NATIONAL FOREIGN TRADE COUNCIL, INC.

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October 30, 2007

Pennsylvania House of Representatives

Re: HB 1085, 1086 & 1087

Dear Representative:

On behalf of the National Foreign Trade Council, an association of some 300 U.S. companies engaged in international trade and investment, I am writing to strongly oppose HB 1085, 1086 and 1087, which would require divestment from a broad array of companies with international operations.

While this legislation purports to address business ties between companies and countries on the U.S. list of state sponsors of terrorism, the provisions are so broad and the legislation is so complicated as to affect hundreds of U.S. and foreign companies, including many whose supposed ties to these countries are variously tenuous, mischaracterized or legitimate under U.S. law. This legislation would indiscriminately harm U.S. and foreign companies as well as individual pensioners in your state while having no effect on the behavior of the targeted governments.

A bad idea, poorly-executed

While we disagree with the principle governing this legislation, the particular way in which it has been drafted magnifies and multiplies the potential problems for businesses, investors and pensioners. Most troubling, the bills appear to require divestment of investments in any company that does any amount of indirect business with targeted countries, including in instances where companies have no direct ties or contact with the offending countries. The United States would no doubt face vigorous complaints from our trading partners if it were to come into effect.

In addition, the humanitarian exception contained in the bill is not absolute. Instead, it would seem to require individual retirement boards to determine if such exemptions apply after receiving a list of companies from, presumably, an outside vendor.

An opaque process fueled by confusion, misinformation and ulterior motives

There are no clear indications as to how pension fund trustees are supposed to comply with the mandate to divest, and there appears to be no transparent process for trustees to decide which companies to divest from. Companies that are captured by its provisions have no obvious recourse to object, in many cases may be unaware that they are on an exclusion list and apparently have no means of getting off the list even if they stop whatever actions resulted in their initial inclusion.

There is no federal list to rely upon, and the available alternatives are highly subjective in terms of their accuracy and the breadth of companies they target. Additionally, some lists of companies are linked to organizations that have foreign policy motives that inform their work, which call into question their validity and the evenhandedness by which the organization evaluates ties to countries like Iran. Even the Securities and Exchange Commission was forced to remove a deeply flawed list of companies purported to be involved in terrorist states when it came to light that at least one company on the list had announced it was ceasing business in Iran, while another was a pharmaceutical company developing a drug in Cuba with the express authorization of the U.S. government.

Serious long-term costs for Pennsylvania pensioners

The broad divestment provisions in the legislation under consideration would require pension funds to divest billions of dollars of investments in major multinational companies. This legislation directly contradicts the ability of State pension funds to prudently manage and invest their assets and would undoubtedly harm individual pensioners and the state retirement system.

Initially, State funds would be hit with transaction costs for divestment, which would likely be substantial given the broad nature of the bills. An analysis of Florida's divestment bill estimated that initial transaction costs could run $45 million for a bill targeted only at certain sectors of business with Iran. The bills before the Pennsylvania State Assembly are much broader.

The broad, catch-all nature of the legislation threatens to eliminate entire stock classes from the pool of potential investments, narrowing State pension fund managers' choices and increasing the overall risk to the portfolio. According to one risk-analysis company, the list of companies subject to divestment numbers about 400. California's State Teachers retirement fund, CalSTRS, estimates that mandatory divestment from Iran's energy sector will cost their fund $1 billion in opportunity costs over the next five years.

The New York Times editorial board opined in a July 22, 2001 editorial regarding Sudan legislation under consideration at the time that, "Tampering with America's capital markets on political grounds -- even sound political grounds -- would set a dangerous precedent." I agree.

Proposed bills contradict federal policy and are of dubious constitutionality

The legislation under consideration also interferes with federal foreign policy and is constitutionally flawed.

Statutes aimed at affecting foreign policy at the state and local levels – as divestment seeks to do – threaten to create a complex web of restrictions and regulations that interfere with the Constitutional rights given to the President to largely conduct foreign policy. The President's Special Envoy to Sudan Andrew Natsios noted the Administration's opposition to state divestment legislation (in April 11 testimony before the Senate Foreign Relations Committee), saying, "There is a reluctance to support this because the fear is that to have each state or municipality conducting its own foreign policy could create chaotic conditions."

I ask you to carefully consider the legislation in light of Mr. Natsios' remarks above and two important court decisions. On February 23 of this year, Judge Matthew Kennelly of Federal District Court for the Northern District of Illinois struck down the state's "Act to End Atrocities and Terrorism in Sudan" in *NFTC v. Giannoulias*. The judge's decision took account of the catastrophic genocide in Darfur, but found the law unconstitutional because "the Act violates federal constitutional provisions that preclude the states from taking actions that interfere with the federal government's authority over foreign affairs and commerce with foreign countries."

Earlier, in a 2000 decision, *NFTC v. Crosby*, the Supreme Court found that state sanctions that go beyond existing federal sanctions were preempted by federal policy and could subvert the policies and objectives of the federal sanctions regime. The court ruled that "It is implausible to think that Congress would have gone to such lengths to empower the President had it been willing to compromise his effectiveness by allowing state or local ordinances to blunt the consequences of his actions." This ruling resulted in the repeal or suspension of a number of selective purchasing restrictions on Burma at the state and local level.

Both decisions set limits on the ability of state governments to impose foreign policy sanctions. Because federal sanctions on Iran are in place, we believe that state sanctions are unconstitutional. The *NFTC v. Giannoulias* and *NFTC v. Crosby* decisions can be found at www.usaengage.org.

State sanctions and divestment bills could impede various federal initiatives to develop a multilateral approach because their impact would fall primarily on companies located in the very countries whose support the President is seeking. This is particularly true with regard to Iran, where the Bush administration has embarked on a new diplomatic initiative that is fundamentally multilateral, relying on the cooperation of key countries in Western Europe plus Russia and China, both in the United Nations and directly, to exert coordinated pressure on Tehran.

Mandating divestment while simultaneously promoting trade with Cuba

As written, the legislation would require divestment from companies doing business with Cuba, which is also on the terrorist list. At the same time, delegations of farmers and businessmen have visited Cuba, along with the Pennsylvania Secretary of Agriculture. In 2005, then-PA Agriculture Secretary Dennis Wolff said, after returning from a trip to Cuba, that, "Building relationships with domestic and international markets is consistent with Gov. Edward G. Rendell's commitment to economic development, and is a win-win situation for Pennsylvania agriculture and for Cuba's dairy industry." *

Mandating divestment while simultaneously promoting trade with the same country is an absurd signal for a state government to send to the nation and the world.

Adding China to the list would make bad legislation dramatically worse

The only way that this legislation could be made worse is by adding more countries to the list of targets for divestment. That is exactly what Rep. Reichley has proposed with an amendment that would add China to the list of offending companies from which divestment would be required. Including China in this list would have a dramatic and overwhelmingly negative impact not only on the returns of Pennsylvania retirement funds but on the reputation of Pennsylvania as a place to do business and on a large number of companies headquartered in the State. Such a move would multiply immeasurably the number of potential lawsuits and other actions by investors and businesses against the State.

Overall, America's values, security and prosperity are best advanced by sustained public and private sector involvement in world affairs. Engagement at all levels – political, economic, religious, educational and cultural - is the best tool to advance America's interests overseas. State sanctions impede engagement and undercut efforts to attract international investment that supports jobs and economic growth. Foreign policy sanctions by states not only undermine the ability of the U.S. to speak with one voice, but also frustrate cooperation with U.S. trading partners who often see them as a violation of U.S. international commitments.

For all of these reasons, I urge you to consider the potentially negative and unintended consequences of this legislation and take the aforementioned court rulings under advisement before proceeding with any divestment legislation. Please do not hesitate to contact me or Jake Colvin of my staff at (202) 887-0278.

Sincerely,

William A. Reinsch
President

* See: http://www.state.pa.us/papower/cwp/view.asp?A=11&Q=439498&tx=1