade Representative (USTR), prior to Senate confirmation of Mayor Ron Kirk for its top position, released a March 1 trade policy agenda for 2009 that states: "We hope to move on the Panama Free Trade Agreement (FTA) relatively quickly."[2] Since then, Kirk has stated that he aspires for congressional consideration of the Panama FTA in June.

When pressed, Kirk has also stated that there has been no decision taken by the Obama administration about moving this leftover Bush trade agreement. This is not surprising, as the Panama FTA would directly conflict with the Obama administration goal of stopping tax-haven abuse that leads to the offshoring of U.S. jobs and investment money, and the objective of cracking down on money laundering and shady financial dealings that undermine our economic and national security.

Panama is a top tax-haven country linked by all the relevant executive and congressional agencies and a panoply of international watchdog groups to tax evasion by U.S. and multinational firms, and to international money laundering and drug trafficking. Not surprisingly, the country is a key target of the "Stop Tax Havens Abuse Act." Moreover, Panama serves as the financial nerve center for Colombian narcotraffickers and paramilitaries, who freely pass the largely unguarded border between the two Latin American countries. Finally, Panama is one of the easiest countries in which to register a foreign subsidiary, with lax taxes and regulations. These factors contribute to Panama having the highest number of subsidiaries of foreign companies (350,000) after Hong Kong.

Why You Should Choose Panama for Offshore Banking and Asset Protection:

"Even Switzerland cooperates on income tax cases if the return is filed falsely like all income was not declared, things were omitted or so the complaining government says. Belize has tax treaties, as do most of the so-called 'tax havens.' There is no better jurisdiction than Panama today!!!!!!" –
From
http://www.panamalaw.org/attributes.html

Some in and out of Congress oppose the Panama FTA because it is a Bush hangover NAFTA-CAFTA-style agreement that reflects the priorities of that administration's corporate backers, rather than the fair-trade reform agenda that American voters backed by electing Obama, who campaigned on renegotiating existing pacts and creating a new model going forward.[3] In addition to Obama, 72 new fair-trade members of Congress from both parties who were elected in 2006 and 2008 to replace supporters of NAFTA-style trade policy have criticized the Bush model, which the Panama FTA replicates.[4] A long list of labor, consumer, environmental, faith, family-farm and other organizations also oppose the Panama FTA because of the agreement's NAFTA-CAFTA-replicating terms, and have described the minimal changes that must be renegotiated in that agreement's text to neutralize its worst problems.[5]

However, the problems with a U.S. FTA with Panama extend beyond what is contained in the pact's text. Despite Panama's status as one of the world's top venues for tax evasion and money laundering, the FTA does not directly or indirectly remedy Panama's problems with tax evasion and money laundering. There are no special requirements that take into consideration, much less try to counter, Panama's banking secrecy rules, lax financial service regulations or designation as a venue for money laundering and tax evasion. In fact, if the Panama FTA were adopted, it would make these matters of bipartisan concern worse, by:

1. Forbidding U.S. policies from treating Panama and Panamanian financial services and transactions differently than we treat those of non-tax- haven countries.

2. Forbidding use of limits on financial transactions, except for very limited circumstances, which is a key tool in many anti-tax-haven and anti-money laundering policies.

3. Locking in U.S. "market access" rights for banks and investors operating in Panama, regarding both cross-border services and establishment of U.S. facilities that would

limit the U.S. government's ability to fight tax-haven abuse and re-regulate financial service firms.

4. Granting expansive new FTA foreign investor rights to Panamanian firms and the 350,000 subsidiaries of U.S., Chinese, and other multinational firms operating in Panama that will allow them to challenge U.S. government regulations in foreign tribunals – including policies that limit financial transactions from banks operating from Panama or owned by Panamanian investors.

In sum, whatever one thinks about the proposed FTA as a general matter, no FTA should go into effect with Panama until that country eliminates its excessive banking secrecy practices, re-regulates its financial sector, and forces banks and multinational subsidiaries to pay their fair share of taxes**.** And, certainly the current FTA should not be implemented because its extension of the NAFTA-CAFTA-style extraordinary foreign investor rights explicitly contradicts U.S. congressional and administration efforts to combat tax evasion and money laundering and re-regulate the finance sector. Moreover, this agreement is a throwback to a past era, as highlighted by the agreement's expansive limits on financial service regulation. The pact was signed in 2007 and clearly predates the bipartisan consensus created by the meltdown that better regulation of financial service is necessary for markets to work productively.

Panama's 1970s Industrial Policy: Creation of a Tax Haven

"I am deeply concerned about recent Panamanian resistance to efforts aimed at cleaning up their banking system, which served as a drug and money-laundering center for years … [We have] met opposition from officials in the Government and banking industries. Panamanian businessmen fear that the agreement would ruin the country's lucrative position as a tax haven and dollar-based financial center."[6]

- *Chairman Charles Rangel (D-N.Y.), now of the Ways & Means Committee, but earlier the Select Committee on Narcotics Abuse and Control chair, Oct. 30, 1990*

In order to understand Panama's financial sector, some background is necessary. In 1970, the Omar Torrijos dictatorship was eager to pursue an industrial policy that would help Panama's economy overcome its historic economic dependence on the Panama Canal. Financial services were to be the new engine of Panama's economy. Torrijos enlisted University of Chicago-trained economist Nicholas Ardito Barletta to develop a banking-sector overhaul that guaranteed total banking secrecy and eliminated usury laws.[7]

> As recently as March 2009, Panamanian officials claimed that their banking model was a "fundamental pillar of the national economy."

The results: Panama does not have a central bank (the dollar is used as legal tender), has no currency restrictions or exchange controls, does not insure deposits, and has never utilized Glass-Steagall type restrictions that separate commercial and investment banking. Panama's income tax system is constituted strictly along territorial lines, with business conducted in Panama by non-resident Panamanian corporations not classified as trade within Panama, making the nation an "100 percent tax haven." Thus all such businesses are exempt from national taxes, including profits, capital gains, and interest on domestic savings and time-deposit accounts. Moreover, Panama avoids tax treaties with other countries regarding repatriated profits. As one scholar of Barletta's reforms indicated:

> "Offshore banking refers specifically to financial operations designed to avoid regulatory and tax restrictions generally imposed by home governments. Many banks establish offices in the nation to provide access to the Panamanian domestic lending market itself. The distinction between foreign and offshore banking is reflected in the licences required by the Panamanian government: foreign banks seeking business with Panamanian clients must obtain a general licence and pay national income taxes, whereas offshore banks obtain an international licence, serve only foreign clients and avoid taxes of any sort."[8]

Indeed, Panama's economy in the post-Barletta period thrives on banking secrecy, and its "comparative advantage" rests on the ease with which U.S. and other firms can create subsidiaries there. As recently as March 2009, Panamanian officials claimed that their banking model was a "fundamental pillar of the national economy."[9]

With Banking Secrecy and Zero Taxes on "Offshore" Corporations, Panama Is One of World's Major Havens for Tax-Dodgers

Tax evasion and financial secrecy are linked closely to drug trafficking, money laundering, and terrorism, which destroy lives and livelihoods in drug-consuming and drug-supplying countries alike, as U.S. Department of Justice documents explain.[10] Behind these massive social costs are countries like Panama, one of the world's leading centers for tax evasion and narcotrafficker money laundering.

According to the U.S. State Department, Panama has over 350,000 foreign-registered companies (i.e. subsidiaries of foreign multinationals),[11] all of which face low to no taxes and regulation. This high rate of foreign incorporation – the country is reportedly second only to Hong Kong – makes the country a magnet for tax evasion.

Top U.S. TARP and Government Contract Recipients In Panama

Many of the top 30 recipients of TARP money have subsidiaries in Panama. Because Panama does not charge taxes on "offshore" subsidiaries, the TARP and other bailout fund recipients may be able to avoid paying significant amounts of U.S. taxes by essentially permanently deferring repatriation of their income in Panama. According to Securities and Exchange Commission (SEC) filings, Citigroup Inc. has a whopping 17 Panamanian subsidiaries, while American International Group, Morgan Stanley and American Express each have one.[12]

Many of the top 100 federal contractors also have Panamanian subsidiaries: BearingPoint, Caterpillar, Dell, EDS, Fluor, General Mills, International Shipholding, Johnson & Johnson, Kraft Foods, Mantech International, McDermott International, Merck, PepsiCo, and Proctor & Gamble. Others top U.S. corporations with subsidiaries in Panama include Altria, Cisco, Ingram, News Corporation, Pfizer, and Sunoco.[13]

A Government Accountability Office (GAO) study identified Panama as one of only 13 countries – *and the only current or prospective FTA partner* – that was listed on *all* of the major tax-haven watchdog lists that also do not have tax transparency treaties with the United States. These lists include the Organization for Economic Cooperation and Development (OECD) Global Forum on Taxation, the National Bureau for Economic Research (NBER), and the Internal Revenue Service (IRS) in a recent U.S. District Court case.[14] As the OECD Global Forum on Taxation's 2008 report notes, Panama is one of only 11 countries that has not signed the U.S. or any other tax evasion *or* tax information exchange agreements (TIEAs),[15] which are the primary means whereby nations cooperate on cracking down on both tax avoidance and double taxation, and which can provide early warning of criminal money laundering and drug trafficking activities. (The Bush administration announced that it had begun preliminary discussion on the matter with Panamanian authorities in 2002,[16] but no progress has been reported since.) Moreover, the OECD reports that Panama is one of only three countries in which officials are unable to obtain access to bank information for *any* tax information exchange purposes even *outside* of treaties.[17]

> "PANAMA IS A TOP TAX-HAVEN JURISDICTION"
>
> - one of only 13 countries – *and the only current or prospective FTA partner* – that was listed on *all* of the major tax-haven watchdog lists that also do not have tax transparency treaties with the United States.
> - one of only 11 countries that have not signed the U.S. or any other tax evasion *or* tax information exchange agreements.
> - one of only three countries in which officials are unable to obtain access to bank information for *any* tax information exchange purposes even *outside* of treaties.

Panama is by far an outlier on this, as other tax havens like Bermuda and Isle of Man have TIEAs negotiated, signed or in force as of the last few years. In early March 2009, Andorra, Liechtenstein, and Switzerland also announced that they would make some limited reforms on tax matters, in response to sustained G-20 pressure in the wake of the meltdown of UBS and other financial institutions that operate in secrecy havens.[18]

Despite this, in the lead up to the G-20 London Summit, when Panama knew it risked being targeted in the forthcoming OECD special report on tax haven, it wrote to the OECD:

> "The Government of Panama commits itself to participate actively in the bilateral and multilateral forums that may be convened to advance such initiatives, including, logically, negotiations to build commitments around the OECD model, **subject to Panama's constitutional and legal constraints, as long as the following premises and principles are respected:**
>
> i) the privacy of persons continues to be protected and guaranteed against undue meddling;
> ii) there is no automatic exchange of information;
> iii) there is no undue triangulation of the information furnished between States;
> iv) information is exchanged in response to individual requests provided on a specific and justified basis;
> v) there is a just transition period for any measure that must be implemented and that would impact the platform of international services offered by the Republic of Panama, understanding that any such measure will be applied at the same time in each and every OECD member State that Panama may consider its competitors in the provision of international services."[19]

This letter makes clear that even in the context of worldwide pressure to do so, Panama is unwilling to consider the reforms widely agreed to be essential to stopping tax-haven abuse, such as providing information on beneficial ownership of accounts (so it is clear who should be taxed) or providing general and automatic exchange of tax information (rather than only in response to specific inquiries related to specific "justified" basis, such as proof of criminal activity). Indeed, what Panama informed the OECD it would be willing to do *in the future* is only to formally agree to its *current* extremely restrictive practices. Further, the response of the Panamanian government to concerns increasingly being expressed in the context of the FTA by members of Congress and the press about its tax-haven and banking-secrecy practices has been to issue a document arguing that there are no such problems in Panama. (We address Panama's recent "fact-myth" document in Appendix II.)

Even in the instance of specific criminal investigations, Panama has one of the world's most restrictive information exchange regimes, possessing only one mutual legal assistance treaty (MLAT), with the United States.[20] However, this treaty explicitly does not apply to instances of "mere" tax evasion.[21] Even in the instance of alleged criminal violations, Panama can refuse to cooperate for many self-defining reasons, including instances where "the execution of the request would prejudice the security or essential public interests of the Requested State [or] the request relates to a political offense."[22] Promoters of Panama's offshore banks brag that the country's government is unlikely to be cooperative:

> "Panama will cooperate in a multi-national case involving narcotics and money laundering (these crimes need to be tied to narcotics). If you are not a narcotics dealer and are not a money launderer you should not be concerned by this. Panama will also cooperate in cases of terrorism and child pornography. The MLAT requires that there first needs to be a criminal prosecution case on file in the criminal courts of the requesting government (which means no fishing expeditions). Then through diplomatic channels involving the embassies, requests are made for information, and then reviewed by Panama officials and a decision on compliance is made or requests for more information are made so a determination can be arrived at. These cases can take months and even years for completion. At times the country where the bank is located has been known to once alerted to the problem, conduct their own investigation first and this usually requires them to seize the relevant records and documents which can stall the process for a long time even years since their justice systems typically moves quite slow and statues of limitation can run out. Please don't construe this to mean Panama does this routinely, it is just something that does occur from time to time around the world… The MLAT has no application to civil cases such as divorce, civil judgments, bankruptcy, business litigation, any sort of civil litigation, civil tax matters etc. Taxation matters of any sort are not covered by this as far as Panama is concerned. Even Switzerland cooperates on income tax cases if the return is filed falsely like all income was not declared, things were omitted or so the complaining government says. Belize has tax treaties, as do most of the so-called 'tax havens.' There is no better jurisdiction than Panama today!!!!!!"[23]

At issue with such tax-haven practices is not only the massive loss of revenue owed the U.S. government and U.S. taxpayers who are playing by the rules. The sort of extreme banking secrecy that Panama practices contributes to global economic instability and has become a target of the G-20 process created to address the current global crisis. Offshore financial centers like Panama are a prime vehicle for corporations to conceal their financial losses and engage in off-balance sheet activities. In the words of Jack Blum, a longtime Senate investigator on tax-haven matters, "Offshore (is) a kitchen, where corporate books are cooked."[24] The Communiqué of the November 2008 G-20 Emergency Summit in Washington on the crisis also made this very clear:

> "Promoting Integrity in Financial Markets: We commit to protect the integrity of the world's financial markets by bolstering investor and consumer protection, avoiding conflicts of interest, preventing illegal market manipulation, fraudulent activities and abuse, and protecting against illicit finance risks arising from non-cooperative jurisdictions. We will also promote information sharing, including with respect to jurisdictions that have yet to commit to international standards with respect to bank secrecy and transparency. National and regional authorities should implement national and international measures that protect the global financial system from uncooperative and non-transparent jurisdictions that pose risks of illicit financial activity… Tax authorities, drawing upon the work of relevant bodies such as the Organization for Economic Cooperation and Development (OECD), should continue efforts to promote tax information exchange. Lack of transparency and a failure to exchange tax information should be vigorously addressed."[25]

The follow-up G-20 summit in April in London issued a Communiqué that committed to action on tax havens in order to restore financial stability and security:

> "We have today also issued a Declaration, *Strengthening the Financial System*. In particular we agree: …to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of tax information."

The April 2009 OECD report referenced in the G-20 Communiqué listed Panama among the countries that had agreed in the past to comply with "internationally agreed tax standards," but had failed to do so.[26] It notes that Panama made its commitment in 2002 and since has completed not a single agreement to implement its promise. In contrast, other countries on the list, which is comprised mainly of tiny island nations, have completed as many as eight compliance agreements, which is still not adequate to be taken off of this list.

The U.S. government has rarely been shy about using its considerable leverage over the Panamanian government.[27] We are not encouraging another invasion to exert U.S. will, but the history of U.S. diplomatic and other interventions in Panama makes it all the more curious that the Bush administration did not use its leverage during the 2004-2007 FTA negotiations to require Panama to sign the standard U.S. tax evasion, information exchange and estate/gift tax agreements. (Not to mention the Hague Evidence Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, another tool in the fight against tax evasion and other financial improprieties.[28]) According to the Internal Revenue Service (IRS), Panama is one of only 17 countries that have not signed any of these.[29] The OECD has noted that it is highly unusual that the U.S. government has not used FTA negotiations with Panama to push for completion of the TIEA. Said the OECD's Jeffrey Owens:

> "It is also important for OECD governments to consider the importance of establishing effective exchange of information mechanisms when expanding trade

> relations with offshore jurisdictions (e.g. through free trade agreements or other similar agreements) so that the further removal of trade barriers does not also result in expanded opportunities for offshore evasion… For example, the U.S. Treasury announced the commencement of TIEA negotiations with Panama in January 2002 and in December 2006 the United States Trade Representative announced the completion of the Free Trade Agreement negotiations with Panama."[30]

At the same time, even getting these treaties signed would not have eliminated the problem, since Switzerland has signed all of them (except the TIEA), yet still has succeeded in sheltering income from U.S. authorities. In the words of Sen. Carl Levin (D-Mich.) "You can't rely on the tax treaty to get at names of people that cheated Uncle Sam."[31] Indeed, as of April 2009, there are no longer *any* countries on the OECD's worst offender list, even as Panama and other countries continue to refuse to implement their OECD promises, leading one observer to call the whole process a "sham" and showing the limited utility of this approach.[32]

Levin and Rep. Lloyd Doggett (D-Texas), currently with six Senate and 64 House cosponsors, introduced the Stop Tax Haven Abuse Act (S. 506, H.R. 1265) in March 2009 as a unilateral U.S. response to address some of the flaws with the tax-treaty approach. The legislation defines Panama as one of 34 "offshore secrecy jurisdictions," and gives U.S. officials the authority to impose Patriot Act-style sanctions on transactions with these jurisdictions. Specifically, it would allow the U.S. Treasury to prohibit (or condition) U.S. financial institutions and agencies from opening, maintaining or allowing transactions through certain accounts for the Panamanian government or financial entities. The 2007 version of the bill was co-sponsored by then-Sen. Barack Obama (D-Ill.), who said "We cannot sit idly by while tax secrecy jurisdictions impede the enforcement of U.S. law."[33]

The Costs of Tax Evasion: $210 Billion or $1 Trillion?

Multinational corporations have become so skilled at evading taxes through the use of offshore tax havens that some firms – including recipients of funds under the Troubled Assets Relief Program (TARP) – pay virtually no taxes. Goldman Sachs, for instance, faced only a 1 percent effective tax rate in 2008.[34] And the overall effective tax rate on U.S. multinationals' foreign-source income is 4 percent, according to a GAO study.[35]

This tax evasion costs the U.S. Treasury handsomely. According to the Office of Management and Budget (OMB), eliminating tax evasion in tax havens could save U.S. taxpayers $210 billion over the coming decade,[36] while the Senate Homeland Security Committee estimates a savings five times as great.[37] (See Appendix I for an explanation of the U.S. international taxation system.)

The anti-tax haven legislation is not the only plank of Democrats' international tax-reform agenda. The Obama administration's new budget projects that the U.S. Treasury will be able to collect an additional $210 billion over the coming decade through a plan to "implement international enforcement, reform deferral, and other tax reform policies."[38] While these measures have not been fully outlined, some experts predict that the menu of options the administration would consider would be drawn from a report that National Economic Council (NEC) Chair Lawrence Summers had drawn up in 2000 while Treasury Secretary. This report suggests that three major options for international tax reform: one which would completely eliminate deferral on foreign-source income; a second which would lower taxes on repatriated foreign-source income; and a third that would tighten certain administrative rules. Throughout, the report takes pains to emphasize that U.S. reforms should be consistent with international norms and obligations, and that the competitiveness of U.S. multinationals operating abroad (with respect to other countries' multinationals in third country markets) should be ensured.[39] (Appendix I provides further background on the U.S. system of international taxation, and how flaws in the current approach contributed to the financial crisis.)

Both the treaty and unilateral approaches have value, but policymakers must have no illusions: until tax havens such as Panama eliminate excessive banking secrecy, re-regulate their financial sector, and tax U.S. and other multinationals operating with their borders, there will be competitive pressure for a race to the bottom in tax and regulatory standards. Both the treaty and unilateral approaches should be implemented as soon as possible, and time should be given to see if they are effective in cracking down on tax evasion and the financial risk stemming from tax havens. However at a minimum, until such evaluation time has passed, U.S. policymakers should not provide the Panamanian government, offshore corporations or investors new tools provided in FTAs to avoid regulation or challenge anti-tax evasion policies in foreign tribunals. Moreover, as we explore later in this report, policymakers should realize that the Panama FTA, rather than improve the tax problems in Panama, may actually make things worse.

Panama as a Major Global Center of Money Laundering, with Special Link to the Colombian Drug Trade

The U.S. State Department's Bureau of International Narcotics and Law Enforcement Affairs lists Panama as a country of primary concern (its most severe designation) for drug-related money laundering. In the Bureau's 2009 International Narcotics Control Strategy Report, they write:

> "By virtue of its geographic position and well-developed maritime and transportation infrastructure, Panama is a major logistics control and trans-shipment country for illegal drugs to the United States and Europe. Major Colombian and Mexican drug cartels as well as Colombian illegal armed groups use Panama for drug trafficking and money laundering purposes…
>
> "The majority of money laundering activity in Panama is narcotics-related or the result of transshipment or smuggled, pirated, and counterfeit goods through Panama's major free trade zone, the Colon Free zone (CFZ). The funds generated from illegal activity are susceptible to being laundered through a wide variety of methods, including the Panamanian banking system, Panamanian casinos, bulk cash shipments, pre-paid telephone cards, debit cards, insurance companies, real estate projects and agents, and merchandise... Panama is an offshore financial center that includes offshore banks and various forms of shell companies that have been used by a wide range of criminal groups globally for money laundering."[40]

In October 2008, the Los Angeles Times reported on a Hezbollah-linked money laundering and drug-trafficking scheme with significant connections to Panama's institutions of international commerce.

The Drug Enforcement Agency of the Department of Justice has profiled Panama year in and out as a financial hub in terror and drug activities. "Since 2002, [drug trafficking organizations] and peso brokers have bulk-smuggled drug proceeds across the Southwest Border into Mexico for placement in Mexican financial institutions (banks, *casas de cambio*, and *centros cambiarios*) to facilitate the [Black Market Peso Exchange] system. The illicit proceeds are used for international wire remittances to countries such as China, Panama, Taiwan, and the United States to purchase goods that are later sold on the black market in Colombia."[41]

The International Monetary Fund echoed these findings in its assessment of Panama:

> "Money laundering has moved towards other parts of the economy in order for launderers to avoid the developed capacity of banks to detect the introduction of illicit capital. The geographic location of Panama makes it an attractive transit area for drugs and related money laundering… An area of great concern involves the role that the Free Zone of Colón (ZLC), the second largest free-trade zone in the world, can play as the originating or transshipment point for goods purchased with proceeds of narcotics trafficking, including through the Black Market Peso

Exchange. The smuggling of currency, drugs, and prohibited chemical materials, the introduction and transshipment of counterfeit merchandise, and several forms of customs fraud also generate criminal proceeds that expose the system to money laundering. Officials advised that the Panamanian jungle border with Colombia is occasionally penetrated by the illegal armed groups".[42]

These links are not only to drug traffickers, but extend to terrorism. The *Los Angeles Times* published a report in October 2008 describing a Hezbollah-linked drug-trafficking and money-laundering scheme with significant connections to Panama's institutions of international commerce. According to that report, "Hong Kong and the Panama free-trade zone served as centers for a scheme whereby drug cash from the U.S. was funneled to firms that use it to buy goods, which are shipped to Colombia and sold to be turned back into cash."[43]

Panama's dealings with the Financial Action Task Force on Money Laundering (FATF), a G-7-established body, mirror the obstructive pattern displayed regarding U.S. and international tax authorities. In 2000, Panama was listed as uncooperative in the fight against money laundering by the G7 Task Force. But a year later, the country was able to be removed from the blacklist for agreeing *on paper* to FATF recommendations, even though money laundering continues to be a major problem *in practice*, as the U.S. government has amply documented. In the words of one offshore lawyer:

> "Only three times has FATF implemented counter measures to countries and they have all been removed. … Panama hired a lawyer who is a genius to write their anti-money laundering laws. He fought vigorously to show they were up to standards and got Panama removed from the blacklist a few years ago while leaving Panama intact as an asset protection tax haven and offshore jurisdiction. Panama still has anonymous bearer share corporations and anonymous foundations. The man was simply brilliant."[44]

Five Simple Measures Panama Could Take to Clean Up Its Act

The Task Force on Financial Integrity and Economic Development is the leading group calling for addressing tax evasion and money-laundering problems. It represents a coalition of over 60 governments and the top transparency NGOs dedicated to curbing illicit money flows in order to have more resources for poor-country development. They advocate five simple reforms that countries should adopt to address these issues. These could be adopted in the body of the FTA text, or as a side letter. Here is a slightly adapted version of their best practices list:

1. **BENEFICIAL OWNERSHIP**: Require that Panama and the United States ensure that the beneficial ownership, control and accounts of companies, trusts, foundations and securities are readily available on public record to facilitate effective due diligence. Task Force experts like Raymond Baker say that lack of information on beneficial ownership is a major problem in Panama. Moreover, the OECD reports that Panama allows the issuance of bearer shares, which disguises the ownership of these securities. Banning the issuance and possession of these shares would deal a major blow to illicit money flows.

2. **AUTOMATIC EXCHANGE OF TAX INFORMATION**: Require Panama to collect from financial institutions data on income, gains, and property paid to non-resident individuals, corporations, and trusts. Mandate that data collected automatically be provided to the U.S. government when U.S. persons are involved. This goes a step beyond the double taxation treaty, which places the onus on the individual tax filer to disclose their income and its sources. Under an automatic exchange regime, if a U.S. taxpayer earned interest income on a Panamanian bank account, Panamanian tax authorities would forward this information on directly to U.S. authorities.

3. **MULTINATIONAL REPORTING**: Require that all multi-national corporations report sales, profits, and taxes paid in Panama (and all jurisdictions) in their audited annual reports and tax returns.

4. **IMPROVED ACCESS TO INFORMATION RELATED TO POSSIBLE MONEY LAUNDERING**: Require that predicate offenses for a money laundering charge are harmonized upward at the most restrictive level and codified. In other words, financial institutions in the United States and Panama should be prohibited from accepting deposits derived from tax evasion, handling stolen property, customs crimes, counterfeiting, trafficking in stolen property, sex and arms trafficking, racketeering and other crimes – regardless of whether they take place in the U.S., Panama, or elsewhere. If financial institutions believe that a depositor may have derived income from these sources, they should be required to file binationally a suspicious activity report – and governments should be able to use these reports as a way to pursue further legal action.

5. **CORRECT TRADE PRICING**: Require that the parties conducting a sale of goods or services in a cross-border transaction between Panama and the United States sign a statement in the commercial invoice certifying that no trade mispricing in an attempt to avoid duties or taxes has taken place and that the transaction is priced using the OECD arms-length principle.

A full description of the Task Force's recommendations are available online at www.gfip.org.

How the FTA Would Make Matters Worse: Undermining U.S. Ability to Counter Tax Evasion and Money Laundering

If passed, the Panama FTA would set back U.S. efforts to combat tax havens and money laundering, and to re-regulate the financial sector more broadly. The FTA's Financial Services, Investment and Services chapters include various provisions that forbid the United States from applying certain forms of regulation on cross-border financial services and transactions from Panama, on U.S. firms and individuals' rights to access services in Panama, and on Panama-registered investors operating financial services within the United States.[45] Currently, the U.S. government is free to use such policy tools in its efforts to combat money laundering and tax evasion in Panama.

Given today's "trade" agreements extend beyond traditional trade matters, such as tariffs, to integrate signatories' investment and service-sector policies and activities, a good agreement would include affirmative obligations on all parties to provide transparency and automatic exchange of tax information, eliminate excessive banking secrecy and re-regulate the financial sector. In contrast, the current Panama FTA text seems written to explicitly coddle investors benefiting from Panama's lax regulatory environment, protect them from government enforcement actions and lock in the radical financial services deregulation model that is a major contributing factor to the current economic crisis.

The Panama FTA text explicitly states: *"Nothing in this Chapter [financial services] requires a Party to furnish or allow access to: (a) information related to the financial affairs and accounts of individual customers of financial institutions or cross-border financial service suppliers."*[46] Further, a provision of the FTA entitled "Transparency" notes that "Each Party commits to promote regulatory transparency in financial services."[47] That is to say the provisions require the countries to be transparent in how they *regulate* financial services, including requiring signatories to make easily accessible information on existing and proposed regulations and policies that apply to financial services, and to provide an opportunity for the other country's government to comment on proposed regulations. However, as highlighted by the provision above, the FTA establishes no obligation on governments to make the records of banks and other financial service firms available to the other government.

In essence, the Panama FTA would protect corporations from unwanted regulation, including of financial services, while limiting governments' right to regulate. It would also eliminate tools now available to the U.S. government to crack down on tax evasion. The Panama FTA does this through extremely complicated and practically impenetrable cross-references between half a dozen chapters of FTA text and references to World Trade Organization (WTO) provisions. As such, the following analysis of these provisions is not for the light of heart or short of attention span. The conclusions to our report offer a summary of this analysis.

1. The FTA Provisions that Forbid Certain Forms of Regulation

To understand the new limits that the Panama FTA would impose on U.S efforts to crack down on tax evasion and money laundering, we must review the FTA's Financial Services, Investment, and Services Chapters (i.e. Chapters 12, 10 and 11, respectively), various Annexes to those chapters, and the overall agreement. As a general matter, the pact's Financial Services chapter governs banking and other financial activities. However, aspects of the FTA's Investment and general Services chapters are "incorporated into and made a part of this [Financial Service] Chapter."[48] This includes the right for foreign firms and investors to be free from limits on the transfers of funds regarding their investments and cross-border trade in financial services; the right to obtain compensation for government actions (short of expropriation) that undermine their expected future profits; and the private enforcement of these new rights in foreign tribunals.

Many of the new rights and privileges – and limits on regulation – that the FTA provides do not apply only to firms owned and operated by Panamanian nationals. The agreement defines "financial institution" to "*mean[s] any financial intermediary or other enterprise that is authorized to do business and regulated or supervised as a financial institution under the law of the Party in whose territory it is located.*"[49] This means that firms from China, Europe, Iran or anywhere else that happen to be registered in and have some operations in Panama could take advantage of the FTA-established rights and tribunals.

A. Panamanian Financial Services and Firms Operating from Panama Must be Treated No Less Favorably than U.S. Services and Firms (or those of non-FTA Countries)

Two key principles of the Financial Services chapter are "National Treatment" and "Most Favored Nation" (MFN) treatment. These two provisions explicitly forbid the United States from doing what almost every conceivable policy designed to crack down on tax evasion and money-laundering jurisdictions does: treat those countries' financial transactions and firms differently from domestic firms and services and firms and services from non-tax haven jurisdictions.

The National Treatment obligation requires that Panama-based investors and Panamanian financial institutions operating there – as well as cross border transactions from firms in Panama – must be treated the same way as U.S. firms and financial services "*with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of financial institutions and investments*."[50] The MFN rule requires the United States to provide Panamanian financial service investors, financial institutions, investments of Panamanian investors in financial institutions, and cross-border financial services supplied by Panamanian-based firms "*treatment no less favorable than that it accords to the investors, financial institutions, investments of investors in financial institutions, and cross-border financial service suppliers **of a non-Party**, in like circumstances*" (emphasis added).[51]

That is to say that even though Panama is specifically targeted by virtually every U.S and international tax-haven and money-laundering list – under the FTA – its financial service transactions and firms must be treated the same as U.S. banks and investors, and no less favorably than the United States treats the financial services and firms of all countries not party to the agreement.[52] Yet, a basic premise of almost every proposal to crack down on tax evasion and money laundering involves treating such venues differently – by limiting their access to other markets and thus their ability to increase risk and complete illegitimate transactions. U.S. policies aimed at cracking down on tax evasion and money laundering that fail to provide these "non-discrimination" and "most favored nation" rights would violate the FTA, and thus be subject to challenge by the Panamanian government in FTA tribunals.[53]

Were such a challenge to be brought, the United States could try to use a defense provided in the FTA's Exceptions Chapter 21. That chapter contains a provision explicating when tax measures are subject to the agreement's terms.[54] That provision provides an exception to National Treatment and MFN rules for "*the adoption or enforcement of any taxation measure aimed at ensuring the equitable or effective imposition or collection of taxes (as permitted by Article XIV(d) of the [WTO's General Agreement on Trade in Services] GATS.*"[55]

On its face, this clause might seem to provide a defense that could be raised when a U.S. law that treats tax-haven countries like Panama differently is challenged. However, it would be at the discretion of the trade tribunal hearing the case to determine if the scope of the exception covers any particular policy. Thus, it is necessary to work through the analysis such a panel would undertake.

To start with, a tribunal would consider the WTO GATS article the Panama FTA exception references. That provision only allows exceptions to National Treatment "*provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection* ***of direct taxes in respect of services or service suppliers of other Members***" (emphasis added).

A footnote to this GATS provision provides more clarity as to what activities the exception covers: "*Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes* ***include measures taken by a Member under its taxation system****…*" and then lists the various mechanisms in international tax policy used to obtain payment under different systems of valuation (emphasis added).[56] To simplify this point, the GATS exception makes clear that while the National Treatment rule generally requires the same treatment for foreign and domestic firms, governments are allowed to use different tax collection mechanisms for revenue earned offshore than is applied to domestic firms.

The provision is not without usefulness, as it includes measures that "*apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures.*" However, this enumerated example must be read in the context of the text preceding it, which specifies that the provision is limited to the "*imposition or* *collection* ***of <u>direct taxes</u> in respect of services or service suppliers of other Members.***" Thus it would cover U.S. policies that may differ from policies applied to like domestic firms that are needed to enforce tax collection from Panamanian service suppliers operating within the United States. It would also apply to such policies needed to collect taxes on cross-border services supplied from Panama that might be subject to U.S. taxes.

To use a hypothetical, assume a Panamanian-registered firm operating in the United States failed to pay taxes on its U.S. income. If that firm's assets were in Panama, the U.S. government could not employ the compliance measures – for instance seizing assets – it would use with respect to a U.S. firm in the same situation. This exception would protect U.S. policies – such as conditioning future operations on paying the back taxes – that treat the Panamanian firm differently than how U.S. tax authorities would treat a similar U.S. firm.

However, this exception does not provide a defense for policies that treats an entire country and all business activities related to it differently based on that country's *general* tax-haven policies.

The United States could also raise a broader exception included in the Financial Services chapter to try to defend a challenged policy. This exception states: "*Notwithstanding any other provision of this Chapter or Chapter Ten (Investment), Thirteen (Telecommunications), including specifically Article 13.16 (Relationship to Other Chapters), or Fourteen (Electronic Commerce), and Article 11.1.3 (Scope and Coverage) with respect to the supply of financial services in the territory of a Party by an investor of the other Party or a covered investment, a Party shall not be prevented from adopting or maintaining measures for prudential reasons,3 including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service supplier,* ***or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party's commitments or obligations under such provisions***" (emphasis added). Footnote 3 (in text above) of FTA Chapter 12 states: "*It is understood that the term "prudential reasons" includes the maintenance of the safety, soundness, integrity, or financial responsibility of individual financial institutions or cross-border financial service suppliers."*[57]

This exception provides the best chance for the United States to attempt to defend policies aimed at cracking down on Panama's tax-haven policies, but unfortunately the prospects that it can be successfully employed are limited by the way the exception is constructed. Again, it would be an FTA tribunal that would determine if the exception were allowed to defend a challenged policy.

First, the United States would have to convince the tribunal that the policy in question is a prudential measure. With respect to policies aimed at tax havens and money laundering, the best U.S. argument is that the policy is important to ensuring "*the integrity and stability of the financial system."* Given the recent focus by the G-20 and other global institutions on the threats posed by tax havens and money laundering on global financial stability, this is a case that can be made with some merit.

However, the tribunal would also consider the definition of "prudential reasons" established in the footnote to the exception. This definition is not helpful to a U.S. defense for anti- tax haven or money laundering policies, in that it establishes a much narrower notion of what is a legitimate goal to include "*maintenance of the safety, soundness, integrity, or financial responsibility of individual financial institutions or cross-border financial service suppliers."* This definition narrowly focuses on ensuring the well-being of specific institutions and services, not the broader finance system. In other words, this definition makes clears that the government may take actions that would otherwise violate the limits on regulation to ensure specific financial institutions and their depositors are safeguarded, however it does not encompass violations of the agreement needed to ensure that the interests of the government as tax collectors or law enforcers are protected.

Second, and most importantly, the United States would have to get around the last sentence of the exception, which unfortunately replicates clauses in many FTA and WTO exception provisions that largely negate the effective use of the underlying exception. The last sentence of the exception provides: "*Where such measures do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party's commitments or obligations under such provisions."* Yet, *only* domestic policies that do not conform with an agreement end up targeted for challenges, and the purpose of such challenges is to force a country to comply with its commitments and obligations under an agreement. That is to say, the last sentence eviscerates the exception's actual use. Even if regulatory measures are taken for prudential reasons, they are not covered by the exception if they undermine the regulatory constraints – in this instance the obligation otherwise established in the agreement to treat Panamanian firms and services the same as domestic ones.

The national treatment and MFN obligations are a significant problem on their own merits, particularly as they relate to policies aimed at addressing systematic tax and banking secrecy policies, but the FTA's limits on financial service regulation extend even further.

B. U.S. Government Would Be Forbidden from Halting, Limiting Financial Transactions from Panama

Most proposals aimed at cracking down on tax evasion and money laundering are typically enforced through limits on transactions to and from target countries. Currently, the U.S. government is generally free to impose such limits.[58] Were the FTA to go into effect, future U.S. or Panamanian governments would not be able to impose limitations on cross-border flows of money (with only certain limited exceptions).

These provisions would also forbid measures to halt capital flight. Yet, limits on the pace of financial transactions are among the tools that economists are recommending to help slow down economically harmful speculation. Moreover, such "speculation taxes" can help governments collect information and can provide early warning signs for improper financial transactions that may signal drug or other trafficking issues.

The Panama FTA's Financial Services chapter incorporates two different provisions from other chapters of the agreement that ban limits on transfers. The first, a provision from the FTA's Investment chapter says: "Each Party shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory."[59] There is an exception to this constraint: "*a Party may prevent a transfer through the equitable, **nondiscriminatory**, and good faith application of its laws relating to: (a) bankruptcy, insolvency, or the protection of the rights of creditors; (b) issuing, trading, or dealing in securities, futures, options, or derivatives; (c) criminal or penal offenses; (d) financial reporting or record keeping of transfers when **necessary** to assist law enforcement or financial regulatory authorities; or (e) ensuring compliance with orders or judgments in judicial or administrative proceedings*"[60] (emphasis added).

Were a U.S. law limiting transfers challenged by Panama, the United States could raise this exception as a defense. However, again, it is within the tribunal's discretion to determine if the exception covers the specific policy in question. A first test the tribunal would apply is whether the policy is discriminatory. For instance, the exception would allow the United States to stop Panama-registered firms from sending money in or out of the United States if such a limit on transfers involved application of a law to *all* firms – U.S. and foreign – as well as to Panamanian firms. Thus, this defense would protect U.S. laws of general application that freeze assets located in the United State related to criminal offenses or as enumerated related to bankruptcy proceedings. However, if a law only applies to stopping transfers related to activities connected with, for instance, a list of tax-haven jurisdictions, it is inherently discriminatory. Some tax experts advocate for across-the-board changes to the rules allowing U.S. firms to defer taxes on offshore income they do not repatriate. Whether or not such a change is politically feasible is an open question. However, were the Panama FTA to go into effect, the U.S. government's current rights to limit transfers would be eliminated.

U.S. laws that condition transfers from U.S. financial service firms and those of all nations on meeting certain requirements with respect to "*financial reporting or record keeping of transfer*" also would not necessarily meet the exception's criteria if such a policy were challenged by Panama in an FTA tribunal. That is the case because the exception allows such conditions when they are "***necessary** to assist law enforcement or financial regulatory authorities*" (emphasis added). The term "necessary" has been interpreted in past trade tribunals to mean that the country seeking to use the exception must prove a negative **–** that no less trade-restrictive means exist to obtain its goal. In fact, WTO panels have ruled that national policies did not meet the "necessary" test in nearly 90 percent of the cases where this defense was raised.[61] Thus, the United States would bear the burden of showing that the specific "*financial reporting or record keeping of transfer*" rules were the least trade restrictive way to stop money laundering or tax evasion.

Given the United States uses various treaties to deal with these problems with respect to other nations, it would be a hard case to prove. The tribunal would have the discretion to determine if Panama's unwillingness to enter into such international agreements would make this approach necessary. However, more practically, the U.S. government would not likely implement such an approach with respect to all countries, given that Congress has become deeply frustrated by the lack of effectiveness of the TIEAs and other existing international approaches. (As noted, Switzerland has signed such agreements with the United States, and still is a major tax-haven and money-laundering nation.)

The other provision limiting transfers that is incorporated into the FTA's Financial Services chapter comes from the FTA's general Services chapter, and relates to cross-border supply of services. That provision requires: "*Each Party shall permit all transfers and payments relating to the cross-border supply of services to be made freely and without delay into and out of its territory.*"[62] This provision has the same exceptions as the provision from the Investment chapter, and thus the same limitations noted above.[63]

The Financial Services chapter also provides a general limiting clause with respect to both provisions banning the limits on transfers. "*Notwithstanding Articles 10.8 (Transfers) and 11.10 (Transfers and Payments), as incorporated into this Chapter, a Party may prevent or limit transfers by a financial institution or cross-border financial service supplier to, or for the benefit of, an affiliate of or person related to such institution or supplier, through the equitable, **non-discriminatory**, and good faith application of **measures relating to maintenance of the safety, soundness, integrity, or financial responsibility of financial institutions or cross-border financial service suppliers.** This paragraph does not prejudice any other provision of this Agreement that permits a Party to restrict transfers*"[64] (emphasis added).

First, this exception covers limits on transfers designed to protect "*the safety, soundness, integrity, or financial responsibility **of financial institutions or cross-border financial service suppliers***" (emphasis added). That is to say that this exception provides a defense for some forms of prudential regulation of financial service firms and activities that limit transfers. However, given the specific enumeration of the goals underlying this exception – which does not include the broad goal of ensuring "*the integrity and stability of the financial system*" included in the general exception noted above, it is difficult to imagine how an FTA tribunal would consider that this exception additionally permits limits on transfers that aim at different policy goals not so listed, such as penalizing tax-haven policies.

U.S. lawyers trying to defend against a challenge could argue that ensuring the collection of taxes and halting money laundering maintains "*the safety, soundness, integrity, or financial responsibility of financial institutions…*" However, could not the converse also be true? Given the exception applies to the status of the firms and services, not to the integrity of a country financial system or its budget, tax evasion that is damaging to the Treasury could also be beneficial to firms.

Further, U.S. government lawyers seeking to apply this exception would run into the non-discrimination requirement. If the law in question applied limits on transfers only with respect to tax-haven countries, how could its application ever be non-discriminatory?

U.S. lawyers seeking to defend against a challenge could also raise the general prudential measures exception noted above, however the prospect that such a defense would be accepted by a tribunal is limited by the problems with this exception also noted above.
In sum, were the Panama FTA to go into effect, the U.S. government could lose its most effective tools for dealing with countries, such as Panama, that are widely recognized as tax havens and venues for money laundering. And, this is not a speculative concern. Already Panama has spoken out at the WTO about how various policies aimed at tax haven countries could violate WTO rules.[65]

C. The U.S. Government Would Be Forbidden from Barring U.S. Nationals from Purchasing Financial Services in Panama, and Panama-Registered Firms Would be Guaranteed the Right to Establish or Acquire Operations Here

There is a common misunderstanding that FTA financial service rules *only* affect domestic policies that discriminate against foreign service-sector firms. In fact, the rules do much more than curb discriminatory laws. The FTA's "Market Access"[66] and "Cross-Border Trade"[67] rules create certain *absolute* rights.

The Cross-Border Trade provision forbids the U.S. government from banning U.S. nationals from purchasing financial services in Panama. *"Each Party shall permit persons located in its territory, and its nationals wherever located, to purchase financial services from cross-border financial service suppliers of the other Party located in the territory of the other Party. This obligation does not require a Party to permit such suppliers to do business or solicit in its territory."*[68] This means that U.S. nationals would gain a new right to move, for instance, their investment portfolios into Panamanian-issued securities. As described above, Panama does not tax foreigners' income in Panama, nor does it provide the U.S. government with information that would facilitate the Treasury to tax that income domestically. Thus, this provision effectively locks in a permanent tax shelter opportunity for U.S. nationals. (The U.S. government *could* tighten the rules on deferral of *all* foreign income, as noted in the previous section. This would be a welcome first step. The problem is that, absent reforms *in* Panama – such as automatic exchange of *all* tax information with U.S. authorities, country-by-country reporting of income, and full disclosure of beneficial ownership of Panama-based assets, etc. – the tightening of deferral on *paper* would amount to only that. In other words, you can't tax it if you don't know it exists.)

The FTA's Financial Services market-access rules set limits not only on how U.S.-Panama trade in services may (or may not) be regulated, but also sets limits on U.S. governmental regulation of foreign services operating *within* the United States. These rules would forbid the U.S. government from banning Panamanian banks or other financial services from establishing operations here, or acquiring existing firms, and also forbid limiting the size of such operations.[69] (Panama not only has a number of internationally competitive banks, but also a large number of financial institutions effectively headquartered in Europe and elsewhere with a business presence in the isthmus.) In an era when even the former IMF Chief Economist Simon Johnson has joined the chorus of these concluding that "too big to fail is too big to exist," the notion of the United States agreeing to an FTA that explicitly bans governments' rights to establish limits on financial firms' size is extremely ill-advised. Further, to the extent that the U.S. government may have second thoughts about the wisdom of allowing banking firms from tax-haven nations to set up shop here or acquire U.S. firms, these rules create an absolute right for Panamanian firms to establish and operate within the United States.

2. The FTA Would Empower Firms Operating in Panama (Including U.S. Subsidiaries with Business Activities in Panama), and Panamanian Firms Operating in the United States, to Challenge U.S. Laws in Foreign Tribunals and Demand Compensation

Among the hundreds of pages of Panama FTA text are nearly word-for-word replicas of the highly controversial foreign-investor privileges of the Central America Free Trade Agreement (CAFTA), which in turn expanded on similar rights found in the North American Free Trade Agreement (NAFTA). These rules incentivize the offshoring of U.S. jobs by eliminating many of the risks and costs otherwise associated with relocation to a developing country, and expose an array of public-interest environmental, health and other safeguards to attack. Because they allow private enforcement actions against U.S. laws outside U.S. courts, allow foreign tribunals to order the U.S. government to pay damages from our tax dollars, and preference foreign firms over domestic ones, these provisions have raised the ire of Republicans and Democrats alike.

Unfortunately, the arrangement announced on May 10, 2007 between President Bush and some Democratic and Republican members of Congress to renegotiate the Bush FTAs to include enhanced labor and environmental rules did not alter these pacts' extreme foreign-investor privilege provisions or their private enforcement in foreign tribunals. In fact, the Bush administration bragged in a fact sheet that *none* of the FTAs' binding language on investor rights would be changed and that the administration had safeguarded the CAFTA foreign investor standard despite the May 2007 deal.[70]

President Obama made reform of these investment provisions a key part of his election effort. He answered "yes" when asked by the Pennsylvania Fair Trade Campaign: "Will you commit to renegotiate NAFTA to eliminate its investor rules that allow private enforcement by foreign investors of these investor privileges in foreign tribunals and that give foreign investors greater rights than are provided by the U.S. Constitution as interpreted by our Supreme Court thus promoting offshoring?" He also told the Texas Fair Trade Campaign that: "While NAFTA gave broad rights to investors, it paid only lip service to the rights of labor and the importance of environmental protection... We should amend NAFTA to make clear that fair laws and regulations written to protect citizens in any of the three countries cannot be overridden simply at the request of foreign investors."[71]

Conservatives, such as former Rep. Butch Otter, now the Republican governor of Idaho, expressed concern with these provisions as well: "I'd like to draw your attention to the fact that CAFTA contains 1,000 pages of international law establishing, among other things, property rights for foreign investors that may impose restrictions on U.S. land-use policy. Chapter 10 of CAFTA outlines a system under which foreign investors operating in the

United States are granted greater property rights than U.S. law provides for our own citizens! Mr. Speaker, that's not encouraging free trade. That's giving away our natural resources and our national sovereignty."[72]

New Democrat Coalition member Rep. Jane Harman (D-Calif.) and other representatives also focused on the foreign investor provisions:

> "We wanted to draw your attention to… the threat that the investor rights rules in the Central America-Dominican Republic Free Trade Agreement (CAFTA) pose to important state and local laws and regulations that protect the environment and public health. Like Chapter 11 of NAFTA, the investor rights provisions of CAFTA give foreign corporations the power to demand payment from the U.S. when public interest protections affect a company's commercial interests… The State of California has now joined state and local government groups in saying that U.S. trade negotiators failed to heed the lessons of NAFTA in their negotiation of the investor rights rules in CAFTA. We hope you will join us in opposing CAFTA."[73]

The concern about these expansive foreign investor rights and their private enforcement across party and caucus lines is logical. Combining the FTA's foreign investor privileges and their private enforcement with various guarantees for Panamanian financial service firms would be a very dangerous mix, but that is exactly what the FTA does.

The Panama FTA investor provisions provide foreign investors operating within the United States greater rights than the U.S. Constitution provides U.S. citizens and firms. This includes the right to skirt U.S. courts and challenge U.S. laws in front of foreign tribunals to demand compensation for U.S. policies that undermine new substantive rights the agreement provides foreign investors. In addition to allowing such private challenges with respect to the ban on limits on transfers, the FTA also establishes new rights for Panamanian firms and investors to obtain compensation for "regulatory takings" – meaning government actions that do not outright seize an investment, but undermine its value. Compensation for such government regulation is almost never allowed in U.S. courts. Key aspects of these expansive foreign investor privileges are incorporated into the FTA's Financial Services chapter, meaning they apply to certain aspects of financial service regulation. As regards an FTA with Panama, the inclusion of such generally ill-advised foreign investor rules, and private enforcement thereof, is especially problematic given Panama's status as a major tax haven and money laundering venue.

A. New Rights to Obtain Compensation from the U.S. Government for U.S. Regulatory Actions that Undermine Future Expected Profits

The Panama FTA's Financial Services chapter incorporates the FTA Investment chapter's provisions on "Expropriation and Compensation" that would require the U.S. government to compensate foreign investors operating from Panama if a U.S. government action "*expropriate[s] or nationalize[s] a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization*."[74] This is the same language that is included in the CAFTA.[75] These provisions establish a right for foreign investors to seek compensation for indirect expropriation.

An Annex relating to this provision, which replicates a similar CAFTA Annex, explains that direct expropriation is "*where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure*." An indirect expropriation is defined as "*an action or series of actions by a Party [member government] [that] has an effect equivalent to direct expropriation without formal transfer of title or outright seizure*." In determining whether an action constitutes an "indirect expropriation," an FTA-established tribunal would be required to consider "*the economic impact of the government action*," "*the character of the government action*," and "*the extent to which the government action interferes with distinct, reasonable investment-backed expectations*."[76] The Annex also notes that "*the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred*."

As noted above, these provisions are extremely controversial. The NAFTA Chapter 11 provisions that Obama, Otter and Harman directly reference have resulted in nearly 50 challenges of federal and state laws, leading to over $36 million in taxpayer funds from NAFTA nations paid to corporations that successfully challenged bans on toxic substances, denials of construction permits for toxic waste dumps and logging regulations. The United States already has spent millions in legal costs to defend against such attacks,[77] and faces nearly $600 million in claims from currently pending challenges. Abner Mikva, a former member of Congress close to President Obama, who served as a panelist on one of the NAFTA investor-state disputes, summarized the views of many when he said, "If Congress had known that there was anything like [Chapter 11] in NAFTA they would never have voted for it."[78]

Lawyers argue about what these provisions mean and when they allow a foreign investor to obtain compensation. However, in the end, it is a foreign investment arbitral tribunal established under the United Nations or World Bank, and operating outside of U.S. law and court procedures, that decides. The only role for the Panamanian and U.S. governments is to determine if an exception for prudential regulatory measures provided in the agreement could provide a defense to such a claim. (See below for more on the process.)

Past concerns about these provisions have centered on challenges to domestic environmental or health laws. Indeed, the Annex noted above has a clause covering such instances: "*Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.*"[79] This has proved small comfort for those concerned with challenges to such laws, as under U.S. law such non-discriminatory regulations are *never* considered an expropriation. However, at issue with the Panama FTA is also how domestic laws relating to taxes, banking secrecy and money laundering that undermine the value of a covered investment, could be challenged.

The Panama FTA clearly provides for such challenges to financial service regulation, and indeed includes a special procedure for their consideration. The general Exceptions chapter of the FTA explicitly states that: *"Article 10.7 (Expropriation and Compensation) and Article 10.16 (Submission of a Claim to Arbitration) shall apply to a taxation measure alleged to be an expropriation or a breach of an investment agreement or investment authorization."*[80] The provision then sets out a special procedure for handling such claims. This includes a process for the tax authorities listed for both countries to meet to try to come to consensus on whether the policy being challenged by an investor from one of the countries is an expropriation. If U.S. and Panamanian authorities cannot agree on this question, then the investor is free to file an investor-state claim six months after requesting the determination. The next section describes how such a dispute would proceed and what option the United States would have to defend its laws.

B. Private Enforcement of New FTA Rights in Foreign Tribunals

The FTA rules on National Treatment, Most Favored Nation treatment, Market Access, Cross-Border Trade and Transfers can be enforced by the Panamanian government challenging U.S. policies in government-to-government dispute resolution before an FTA tribunal.[81] However, the FTA's Financial Services chapter also incorporates the private enforcement system of the Investment chapter with respect to compensation for "regulatory takings" and the ban on limits on transfers.[82]

Not only Panamanian nationals and their firms would be empowered under the FTA to use this private enforcement system. Rather, it applies to the 350,000 foreign subsidiaries operating in Panama – including U.S. subsidiaries that have "substantial business activities" there.[83]

This is extremely problematic, because an array of financial service regulation and tax-haven elimination goals of Congress and the Obama administration fall within the limits on regulation and rights for foreign banks and investors included in the Panama FTA. Perhaps Panama's government might hesitate to drag the United States before an international tribunal if we limited certain risky transactions or conditioned access to U.S. financial services on banking transparency in Panama. Although, given Panama's main comparative advantage is its bad bank and tax practices (and it has already complained to the WTO about such measures), who can predict?

However, a private investor or institution would not have to make such diplomatic considerations, and under the FTA would be empowered to enforce the pact's investor rights terms. The Panama FTA investor-state private enforcement system (like those in NAFTA and CAFTA) would empower Panama-based subsidiaries of U.S., Chinese, European and other multinationals to privately enforce this right of compensation by circumventing domestic courts and domestic law to bring cases based on FTA law directly against signatory governments in foreign tribunals.[84] This "investor-state dispute settlement" system uniquely empowers foreign investors to *privately* enforce the terms of a *public* contract between governments (i.e. private enforcement of a government-government agreement).[85] Cases under this FTA provision are submitted to tribunals that operate in the United Nations (United Nations Commission on International Trade Law, i.e. UNCITRAL) or World Bank (International Center on Settlement of Investment Disputes, i.e. ICSID). These tribunals operate outside of the signatory countries' court systems and enforce FTA (not domestic) property rights law. There is no limit placed on the awards that these foreign tribunals can order governments to pay foreign investors.[86]

The Panama FTA has a special dispute resolution clause covering investor-state disputes arising under the agreement's financial services chapter.[87] This provision establishes a process for determining whether the prudential exception described above can be used as a defense against such investor-state claims for compensation. Under this system, a Financial Services Committee comprised of officials from both countries is tasked with trying to determine "whether, and to what extent" the prudential exception "is a valid defense to the claim of the investor."[88] However, if those officials cannot come to an agreement in 60 days, then the investor may request an arbitral tribunal to decide the matter. If the investor does not do so, ten days after the 60 days expires, the matter proceeds to the UNICTRAL or ICSID tribunal.

Whether Panamanian officials would agree to U.S. use of such a defense would be based, in part, on the requirements of the prudential measures exception. As noted above, this exception has significant limits with respect to useful application. Most importantly, it is hard to imagine how officials from the home country of a challenging investor would agree the exception applies, given its requirement that: "*Where such measures [domestic polices] do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party's commitments or obligations under such provisions.*"

AIG Could See Further Tax-Dollar Windfall from FTA

In recent months, the American International Group (AIG) has dominated headlines with taxpayer outrage over its bailouts and bonuses.[89] But fair-trade advocates around the world have long targeted AIG for its leading role in pushing financial service deregulation through trade agreements. For instance, AIG has been a leading proponent of financial services deregulation in the WTO. The corporation also played a leading role in obtaining U.S. congressional passage of legislation revoking annual review on China's most favored nation status and establishing permanent MFN status for China so as to facilitate China's entry into the WTO. This came after AIG pushed for and obtained various insurance deregulation and liberalization terms in the U.S.-China WTO accession agreement.[90]

More recently, AIG, and financial services lobby groups it belongs to, have played a leading role in pushing the Panama FTA, and in particular the provisions that allow entities incorporated in Panama the right to sue U.S. taxpayers in foreign tribunals for taxpayer compensation if new U.S. regulations undermine their "expected future profits."[91] As it turns out, these FTA provisions could directly benefit AIG-linked interests.

Using U.S. courts, AIG now "is quietly fighting the federal government for the return of $306 million in tax payments, some related to deals that were conducted through offshore tax havens," according to a March 19, 2009 *New York Times* story.[92] Specifically, AIG's U.S. court filings include demands to retroactively deduct from its taxable U.S. income a stream of cash payments and shares of AIG stock *paid as compensation to its employees* by a Panama-registered corporation acting on its behalf. The latter corporation is the Starr International Company Inc., or SICO, whose chairman is Maurice "Hank" Greenberg, himself the former head of AIG. According to press reports, SICO is AIG's largest private shareholder[93] and an erstwhile provider of reinsurance and other services to AIG, *and operates a compensation pool for AIG's top staff.* The opaque relationship between AIG and SICO has played out in court battles since 2005, when Greenberg was forced out of AIG.[94] (In fact, on February 27, the same day that AIG filed against the U.S. government, Greenberg filed against AIG, claiming that the price of AIG shares awarded to him through the SICO compensation plan had been artificially inflated.[95])

How is this case linked to the FTA? Take a company like SICO, whose business model seems to be premised entirely on being able to engage in shady offshore financial dealings with minimal regulatory oversight, on behalf of companies like AIG. (Note that, as of December 31, 2008, AIG also has a direct subsidiary in Panama – Underwriters Adjustment Company, Inc.)[96] If the Panama FTA were implemented, AIG's Panama-registered subsidiaries (or firms linked to the company like SICO) would be newly empowered to demand taxpayer-dollar damages for U.S. financial service regulations or limits on transfers related to Panama's status as a tax haven country that it could claim undermined its future expected profits and were thus "tantamount" to ("indirect") "expropriations." These cases would be heard by UN or World Bank tribunals, and could be brought to attack domestic regulatory measures that would not be considered expropriations under the U.S. Constitution as interpreted by the U.S. Supreme Court.[97]

The effect of these excessive Panama FTA investor rights could be a watering down or chilling of much needed financial-sector re-regulatory efforts. Anyone who has followed AIG or Greenberg knows that the aggressive firm and mercurial executive would not show the slightest hesitation in using every channel available to them to escape U.S. taxes and regulations, and indeed to profit at the taxpayers' expense. *Indeed, filings made with the U.S. Trade Representative's Office by financial-service associations of which AIG is a part indicate that this so-called investor-state system that allows corporations to directly sue government in foreign tribunals is a major motivation for their advocacy in favor of the Panama FTA.*[98]

C. The FTA Would Create New Rights for Foreign Investors not Existing in the WTO or the U.S.-Panama Bilateral Investment Treaty.

The FTA's new rights and privileges for Panamanian firms and U.S. and other firms operating in Panama extend beyond those provided under existing WTO rules in several key ways. First, there is no investor-state mechanism under the WTO, so only the governments, not private businesses or investors, can enforce the agreement's terms. Given the Panamanian government has already raised whether various anti-tax haven proposals violate WTO GATS rules, the notion of creating additional constraints on such policies and a whole new category of private sector challengers is now prudent.

Second, the United States and Panama already have a Bilateral Investment Treaty (BIT) in place. Panama was one of the first nations to sign a U.S. BIT, which U.S officials used as a template for the investment chapters of NAFTA and similar FTAs. The Senate took nearly a decade to give its advice and consent to the BIT – which was signed in 1982 – due to concerns over the Manuel Noriega dictatorship.

When the BIT finally received a hearing in 1990, only two senators attended. The State Department official who testified before the committee said: "The treaty serves as a key precedent for investment treaties in the region… Many Latin American countries, including Panama in the past, resisted international arbitration through their adherence to the Calvo doctrine, a resistance which is beginning to break down with each successive negotiation in the region… the exhaustion of local remedies is not required before arbitration can begin… It's a good insurance policy, and the fact that a country adheres to international arbitration is a strong signal toward investors. It is an inducement for investment."[99]

There has only been one known case under the U.S.-Panama BIT. It was launched by Nations Energy Corp., a subsidiary of Tuscon-based UniSource Energy Corporation, and it is apparently related to problems with the privatization of a power plant (COPESA). Little information about this case is available.[100]

There are key differences between the BIT and the FTA. According to the USITC, "the new TPA would extend coverage to a significant number of industry sectors which were excluded from the BIT… One particular area of new opportunity for U.S. investors is in the Panamanian retail sector, where investment would be permitted beginning in 2010."[101] The FTA's definition of investment is also expanded relative to the BIT to include the expectation of gain or profit, or the assumption of risk; bonds, debentures, other debt instruments, and loans; futures, options, and other derivatives; authorizations and similar rights conferred pursuant to domestic law; and movable or immovable property, and related property rights, such as leases. In short, a wide range of expropriation challenges could be launched under the FTA that were not possible under the BIT.

Conclusion and Policy Recommendations

The Obama administration already has changed an array of policies implemented by the Bush administration, including some that received little play during the election. And the Obama administration has launched numerous initiatives to deliver on priority campaign commitments for change. Therefore, it has shocked many that USTR Kirk has repeatedly declared that the NAFTA-style Panama FTA negotiated by Bush should be adopted by the Obama administration as its own and pushed through Congress.

The Panama FTA directly and starkly contradicts commitments made by Obama during the campaign on issues that gained high national public profile: closing tax loopholes, re-regulating finance and reforming the U.S. trade-agreement model. The Panama FTA further conflicts with other initiatives the Obama administration has endorsed – such as the Stop Tax Havens Abuse Act and financial service re-regulation.

It seems perverse that in contrast to other leftover Bush administration initiatives that conflict with the Obama agenda and have been discarded, the Obama administration would consider adopting as its own Bush's Panama FTA. The fact that this Bush trade agreement conflicts with other Obama administration policy and political goals makes it even more unbelievable that the administration would consider employing its political capital and time to pass this pact.

Indeed, at a time of unprecedented levels of anger about our failed trade and deregulation policies, the Obama administration has a unique opportunity to deliver on the President's campaign commitments to close tax loopholes that promote offshoring and reform U.S. trade policy. The Panama FTA could provide a useful vehicle to move Obama's commitments to create a new trade-agreement model moving forward, by requiring Panama to remedy its tax-haven and banking-secrecy policies and by renegotiating the pact itself to eliminate the problems with the NAFTA-CAFTA model that Obama himself identified. This includes extreme foreign investor rights, secret foreign tribunals being used to challenge U.S. regulatory policy, and more.[102]

It is far from a hypothetical threat that U.S. measures to crack down on tax havens like Panama could bring a trade-pact challenge, were the Panama FTA implemented as it is currently written. First, the United States has already lost WTO GATT cases related to its income tax treatment of foreign corporations, as it has lost nearly 90 percent of the WTO cases brought against its domestic policies. Second, as noted, Panama has already claimed that some of the OECD measures against tax havens would allow them to launch a WTO GATS case; a recent paper from trade advisors to small nations on these matters suggests both GATS and GATT could be violated by these measures.[103] Finally, a panoply of corporate interests have already claimed that the 2007 Stop Tax Havens Abuse Act could violate trade agreement obligations.[104] All of this underscores that **U.S. policymakers cannot simply pursue a free-standing tax treaty or domestic-policy "fix" to the tax haven problem: they must simultaneously advocate for reform of overreaching trade agreement terms that explicitly conflict with reform policies.**

To ensure that the Panama FTA does not undermine efforts to remedy the specific tax haven, banking secrecy and money laundering problems with respect to the Panama outlined in this report, the Obama administration should renegotiate the Panama FTA[105] to:

1. Eliminate the FTA provisions that ban limits on transfers, which would remove from the U.S. the key policy tool for acting against banking secrecy, tax haven policies and money laundering;
2. Remove the investor-state enforcement system, which would allow hundreds of thousands of private investors from around the world that are registered and have operations in Panama to challenge U.S. anti-tax haven policies for cash compensation;
3. Remove the FTA's restrictions on financial regulations, including those that forbid limits on financial service firms' size or establishment of firewalls between different financial service businesses, and add to the FTA's financial services text a set of required minimum financial regulatory standards that signatories to the agreement would agree to adopt in domestic law and enforce and that could be based on the re-regulation proposals now being formulated in multilateral and domestic forums; and
4. Require that the FTA be terminated if Panama fails to maintain the transparency standards outlined below, which should be passed before the FTA goes into effect. (As a related measure, the Obama administration should create an independent regulatory agency, perhaps along the lines of the Financial Product Safety Commission proposed by Sen. Dick Durbin (D-Ill.) and others, and authorize this body to perform regular evaluations of Panama's maintenance of these new standards. These evaluations would form the basis for the invocation of the FTA termination measure.)

Moreover, whatever one thinks about the proposed FTA as a general matter, no FTA should go into effect with Panama until that country eliminates its excessive banking secrecy practices, re-regulates its financial sector, and forces banks and multinational subsidiaries to pay their fair share of taxes**.** Major progress towards those criteria would include these five reforms, outlined in the box above:

1. BENEFICIAL OWNERSHIP: Require that Panama and the United States ensure that the beneficial ownership, control and accounts of companies, trusts, foundations and securities (including bearer shares) are readily available on public record to facilitate effective due diligence.

2. AUTOMATIC EXCHANGE OF TAX INFORMATION: Require Panama to collect from financial institutions data on income, gains, and property transfers paid to non-resident individuals, corporations, and trusts. Mandate that data collected automatically be provided to the U.S. government when U.S. persons are involved, as now occurs with respect to Canada. This also helps sidestep some of the shortcomings of existing treaty instruments, such as the non-automatic tax information exchange agreements and double taxation treaties.

3. MULTINATIONAL REPORTING: Require that all multinational corporations report sales, profits, and taxes paid in Panama (and all jurisdictions) in their audited annual reports and U.S. tax returns.

4. IMPROVED ACCESS TO INFORMATION RELATED TO POSSIBLE MONEY LAUNDERING: Require that predicate offenses for a money laundering charge are harmonized upward at the most restrictive level and codified.

5. CORRECT TRADE PRICING: Require that the parties conducting a sale of goods or services in a cross-border transaction between Panama and the United States sign a statement in the commercial invoice certifying that no trade mispricing in an attempt to avoid duties or taxes has taken place and that the transaction is priced using the OECD arms-length principle.

Appendix I: U.S. International Taxation Law

Tax and trade policies have always been intimately linked. In the early years of the U.S. republic, the federal budget was financed almost exclusively through revenues from tariffs, which were kept high to protect so-called "infant industries." As U.S. industries matured and began pushing freer trade policies, the government had to find other means of raising funds.[106] In 1913, progressive reformers succeeded in getting the Sixteenth Amendment to the Constitution passed, stating that "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

From the beginning debates around the matter, Congress was concerned that U.S.-chartered corporations would seek to avoid the U.S. income tax by relocating their operations overseas, thereby offshoring U.S. jobs and investment, shifting the burden of taxes to firms and families that earned their income at home, and eroding the progressivity of the tax system. The resolution: the U.S. system of international taxation combines what are known as "residence" elements (U.S. corporations pay taxes on both their domestic and foreign operations) and "source" elements (even foreign corporations operating in the United States pay some income tax).

As other countries instituted income taxes around the same period, it became obvious that firms with multinational operations could suffer double taxation: i.e. a U.S. firm with a subsidiary in France might be taxed twice on its French operations, once each by the U.S. and French authorities. To avoid this situation, Congress passed the Revenue Act of 1918, which allowed U.S.-based multinationals to deduct from their U.S.-taxable income any taxes paid to foreign governments, once this income had been repatriated to the United States in the form of dividends.

But as a leading tax historian concluded, "If the tax rate of the foreign country is low or the deferral of U.S. tax is sufficiently lengthy, the present value of the U.S. tax can be very close to zero – an exemption."[107] Moreover, a U.S. corporation can avoid U.S. taxes by simply changing its nationality by re-incorporating abroad in a low-tax country, and then having the latter entity subsume the former. This is known as a corporate "inversion," which is what U.S. federal contractor (and former Delaware corporation) McDermott International, Inc. did when it reincorporated in Panama.[108]

Finally, U.S. tax rules allow deductions for interest payments. This can be gamed by both inverted and non-inverted corporations to reduce their overall U.S. tax liability. Inverted corporations can engage in "earnings stripping," meaning that the newly foreign-incorporated parent can "loan" money to its U.S. "subsidiary," and the subsidiary can repay money to the parent company and deduct interest payments from its U.S.-source taxes. Similar schemes can be rigged by even non-inverted firms with their foreign-based subsidiaries.[109]

Thus there are two perspectives on tax competitiveness concerns. The first is a more corporate-oriented perspective, which worries that even moderate taxes would encourage

U.S. firms to reincorporate abroad, and is concerned about how U.S.-domiciled corporations are able to compete with foreign-domiciled corporations in foreign markets. Under this view, the U.S. would be better off reducing corporate income taxes on both residence- and source bases. This was the Bush administration's point of view, and was contained in the so-called "American Jobs Creation Act of 2004" (P.L. 108-357), which reduced taxes owed on repatriated dividends from the standard 35 percent to only 5.25 percent.[110] The second tax competitiveness concern is that, by having loose regulations on foreign tax credits, deferrals, and inversions, the tax code gives incentives for companies with U.S. operations and workers to offshore their production to low-tax, lax-regulation locales. This appears to be the approach of the Obama administration and most congressional Democrats.

The preponderance of highly deregulated markets in tax havens like Panama is cited as a prime cause of the current financial meltdown. As the Congressional Oversight Panel (COP), established to oversee the finance bailout, stated:

> "The rapid globalization of financial markets in recent decades has created a new set of problems for national regulators and exposed market participants to an additional element of risk. Capital is able to flow freely across international borders, while regulatory controls are bound to domestic jurisdictions. Private actors, therefore, have the benefit of seeking out regulatory climates that best accommodate their financial objectives. Countries, in turn, bid for capital flows by adjusting their tax and regulatory schemes, as well as their legal infrastructure and employment laws. While New York and London tout their preeminence as financial capitals, Tokyo, Hong Kong, Singapore, Bahrain, and Doha, Qatar have all become financial hubs. At the same time, certain offshore tax havens, such as the Cayman Islands, the Bahamas, and the Channel Islands have developed local industries catering to the financial services needs of foreigners. Often, the sole comparative advantage offered by these locations is the opportunity to profit from 'regulatory arbitrage.' The consequence is a global race to the bottom whereby deregulation is pursued to the detriment of market stability."[111]

And as Jeffrey Owens – the Director of OECD's Center for Tax Policy and Administration – testified recently before the U.S. Senate Finance Committee:

> "With the growth of cross-border capital flows, the potential for abuse created by the lack of access to bank information for tax purposes and the resulting adverse consequences have increased exponentially. At the same time, tax authorities find it more and more difficult to monitor foreign portfolio investments of their residents because of the removal of traditional sources of information on these transactions (e.g. exchange controls). Thus, a decision by one country to prevent or restrict access to bank information for tax purposes is now more likely than ever before to adversely affect tax administrations of other countries."[112]

Appendix II: Unpacking the Panamanian Government's Response to Concerns About the Country's Tax-Haven, Banking-Secrecy and Money-Laundering Problems

Panama's banking-secrecy and tax-haven policies have gotten considerable attention of late, as the country has been singled out in the G-20 summit process as a tax haven, and U.S. critics of the leftover Bush-era Free Trade Agreement (FTA) with Panama have highlighted the problem. The Panamanian government has circulated a flyer in response to these issues. The main thrust of the flyer, unbelievably, is that critics are mistaken and there are no such problems in Panama. This is an interesting approach, given Panama is identified as a top tax-haven country by all the relevant executive and congressional agencies and a panoply of international watchdog groups, which also established links to tax evasion by U.S. and multinational firms, and to international money laundering and drug trafficking. Following is a point-by-point rebuttal.

PROBLEM I. In response to the claim that "**Panama's economy thrives on banking secrecy**," the government responds that:

> "Panama has a real economy that thrives on a well diversified services industry that includes transportation, tourism, and ports. Panama's banking sector does not provide secrecy to its clients; like every other international banking system, it provides privacy and confidentiality; in fact, Panama's confidentiality practices follow customary international 'bank discretion' guidelines. All institutions must comply with orders for disclosure of information to the Judiciary or the Financial Analysis Unit (UAF), Panama's anti-money laundering agency. Suspicious transactions (including cash transactions over $10,000) generate an obligation for banks, financial institutions and selected non-financial institutions to report to the appropriate supervisory agency. The U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) and Panama's UAF maintain an Exchange of Information Mechanism for the prevention and prosecution of money laundering, as well as with the financial intelligence units of 29 other countries. Panama also has accords to allow for the exchange of information with the United States Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision. The United States and Panama have a Mutual Legal Assistance Treaty in effect as well facilitating judicial assistance to summon witnesses, to compel the production of documents and other real evidence, to issue search warrants, and to serve processes."

These points are irrelevant and/or misleading.

1. That other economic activities occur, in Panama besides banking-secrecy related activity is neither contested nor a response to fact that 350,000 firms have offshore corporate entities there, that Panama does not charge such entities taxes, and that Panama has excessive banking secrecy rules, i.e. the original allegation.

2. The point referencing various U.S.-Panama agreements is irrelevant. With respect to the MLAT: Panama resisted this for years, and finally signed up in 1991 after immense congressional pressure. However, this agreement only applies to instances where U.S. law enforcement officials need *confirmation* of crimes that they already have proved were committed. That is to say that this agreement does not cover the critical circumstance of U.S. officials seeking information needed to investigate if a crime has been – or more relevantly is being – committed. Further, the MLAT provides numerous exceptions that allow Panama enormous discretion to withhold information, even if U.S. officials have already proved a crime has occurred. The FinCen agreement does not extend to tax evasion, but rather covers law enforcement with respect to other activities. As well, it provides Panama with the same discretion and exceptions as the MLAT. (Most countries have FinCen agreements with the United States, established through the process set in motion by the Financial Action Task Force (FATF) and its associated regional bodies.[113]) These "accords" do not address concerns raised by the G-20 or Panama FTA critics. To effectively address these concerns, Panama would need not only to sign the Tax Information Exchange Agreement (TIEA), Double Taxation Treaty (DTT), Estate and Gift Tax Treaties, and the Hague Evidence Convention, but then additionally allow automatic exchange of tax information.

3. A similar point can be made with respect to the other agreements. The Panamanian government retains all the discretion in this instance with respect to whether it investigates various activities and whether it shares this information outside of the government – or within it.

PROBLEM II. In response to the claim that, **"A US-Panama Trade Promotion Agreement would undermine the Stop Tax Haven Abuse Act (HR 2136/S.681**)," the Panamanian government says:

> **"**HR 2136/S.681 and the US Panama TPA cover very different matters, the former covers tax issues and the latter deals with bilateral trade. US-Panama cooperation, which ranges from joint drug interdiction to PANAMAX military exercises to the Container Security initiative, has never interfered with ongoing attempts to increase the scope of other instances of collaboration or to negotiate future agreements, including bilateral tax treaties."

This is a "non-response" response. That Panama has cooperated with the United States in certain policy areas is certainly not relevant, given Panama has a long history of *not* cooperating with the United States with respect to the tax-haven problems addressed by the Stop Tax Haven Abuse Act – that is why Panama is a target country of that Act. The claim that the Act and the FTA "cover very different matters" suggests that the author of this document has not read the FTA. The FTA includes specific prohibitions on financial transfer controls, and establishes investor rights to challenge – as measures tantamount to expropriations – a wide range of prospective financial service and tax related U.S. policies. Indeed, the FTA sets out special rules for such investor challenges of tax policies.

PROBLEM III. In response to the claim that, **"**The US Government Accountability Office identified Panama as one of only eight countries, and the only current prospective TPA partner, listed on all of the major tax-haven watchdog lists," the Panamanian government responds:

> "The GAO study identifies 50 jurisdictions (a combined listing of the jurisdictions on three different lists). Of 50 jurisdictions, 24 appear are on all three lists, 14 are on two of the lists, and 12 are on one list. Panama would not be the first country with a financial services-based economy to have a TPA with the United States. Singapore, which has a similar economy, is already a US TPA partner."

The flyer attacks this point by pointing out that the GAO report lists a higher number of countries than is referenced here, and that Singapore (an FTA partner) also has "a similar economy." A few things are worth pointing out here. First, the author does not dispute that Panama is a tax haven, only that other countries are also tax havens, i.e. this is a "we're not the only one that beats our wife" argument. And the author doesn't dispute that Panama is the only FTA partner listed by all three groups in the GAO report. The reference to Singapore as having a "similar economy" is unclear. Is the flyer noting that Singapore if ***also*** a tax-haven economy, even if it does not appear in the three lists of such venues in which Panama alone as a current or prospective FTA partner does?

The only accurate assertion in the flyer is with respect to the number 8, which should be 13 countries listed on all of the major tax-haven watchdog lists. Thus, what is accurate, but hardly a defense for Panama is that: "The GAO identified Panama as one of only 13 countries, and the only current or prospective FTA partner, listed on all of the major tax-haven watchdog lists that also do not have tax transparency pacts in place with the U.S."

PROBLEM IV. In response to the claims that **"Panama has long been a key target of OECD for its resistance to international norms in combating tax evasion and money laundering**" and "**The State Department and the DEA have consistently identified Panama's financial sector as a conduit for Colombian and Mexican drug trafficking funds**," the Panamanian government responds:

> **"**Since 2001, Panama has been removed from the OECD's Financial Action Task Force (FATF) list of non-cooperating countries and territories, stating that "Panama has addressed all previously identifies deficiencies." In 2002, the OECD removed Panama from its list of non-cooperative tax havens, after finding that "Panama has made a commitment to improve the transparency of its tax and regulatory systems" and referring to Panama as a committed jurisdiction. The 2009 State Department International Narcotics Control Report finds that Panama is in compliance with all 16 primary concerns regarding Money Laundering and the Financing of Terrorism stated in this year's report…
>
> "Combating money laundering is one of the Government of Panama's top objectives in its National Drug Control Strategy. The Drug Enforcement

Administration (DEA) Panama Country Office works closely with Panamanian police forces in projects to facilitate major international investigations and DEA Priority Target Organization (PTO) cases. The State Department's 2009 International Narcotics Control Report states clearly that 'Panama has a comprehensive legal framework to detect, prevent, and combat money laundering and terrorist financing, and provides excellent cooperation with U.S. law enforcement agencies in combating drug trafficking, money laundering and financial crimes.'

"DEA's Chief of Operations Michael Braun stated in 2005, before the House Western Hemisphere Sub-committee, that 'Panama and the DEA are aggressively investigating these trends at an unprecedented level of cooperation to identify the organizations and money laundering systems that operate behind this movement of drug cash.' Mr. Braun also declared that 'Panama has taken aggressive steps to strengthen its anti-money laundering laws, governmental infrastructure, and private sector outreach, and has become a leader in Central America in the fight against money laundering.' Dating back to June 2001, the U.S. Department of the Treasury FinCEN effectively removed the Advisory regarding Panama's banking system, noting that *'Panama has enacted significant reforms to its counter-money laundering system.'*

"Panama has effective information exchange mechanism in place with the United States to combat money laundering and cooperates regularly with US agencies in this area. Panama and the U.S. have ratified the Inter-American Convention on Mutual Assistance in Criminal Matters, which provides a multilateral cooperation mechanism among the 24 contracting parties to this treaty."

1. Noting that Panama is not on the FATF watch list is meaningless, because that list is worthless. No country has been on this list since 2006, even as the OECD tax unit has listed over 30 nations as not complying with internationally agreed tax norms.[114]

   Noting that Panama was taken off of the OECD's list of "uncooperative tax havens in 2002" proves nothing. To get off this list and get moved to the OECD's list of "committed jurisdictions" requires only "commitments to the OECD to implement transparency and effective exchange of information for tax purposes."[115] Indeed, the latest April 2009 OECD tax-haven watch list includes Panama among 30 countries that agreed to conform to international tax norms, but failed to do so. Indeed, the OECD report notes that Panama made its commitment in 2002 and since has not completed a single agreement to implement its promise. In contrast, other countries on the list, which is comprised mainly of tiny island nations, have completed as many as eight compliance agreements, which is still not adequate to be taken off of this list.

2. At this point, there are no longer any "uncooperative tax havens," but a lighter category of "uncommitted jurisdictions."[116] Being moved off the OECD list does NOT mean that Panama is not a tax haven, it does not mean they signed Tax Information Exchange Agreements, it does not mean that they have *automatic* exchange of tax information –

Panama has done none of this. **The OECD made pretty clear what they thought of Panama's record in a recent speech:**

> **"The fact is that we are now in the business of implementation," said Owens, who named only Panama as a country that has made no progress since 2000. "The days of making commitments and then taking years to put those commitments into practice are over," he said. "The vast majority of the 30 jurisdictions that made commitments in 2000 have not made any progress," Owens said. "The primary exceptions are the Isle of Man, Jersey, and Guernsey."[117]**

Even as recently as March 25, 2009, Panama's government has explicitly refused to an automatic sharing of tax information.[118]

3. On the final points, while State Department documents usually make some concessions to diplomacy by saying both good and bad things about the country, the relevant question is whether a country appears on the U.S. State Department **watch-lists**. Year in and year out, Panama is on the State Department's International Narcotics Control Report's list of countries of primary concern.[119] The reports says:

> "By virtue of its geographic position and well-developed maritime and transportation infrastructure, Panama is a major logistics control and trans-shipment country for illegal drugs to the United States and Europe. Major Colombian and Mexican drug cartels as well as Colombian illegal armed groups use Panama for drug trafficking and money laundering purposes…
>
> "The majority of money laundering activity in Panama is narcotics-related or the result of transshipment or smuggled, pirated, and counterfeit goods through Panama's major free trade zone, the Colon Free zone (CFZ). The funds generated from illegal activity are susceptible to being laundered through a wide variety of methods, including the Panamanian banking system, Panamanian casinos, bulk cash shipments, pre-paid telephone cards, debit cards, insurance companies, real estate projects and agents, and merchandise... Panama is an offshore financial center that includes offshore banks and various forms of shell companies that have been used by a wide range of criminal groups globally for money laundering."[120]

The U.S. Department of Justice's National Drug Threat Assessment 2009 paints a similarly grim picture of Mexican and Colombian narcotrafficking funds moving virtually unchecked through Panama.[121]

PROBLEM V. In response to the claims that **"US corporate interest take advantage of Panama's comparative advantage in banking secrecy, tax evasion and money laundering**" and "**The advantage Panama has rests on the ease with which US and**

other companies can create subsidiaries there," the Panamanian government responds that:

> "Panama's comparative advantage stems from a strategic geographical position, a well developed logistics platform, a stable political landscape, a highly educated workforce, and legal certainty. Global investors choose Panama for its modern, well-regulated and integrated serves sector, as well as its robust financial system and dollarized economy…"
>
> "The recent World Bank Doing Business report found that Panama had streamlined and reformed its regulations in order to better register and start-up businesses, **as a way to increase competitiveness and entrepreneurship.** Panama's corporation laws are modeled after the State of Delaware Corporation Law, to foster a legitimate economic interest of global investors that which to take advantage of Panama's competitiveness and strategic position. US companies create subsidiaries in Panama to facilitate the distribution of US exports throughout the rest of Latin America, given Panama's central location between Central and South America."

Since no one claims that the ONLY reason Panama attracts corporate subsidiaries is banking secrecy, there is no need to respond to the counterpoint. It's worth pointing out, however, that there is a long paper trail of nearly 40 years showing corporations taking advantage of Panama's lax regulatory climate and zero taxation rate. The flyer's characterization is also contrary to how the plethora of Panamanian lawyers sells the comparative advantage of their country on the many many websites hawking their services. And one need only look at the latest American International Group-Starr International Corporation court flap (in which AIG is seeking repayment of U.S. taxes related to the AIG-affiliated Panamanian corporation SICO's revenue) to see that firms locate in Panama primarily to avoid meaningful oversight and taxes.[122]

Delaware's incorporation law is actually extremely controversial. It is opposed by most corporate reform and public-interest groups. This is also a form of the "I'm not the only one who beats my wife" defense.

PROBLEM VI. In response to the claim that **"Panama is one of the few countries that have refused to sign any tax information exchange treaties,"** the government responds that:

> "As for the prevalence of such treaties with other countries, the U.S. Treasury's Master List of Tax information Exchange Treaties shows that out of 124 countries and/or territories, the United States has signed or has in force only 25 Tax Information Exchange Agreements (TIEAs); 99 countries and/pr territories have not signed TIEAs with the US. Moreover, only 5 of 17 current US TPA partners have signed TIEAs with the US."

First, again, it's worth noting that they cannot claim that Panama has any TIEAs in place with the United States or any other country, only that other countries also do not. That's a pretty shameless response. The second point is that the quote refers to *any* TIEAs in place, not only a U.S. TIEA. The OECD's latest Tax Cooperation report identifies Panama as one of only 11 countries it monitors that have no TIEAs or DTTs in place with *any* country.[123] (A full list of U.S. TIEAs and other treaties is available in the footnote.[124]) It's worth noting, again, that Panama is the only current or prospective FTA partner on all three lists in the GAO report.[125]

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The bigger issue is not just that Panama happens to be on certain watch lists, or has or has not signed certain treaties. Fixing Panama and other tax havens requires more than signing these treaties. No FTA should be signed with Panama until it:

- eliminates its excessive banking secrecy practices,
- re-regulates its financial sector, and
- forces banks and multinational subsidiaries to pay their fair share of taxes.

The OECD has noted that it is highly unusual that the U.S. government has not used FTA negotiations with Panama to not even push for completion of the TIEA. Said the OECD's Jeffrey Owens:

> "It is also important for OECD governments to consider the importance of establishing effective exchange of information mechanisms when expanding trade relations with offshore jurisdictions (e.g. through free trade agreements or other similar agreements) so that the further removal of trade barriers does not also result in expanded opportunities for offshore evasion… For example, the U.S. Treasury announced the commencement of TIEA negotiations with Panama in January 2002 and in December 2006 the United States Trade Representative announced the completion of the Free Trade Agreement negotiations with Panama."[126]

The Task Force on Financial Integrity – the leading group calling for addressing tax evasion and money-laundering problems and representing a coalition of over 60 governments and the top transparency NGOs dedicated to curbing illicit money flows in order to have more resources for poor-country development – also has a report discussing the transparency steps that Panama and other havens need to adopt, linked to in the footnote.[127] A key point in this Task Force report is that countries need not only to sign bilateral treaties, which leaves them discretion in what they share with U.S. authorities, but that they AUTOMATICALLY share this information.

ENDNOTES

[1] Kevin Drawbaugh and Corbett Daly, “Obama admin. backs tax haven bill, IRS eyes cheats,” *Reuters*, March 3.2009.
[2] Office of the U.S. Trade Representative, “2009 Trade Policy Agenda and 2008 Annual Report *of the President of the United States on the Trade Agreements Program,”* March 1, 2009, at 2 and 116-117. Available at: http://ustr.gov/assets/Document_Library/Reports_Publications/2009/2009_Trade_Policy_Agenda/asset_upload_file86_15410.pdf.
[3] See http://www.citizen.org/hot_issues/issue.cfm?ID=2157 for more detail.
[4] Todd Tucker, “Election 2008: Fair Trade Gets an Upgrade,” Public Citizen Report, November 2008. Available at: http://www.citizen.org/documents/ElectionReportFINAL.pdf. Accessed April 23, 2009.
[5] See Letter from 350 Organization to USTR Ron Kirk, dated March 18, 2009. Available at: http://www.citizen.org/documents/NewDayOnTrade_Final.pdf. Accessed March 27, 2009.
[6] Rep. Charles Rangel (D-N.Y.), “Panamanian Resistance To Financial Crimes Mutual Legal Assistance Treaty Must Be Addressed,” *Congressional Record*, 136, October 26, 1990.
[7] Barney Warf, “Tailored for Panama: Offshore Banking at the Crossroads of the Americas,” *Geografiska Annaler*, 84:1, 2002.
[8] Barney Warf, “Tailored for Panama: Offshore Banking at the Crossroads of the Americas,” *Geografiska Annaler*, 84:1, 2002, at 39.
[9] Letter from Panamanian Commerce Minister Gisela A. de Porras to OECD Secretary General José Angel Gurría, dated March 25, 2009. Available at: http://mensual.prensa.com/mensual/contenido/2009/03/26/hoy/Negocios/CARTA_COMPROMISO_2009.pdf Accessed April 28, 2009.
[10] National Drug Intelligence Center, “National Drug Threat Assessment 2009,” U.S. Department of Justice. Available at: http://www.usdoj.gov/ndic/pubs31/31379/index.htm#Contents. Accessed March 16, 2009.
[11] Barney Warf, “Tailored for Panama: Offshore Banking at the Crossroads of the Americas,” *Geografiska Annaler*, 84:1, 2002.
[12] Securities and Exchange Commission, EDGAR Filings, Form 10-K, Exhibit 21, Company Annual Reports for 2008 and/or 2009, accessed February-March 2009.
[13] Government Accountability Office, “Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions,” GAO-09-157, December 2008.
[14] Government Accountability Office, “Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions,” GAO-09-157, December 2008. Available at: http://www.gao.gov/products/GAO-09-157. Accessed April 21, 2009.
[15] Global Forum on Taxation, “Tax Cooperation: Towards a Level Playing Field,” Organization for Economic Cooperation and Development, 2008, at 11.
[16] U.S. Treasury Department statement, Jan. 8, 2002. Available at: http://www.treasury.gov/press/releases/po907.htm. Accessed April 21, 2009.
[17] Global Forum on Taxation, “Tax Cooperation: Towards a Level Playing Field,” Organization for Economic Cooperation and Development, 2008, at 15.
[18] Lynnley Browning, “Switzerland Agrees to Aid in Pursuit of Tax Cheats,” *New York Times*, March 13, 2009. It is worth noting, however, that these countries did not commit to automatic transfer of tax information or public disclosure of beneficial ownership, let alone broader demands to increase transparency or promote economic stability identified later in this report.
[19] Letter from Panamanian Commerce Minister Gisela A. de Porras to OECD Secretary General José Angel Gurría, dated March 25, 2009. Available at: http://mensual.prensa.com/mensual/contenido/2009/03/26/hoy/Negocios/CARTA_COMPROMISO_2009.pdf Accessed April 28, 2009.
[20] Global Forum on Taxation, “Tax Cooperation: Towards a Level Playing Field,” Organization for Economic Cooperation and Development, 2008.
[21] Treaty Between the United States of America and the Republic of Panama on Mutual Assistance in Criminal Matters, Article 2(2).
[22] Treaty Between the United States of America and the Republic of Panama on Mutual Assistance in Criminal Matters, Article 3(1).
[23] *See* “Why You Should Choose Panama for Offshore Banking and Asset Protection,” http://www.panamalaw.org/attributes.html, accessed March 3, 2009.)(“Panama will cooperate in a multi-national case involving narcotics and money laundering (these crimes need to be tied to narcotics). If you are not a narcotics dealer and are not a money launderer you should not be concerned by this. Panama will also cooperate in cases of

terrorism and child pornography. The MLAT requires that there first needs to be a criminal prosecution case on file in the criminal courts of the requesting government (which means no fishing expeditions). Then through diplomatic channels involving the embassies, requests are made for information, and then reviewed by Panama officials and a decision on compliance is made or requests for more information are made so a determination can be arrived at. These cases can take months and even years for completion. At times the country where the bank is located has been known to once alerted to the problem, conduct their own investigation first and this usually requires them to seize the relevant records and documents which can stall the process for a long time even years since their justice systems typically moves quite slow and statues of limitation can run out. Please don't construe this to mean Panama does this routinely, it is just something that does occur from time to time around the world."

[24] Quoted on Tax Justice Network website, at http://www.taxjustice.net/cms/front_content.php?idcat=93.

[25] G-20 Declaration of the Summit on Financial Markets and the World Economy, November 15, 2008, Washington DC. Available at: http://www.g20.utoronto.ca/2008-leaders-declaration-081115.html. Accessed March 27, 2009.

[26] Progress Report On The Jurisdictions Surveyed By The OECD Global Forum In Implementing The Internationally Agreed Tax Standard, April 2, 2009, http://www.oecd.org/dataoecd/38/14/42497950.pdf. Countries listed with Panama include: Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Dominica, Gibraltar, Grenada, Liberia, Liechtenstein, Marshall Islands, Monaco, Montserrat, Nauru, Neth. Antilles, Niue, St Kitts and Nevis, St Lucia, St Vincent Grenadines, Samoa, San Marino, Turks and Caicos Islands, and Vanuatu.

[27] John Lindsay-Poland, *Emperors in the Jungle: The Hidden History of the U.S. in Panama*, (Durham: Duke University Press, 2003). The United States has intervened in Panama at least 20 times, most notably in 1903, when the Theodore Roosevelt administration effectively created the country by encouraging and enabling its secession from Colombia. As a result of this intervention, the U.S. government was granted control of a ten-mile-wide zone in perpetuity where U.S. (not Panamanian) laws would apply. In 1977, the Jimmy Carter administration negotiated a treaty with Omar Torrijos' military dictatorship to hand over control of the canal to Panama in 1999. Nonetheless, successive U.S. governments before and after the 1977 treaty were accustomed to dictating Panama's internal affairs. Until 1990, the U.S. Senate refused to give advice and consent to a 1982 bilateral investment treaty with Panama until military dictator Manuel Noriega (formerly a CIA asset) was removed from power by invasion. And in 2007, the Bush administration and U.S. Congress refused to move the Panama FTA until National Assembly Speaker Pedro Miguel González Pinzón was removed from his leadership post.

[28] Hague Convention of 18 March 1970 on the Taking of Evidence Abroad in Civil or Commercial Matters. Available at: http://www.hcch.net/index_en.php?act=conventions.text&cid=82. Accessed March 16, 2009.

[29] Internal Revenue Service, "Master List – Tax Treaties, MLATs, SCIPs, TIEAs, Hague Evidence Convention," U.S. Department of Treasury. Available at: http://www.irs.gov/pub/irs-apa/treaty.pdf. Accessed March 16, 2009.

[30] Jeffrey J. Owens (Director, OECD Center for Tax Policy and Administration), Testimony Before Senate Finance Committee On Offshore Tax Evasion, May 3, 2007. Available at: http://finance.senate.gov/hearings/testimony/2007test/050307testjo.pdf. Accessed March 6, 2009.

[31] Peter Cohn, "Geithner Outlines Support for Crackdown," *Congress Daily AM*, March 4, 2009.

[32] Alexander Neubacher, "The World's Shortest Blacklist: Why the Fight Against Tax Havens is a Sham," *Der Spiegel*, April 11, 2009.

[33] Sen. Barack Obama (D-Ill.), "Statements on Introduced Bills and Joint Resolutions," *Congressional Record*, Feb. 17, 2007. He went on to say: "There is no such thing as a free lunch – someone always has to pay. And when a crooked business or shameless individual does not pay its fair share, the burden gets shifted to others, usually to ordinary taxpayers and working Americans without access to sophisticated tax preparers or corporate loopholes. This bill strengthens our ability to stop shifting the tax burden to working families. All of us must pay our fair share of the cost of securing and running this country. There is no excuse for benefiting from the laws and services, institutions, and economic structure of our Nation, while evading your responsibility to do your part. I believe it is our job to keep the system fair, and that is what this bill seeks to do."

[34] http://www.bloomberg.com/apps/news?pid=20601087&sid=aznONFlyupOI&refer=home#

[35] Government Accountability Office, "Effective Tax Rates are Correlated with Where Income is Reported," GAO-08-950, August 2008.

[36] Office of Management and Budget, "A New Era of Responsibility: Renewing America's Promise," February 2009, at 122. Available at: http://www.whitehouse.gov/omb/assets/fy2010_new_era/A_New_Era_of_Responsibility2.pdf. Accessed March 6, 2009.

[37] Permanent Subcommittee on Investigations, "Tax Haven Banks and U.S. Tax Compliance," U.S. Senate Committee on Homeland Security and Governmental Affairs, July 17, 2008, at 1. Available at:

http://hsgac.senate.gov/public/_files/REPORTTaxHavenBanksJuly1708FINALwPatEliseChgs926080.pdf. Accessed March 6, 2009.

[38] Office of Management and Budget, "A New Era of Responsibility: Renewing America's Promise," February 2009, at 122. Available at: http://www.whitehouse.gov/omb/assets/fy2010_new_era/A_New_Era_of_Responsibility2.pdf. Accessed March 6, 2009.

[39] Office of Tax Policy, "The Deferral of Income Earned Through U.S. Controlled Foreign Corporations," Department of the Treasury, December 2000. Available at: http://www.treas.gov/offices/tax-policy/library/subpartf.pdf. Accessed March 6, 2009.

[40] Bureau of International Narcotics and Law Enforcement Affairs, "International Narcotics Control Report," February 2009. Available at: http://www.state.gov/p/inl/rls/nrcrpt/. Accessed March 5, 2009.

[41] DEA National Drug Threat Assessment 2009, http://www.usdoj.gov/ndic/pubs31/31379/finance.htm

[42] International Monetary Fund Legal Department, "Financial Sector Assessment Program, Republic of Panama, Detailed Assessment of Anti-Money Laundering and Combating the Financing of Terrorism," September 2006, at 6. *See* http://www.cfatf.org/profiles/media/PANAMA%20AMLCFT%20Detailed%20Assessment%20Report.pdf.

[43] Chris Kraul and Sebastian Rotella, "Drug Probe finds Hezbollah Link," *L.A. Times*, Oct. 22, 2008.

[44] http://www.panamalaw.org/financial_action_task_force.html.

[45] Throughout this report, our references to Panamanian investors includes all corporations registered in the country that also have "substantial business activities" there, i.e. the definition envisioned in Panama FTA Art. 10.12.2. Thus, a corporation from any country that does more than open a P.O. box could be considered a "Panamanian investor."

[46] Panama FTA Art. 12.7.

[47] Panama FTA Art. 12.11. "*The Parties recognize that transparent regulations and policies governing the activities of financial institutions and cross-border financial service suppliers are important in facilitating both access of foreign financial institutions and foreign cross-border financial service suppliers to, and their operations in, each other's markets. Each Party commits to promote regulatory transparency in financial services."*

[48] Panama FTA Art. 12.1.2.a.

[49] Panama FTA Art. 12.20.

[50] Panama FTA Art. 12.2 (National Treatment): "*1. Each Party shall accord to investors of the other Party treatment no less favorable than that it accords to its own investors, in like circumstances, with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of financial institutions and investments in financial institutions in its territory. 2. Each Party shall accord to financial institutions of the other Party and to investments of investors of the other Party in financial institutions treatment no less favorable than that it accords to its own financial institutions, and to investments of its own investors in financial institutions, in like circumstances, with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of financial institutions and investments. 3. For purposes of the national treatment obligations in Article 12.5.1, a Party shall accord to cross-border financial service suppliers of the other Party treatment no less favorable than that it accords to its own financial service suppliers, in like circumstances, with respect to the supply of the relevant service*." The FTA contains a provision that also requires: "*Under terms and conditions that accord national treatment, each Party shall grant financial institutions of the other Party established in its territory access to payment and clearing systems operated by public entities, and to official funding and refinancing facilities available in the normal course of ordinary business. This paragraph is not intended to confer access to the Party's lender of last resort facilities."* Panama FTA Art. 12.13.

[51] Panama FTA Art. 12.3.

[52] Exceptions to this general rules are contained in Annexes to the FTA. The U.S. Annex II contains an exception that is most relevant to this discussion: *"The United States reserves the right to adopt or maintain any measure that accords differential treatment to countries under any bilateral or multilateral international agreement in force or signed prior to the date of entry into force of this Agreement.*" Thus, with respect to taxation, the United States can treat Panama differently than it treats countries with which it has, for instance, specific taxation treaties, such as on avoiding double taxation. Other financial service exceptions to this rule include incorporation of U.S. limits set in the WTO GATS on cross-border trade in services, which, in regards to financial services there are very few (II-US-9); various MFN exception with respect to special treatment provided to Canada; and various national-treatment exceptions with respect to citizenship requirements for offering certain bond services and establishing certain forms of banks and various deposit and other requirements. For foreign-owns banks operating in the United States.

[53] Panama FTA Art. 12.18.

[54] Panama FTA Art. 21.3.

[55] Panama FTA Art. 21.3.4.g.

[56] WTO GATS Art. *XIV(d) footnote 9: " Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which: (i) apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or (ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or (iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or (iv) apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or (v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or* (vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base." Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure.

[57] Panama FTA Art. 12.10.1.

[58] We say "generally" because Panama already has claimed that various international efforts to crack down on tax havens conflict with WTO rules. Panama's WTO intervention did not cite any specific provision, but analysts presume Panama's claim refers to WTO General Agreement on Tariffs and Trade (GATS) Article XI (Payments and Transfers), a provision that is much narrower than the FTA's general ban on limits on transfer, GATS Article XI(1) states: "*Except under the circumstances envisaged in Article XII, a Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments.*" The Article XII referenced pertains to restrictions to safeguard the balance of payments taken in compliance with International Monetary Fund terms. Given the GATS provisions applies only to "*restrictions on international transfers and payments* ***for current transactions relating to its specific commitments*****"** (emphasis added), it does not pose a broad constraint on the U.S. ability to halt transfers.

[59] Panama FTA Art 10.8.1 incorporated into FTA Financial Service Chapter at Panama FTA Art. 12.1.2.(*Such transfers include: (a) contributions to capital; (b) profits, dividends, capital gains, and proceeds from the sale of all or any part of the covered investment or from the partial or complete liquidation of the covered investment; (c) interest, royalty payments, management fees, and technical assistance and other fees; (d) payments made under a contract, including a loan agreement; (e) payments made pursuant to Article 10.6.1 [compensation relating to losses suffered… owing to armed conflict of civil strife] and 10.6.2 [compensation related to government requisitioning or destruction of an investment during armed conflict or civil strife] and Article 10.7 [compensation for expropriation or indirect expropriation]; and (f) payments arising out of a dispute;*

[60] Panama FTA Art 10.8.3.

[61] The relevant cases where the defendants invoked the necessary clause during the pre-WTO and WTO era are: US - Shrimp 2006, China - Auto Parts 2006, US – Gambling 2004, EC - Trademarks 2003, EC - Tariff Preferences 2002, Canada- Wheat 2002, Korea - Beef 1999, Canada - Periodicals 1996, US-Tuna Dolphin 1994, US-Beer 1992, Thailand-Cigarette 1990, and US-Section 337 1989. In all these cases, the panel ruled that the challenged policies were not "necessary" in the context of the invoked exception. Only in Brazil-Tyres 2007 and EC – Asbestos 1998 was the necessity invocation upheld.

[62] Panama FTA Art. 11.10.1.

[63] Panama FTA Art. 11.10.3.

[64] Panama FTA Art. 12.10.3.

[65] Council for Trade in Services, "Report of the Meeting Held on 9 July 2001," WTO S/C/M/54, Released Aug. 27, 2001. In this meeting, the Panamanian delegation's intervention focused on how GATS exceptions would not apply to OECD measures on harmful tax havens, because Panama does not have any double taxation treaties (which is one of the GATS exceptions). In regards to the other exception, on the "the imposition or collection of direct taxes in respect to services or service supplier of other members," the Panamanian delegation said: "It was difficult to imagine how the Panamanian tax regime could have an impact on the ability of other jurisdictions to impose and collect taxes on Panamanian services or suppliers that required the application of discriminatory measures, measures distinct to those used in the cases of other suppliers other than nationality."

[66] Panama FTA Art. 12.4.

[67] Panama FTA Art. 12.5.

[68] Panama FTA Art. 12.5.2.

[69] Panama FTA Art. 12.4. ("Neither Party may adopt or maintain, with respect to financial institutions of the other Party or investors of the other Party seeking to establish such institutions, either on the basis of a regional subdivision or on the basis of its entire territory, measures that: (a) impose limitations on: (i) the number of financial institutions whether in the form of numerical quotas, monopolies, exclusive service suppliers, or the

requirements of an economic needs test; (ii) the total value of financial service transactions or assets in the form of numerical quotas or the requirement of an economic needs test; (iii) the total number of financial service operations or on the total quantity of financial services output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test; or (iv) the total number of natural persons that may be employed in a particular financial service sector or that a financial institution may employ and who are necessary for, and directly related to, the supply of a specific financial service in the form of numerical quotas or the requirement of an economic needs test;…

[70] USTR suggested that "the four pending FTAs (as well as the other FTAs we have concluded in the past five years) fully achieve" the congressional requirement that no foreign investors not be accorded greater rights than U.S. investors operating in the United States. S*ee* http://ustr.gov/assets/Document_Library/Fact_Sheets/2007/asset_upload_file146_11282.pdf

[71] Letters can be found at: http://www.citizen.org/hot_issues/issue.cfm?ID=2157/ Accessed March 6, 2009.

[72] Rep. Clement LeRoy "Butch" Otter (R-Idaho), Floor Statement on CAFTA, July 29, 2005.

[73] On file with Public Citizen.

[74] Panama FTA Art. 10.7, incorporated into the Financial Services Agreement at FTA Art. 12.1.2.a.

[75] See CAFTA Art. 10.7:" No Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization ("expropriation")…"

[76] Panama FTA Annex 10-B, Arts. 3 and 4..

[77] See http://www.citizen.org/documents/Ch11CasesChart-2009.pdf; See also, Mary Bottari and Lori Wallach, "NAFTA Chapter 11 Investor-State Cases: Lessons for the Central America Free Trade Agreement," Public Citizen Report, February 2005.

[78] Quote from the Honorable Abner Mikva, former U.S. federal judge and NAFTA panelist in the Loewen case. *See* Adam Liptak, "NAFTA Tribunals Stir U.S. Worries," *New York Times*, April 18, 2004. On Mikva's connection to Obama, *see* Abner J. Mikva, "Present Perfect," *New York Times*, Feb. 16, 2008.

[79] Panama FTA Annex 10-B Art. 4(b).

[80] Panama FTA Art. 21.3.6.

[81] Panam.a FTA Art. 12.18.

[82] Panama FTA Art. 12.1.2: (Scope and Coverage) Chapters Ten (Investment) and Eleven (Cross-Border Trade in Services) apply to measures described in paragraph 1 only to the extent that such Chapters or Articles of such Chapters are incorporated into this Chapter: (a) Articles 10.7 (Expropriation and Compensation), 10.8 (Transfers), 10.11 (Investment and Environment), 10.12 (Denial of Benefits), 10.14 (Special Formalities and Information Requirements), and 11.12 (Denial of Benefits) are hereby incorporated into and made a part of this Chapter; (b) Section B of Chapter Ten (Investment) is hereby incorporated into and made a part of this Chapter solely for claims that a Party has breached Article 10.7 (Expropriation and Compensation), 10.8 (Transfers), 10.12 (Denial of Benefits), or 10.14 (Special Formalities and Information Requirements), as incorporated into this Chapter; (c) Article 11.10 (Transfers and Payments) is incorporated into and made a part of this Chapter to the extent that cross-border trade in financial services is subject to obligations pursuant to Article 12.5.

[83] Panama FTA Art. 10.12.2

[84] The only limit on the right of U.S. subsidiaries and firms from countries besides the United States and Panama to bring such cases is if the United States or Panama used FTA provisions seeking to deny the benefits of the FTA to such a party "if the enterprise has no substantial business activities in the territory of the other Party, and persons of a non-Party, or of the denying Party, own or control the enterprise." Panama FTA Art. 10.12.2.

[85] Panama FTA Arts. 10.15 -10.27.

[86] Panama FTA Arts. 10.15-10.27.

[87] Panama FTA Art. 12.19.

[88] Panama FTA Art. 12.19.2.

[89] Mary Williams Walsh And David M. Herszenhorn, "A.I.G. Seeking Return of Half of Its Bonuses," *New York Times*, March 18, 2009.

[90] Comments by Harry L. Freeman in Pierre Sauvé and James Gillespie, "Financial Services and the GATS 2000 Round," Brookings-Wharton Papers on Financial Services, 2000; "AIG Holds Up China WTO Accession," Washington Report by James Orr Associates, Aug. 1, 2001. Available at: http://www.sysrv.com/joa/docs/08-01-01%20Washington%20Report-Client.pdf. Accessed March 26, 2009.

[91] U.S.-Panama Free Trade Agreement, Article 10.29: "*Definitions: For purposes of this Chapter:… investment means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, **the expectation of gain or profit,** or the assumption of risk*" (emphasis added). On AIG's advocacy, see AIG and Latin American Trade Coalition Letter to Congress, dated Sept. 9, 2008. Available at: http://www.latradecoalition.org/NR/rdonlyres/e2wg4e2rgv7fqlixnh5zwwwp5yginjdeb5cg4ziuwfo5s7j2nmy6xju4g

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