

**Trading Away the Future:**

Concerns Arising From the Investor-State Mechanism of the North American Free Trade Agreement and its Extension throughout the Americas

**A background paper prepared by the Episcopal Commission for Social Affairs (CCCB) for the Conference on Humanizing the Global Economy**

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Social Affairs Office  
Canadian Conference of Catholic Bishops  
90 Parent Avenue  
Ottawa, ON K1N 7B1

Telephone: (613) 241-9461, extension 231  
Fax: (613) 241-5087  
E-mail: [mchabot@cccb.ca](mailto:mchabot@cccb.ca)

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### **Introduction**

Free trade agreements in Canada are relatively contemporary phenomena, which have not been met without controversy. A major concern with the North American Free Trade Agreement (NAFTA) has been the newfound power of private companies to sue states for perceived losses of profit. Implications abound for issues of state sovereignty, the capacity to provide environmental protection by law, and ultimately, the democratic participation of people in their future governance. These questions demand the attention and reflection of people of faith, especially in the light of Catholic social thought.

This short paper was prepared for the Social Affairs Office of the Canadian Conference of Catholic Bishops in anticipation of the January 2002 conference in Washington D.C., *Humanizing the Global Economy*. The document attempts to briefly explain the Investor-State Mechanism, already in place in the North American Free Trade Agreement, and outlines some current controversies that the agreement has caused in each of the three NAFTA partner countries. The paper then presents some reflections from the Catholic tradition that might further our responses to these challenges of globalization. Finally, some references for further reading and study are provided.

### **Free Trade Area of the Americas (FTAA): Background**

The FTAA is the latest in a series of attempts to liberalize trade and investment. The agreement is modeled on NAFTA, which was signed in 1994 by Canada, the U.S.A. and Mexico. In fact, the FTAA has been described as “NAFTA plus.”

Trade and investment among the three member nations has increased greatly since the advent of NAFTA. There has been a corresponding period of overall economic growth, although it now appears that North America is in the midst of a troubling recession. Supporters of NAFTA point to general economic indicators as proof that the agreement is beneficial, but there is a dark underside to these realities. All three countries display alarming and growing gaps between rich and poor in their societies, with life becoming more difficult and uncertain for a majority of citizens, while a much smaller number of investors, managers and professionals have become increasingly wealthy.

In 1994, leaders from 34 countries began negotiations toward a Free Trade Area of the Americas (FTAA). Unfortunately, these talks have almost always occurred behind closed doors, preventing citizens from being able to speak to them within the trade forum. A draft agreement of the FTAA was discussed in April 2001, just prior to a hemispheric Summit of the Americas meeting in Quebec City. The intent is to complete the negotiations by 2005. Those concerned about the FTAA describe it as the most sweeping

trade and investment agreement in history. There are serious indications that it could boldly remove power from citizens and their elected governments, leaving transnational corporations and trade tribunals operating in secret.

## **Chapter 11 - The Investor-State Mechanism**

Those negotiating the FTAA propose to incorporate into that agreement NAFTA's Chapter 11. The FTAA draft texts were published by the FTAA's Trade Negotiations Committee on July 3, 2001. An analysis by a coalition of research groups participating in the Hemispheric Social Alliance suggests that, "The draft text includes virtually verbatim the full text of NAFTA's 'investor-state' mechanism, which would give foreign corporations special rights to use secretive and unaccountable international arbitration rather than domestic courts to roll back democratically enacted laws and regulations throughout the Americas – as they have already begun to do in North America."

Traditionally, governments have understood their role as one of regulating certain activities of corporations to serve the public interest. This was meant to ensure, for example, that the environment was protected against degradation, and that workers were fairly treated. But the Investor-State mechanism contained in Chapter 11 of NAFTA is turning this historical relationship on its head.

The primary focus of Chapter 11 has been to limit government's capacity to support environmental, health and other public values in the face of commercial interests. This measure makes it increasingly difficult for governments to act in the best interests of the citizens who have elected them.

Corporations have moved quickly to seize the advantage open to them under Chapter 11. They have launched approximately 15 lawsuits that strike at the heart of government policy-making and national sovereignty, taking aim particularly at laws protecting the environment. Information on these Chapter 11 cases remains incomplete because under NAFTA rules they are shrouded in secrecy, in stark contrast to normal proceedings in domestic courts of law, which are open to the public. Nevertheless, this paper provides examples from Mexico, the U.S.A. and Canada of what we do know about some current challenges under this investor-state mechanism. (see: text boxes)

### **NAFTA Chapter 11: Investor-State Mechanism Case Studies**

#### **Case # 1:**

***Ethyl Corporation versus Canada***

***Statement of claim: Oct. 2, 1997***

***Out-of-court settlement: US\$13 million, 1998***

Canada banned the importation of a gasoline additive called MMT, produced by Virginia-based Ethyl Corporation. The government had evidence that MMT was both a health and an environmental hazard.

Canadian officials went into the case with confidence, but despite the fact that NAFTA is supposed to allow governments to pass environmental legislation, it was clear from deliberations of the tribunal that Canada was going to lose the case. Rather than face a US\$250 million penalty based on the loss of future profits claimed by Ethyl, Canada decided to settle under the following conditions: a US\$13-million payment to Ethyl, the removal of the ban on MMT in Canadian gasoline, and a public apology to Ethyl for implying that its product was hazardous.

The proceedings were conducted in secret, in accordance with the NAFTA Investment chapter provisions, and were widely criticized in Canada. They provided a rude awakening regarding the impacts of the NAFTA expropriation provision. They also resulted in a direct reduction of Canadian health and environmental protections.

**Case #2:**

***S.D. Myers versus Canada***

***Statement of Claim: Oct. 30, 1998***

***Claim \$US 20 million***

***Award: Pending***

In October 1998, US-based S.D. Myers Inc., which treats electrical transformers containing toxic PCBs, filed a claim for US \$30 million for losses it claims to have incurred during a ban between 1995 and 1997 on the export of PCB wastes from Canada.

The Canadian government states Canada is bound by international conventions stipulating that PCBs must be destroyed in an environmentally sound manner, and that US standards for PCB disposal are not as high as Canada's. The wastes were destroyed in a Canadian facility in Alberta, and the export ban was revoked in 1997.

The US government, for its part, also controls cross-border movement of PCBs. In November of 2000, the tribunal found that the ban did contravene NAFTA's investment chapter regarding national treatment and minimum standards of treatment of foreign investors. The panel is now determining whether S.D. Myers suffered damages.

The Canadian government has applied to the (domestic) Federal Court to have the tribunal's partial award set aside, arguing, among other things, that the award conflicts with an established Canadian policy requiring disposal of PCBs and PCB wastes in Canada to comply with the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal.

**Case # 3:**

***Methanex Corp. versus the United States***

***Statement of claim: Dec. 3, 1999***

***Claim: US\$970 million***

This Vancouver-based company is suing the US government for \$US970 million because the State of California ordered the phasing out of the chemical MTBE, a methanol-based gas additive, by late 2002.

MTBE was introduced in the mid-1990s to increase the efficiency of fuel burning and to decrease pollution, but there were concerns that when it leaked from underground storage tanks it would contaminate groundwater.

Using NAFTA rules, Methanex claims that its share price and potential revenues have been drastically affected by the controversy, amounting to an expropriation of its future profits due to lower sales, lower product prices and higher costs. It is claiming damages based on lost future business and compensation for the loss in share value.

The Governor of California called MTBE “a significant risk” to the environment in his state, due to concerns that it is polluting water.

In a letter to US Trade Representative Robert Zoellick, 14 California assembly members and senators expressed concern regarding the Methanex case:

“We as California legislators find it problematic to be told by remote and unelected trade officials what paradigms or standards we must apply in writing environmental and public health laws for the people of our state.”

The Methanex decision will be most important with respect to NAFTA Chapter 11. If the ruling is in favour of Methanex, many other companies may undertake similar challenges targeting environmental laws they do not like. This would place the U.S.A. and Canada under enormous pressure to look at changing the NAFTA agreement.

**Case # 4:**

***Metalclad vs Mexico***

***Statement of claim: Oct. 1997***

***Award: US\$16.7 million, August 2000***

This case was brought by an American waste-disposal company against the Government of Mexico. Metalclad purchased a Mexican waste disposal company, which had knowingly disobeyed the law in Guadalupe, the site of Metalclad's proposed waste disposal plant.

The site was badly run and had already contaminated the local water supply. The village refused an operating licence for the plant. The governor deemed it an environmental

hazard to surrounding communities, and ordered the plant closed down. Eventually, he decreed the site as part of a 600,000 acre ecological zone.

Metalclad claimed that the state breached Chapter 11 of NAFTA by declaring its waste disposal site a special ecological zone, causing it to lose that investment and the profits it would have gained. The company sought compensation of some \$90 million for expropriation, a figure larger than the combined annual income of every family in the county where the Metalclad facility is located.

In August 2000, a tribunal found that Mexico had breached the Investment chapter and awarded Metalclad \$US 16.7 million, the amount it had spent in the matter. The Mexican government has appealed the award to the Supreme Court of British Columbia, since hearings of the case had been held in British Columbia. The appeal is ongoing.

The case raises important questions about whether governments retain the authority to enact environmental controls on foreign investors and about the powers of local governments.

### Sources

Civilizing Globalization: Trade and Environment, Thirteen Years On, Michelle Swenarchuk, Canadian Centre for Policy Alternatives, October 2001.

NAFTA's Big Brother: The Free Trade Area of the Americas and the Threat of NAFTA-style "Investor-State" Rules, Murray Dobbin, Council of Canadians, March 2001.

### **FTAA & the Future**

There is a great deal at stake in the FTAA talks. The legal cases that have arisen from Chapter 11 demonstrate what is in store for sovereign governments if the FTAA is signed in its currently proposed form.

Proponents of free trade agreements portray them, benignly, as simply making it easier for countries to engage in trading goods. In fact, the agreements are less about trade than they are about investment, permitting corporations to move capital to the most advantageous location possible. Capital can cross borders, unhindered, but interestingly the existing agreements, including NAFTA, do not allow for most workers to move in the same free manner.

The goal of the FTAA is to expand the current NAFTA provisions to an additional 31 countries in the Western hemisphere, combining powerful restrictions on public policy-making with the unprecedented protection of corporate property rights found in Chapter 11.

The Canadian government has come under significant public pressure as Canadians have come to realize that NAFTA, and in particular Chapter 11, will erode the power of all levels of government to provide public services and to act in the best interest of their citizens. Canada's Trade Minister promised that he would attempt to have Chapter 11 rewritten, but a group of large corporations released a letter during the Quebec Summit (April 2001) demanding that Chapter 11 not be changed. Ottawa now appears to have backed down, suggesting that it desires only to clarify the intent of this clause.

There was evidence of great unease at Quebec City on the part of some Latin American and Caribbean leaders, who questioned the assertion that a neo-liberal economic model was the answer to their countries' problems. Those leaders demanded that funds be directed to economically poorer countries, allowing them to make a gradual, planned transition to the free trade zone. Caribbean and Andean countries also pushed for some legal form of deferential treatment within the FTAA. Canada, the U.S.A. and Mexico are strong and independent countries, but NAFTA's Chapter 11 is already having adverse effects on their people. Most other countries signing the FTAA will be in a much more vulnerable position.

Already, economically poorer countries are being forced by the World Bank and the IMF to deregulate their economies, as they struggle to maintain measures that can help strengthen their industries and social programs. The FTAA, with an investment clause resembling NAFTA's Chapter 11, has been shown it can be used as a tool to limit such government initiatives on behalf of citizens.

Citizen and civil society groups are promoting an alternative approach to rules for trade and investment. They argue that trade regimes should ensure that basic human, labour, environmental and indigenous peoples' rights, as defined by international protocols, take precedence over investor rights.

#### Sources:

Canadian Government Retreats on NAFTA Investor-State Concerns, Scott Sinclair, Canadian Centre for Policy Alternatives, June 2001.

NAFTA Investor Rights Plus: An Analysis of the Draft Investment Chapter of the FTAA, (sponsored by the Hemispheric Social Alliance, [www.asc-has.org](http://www.asc-has.org)), Canadian Centre for Policy Alternatives, June 2001.

NAFTA's Big Brother: The Free Trade Area of the Americas and the Threat of NAFTA-style "Investor-State" Rules, Murray Dobbin, Council of Canadians, March 2001, see: [www.canadians.org](http://www.canadians.org)

The FTAA After Quebec: What Happened? What's Next?, Marc Lee, Canadian Centre for Policy Alternatives, June 13, 2001, see: [www.policyalternatives.ca](http://www.policyalternatives.ca)

The Free Trade Area of the Americas and the Threat to Social Programs, Environmental Sustainability and Social Justice in Canada and the Americas, Maude Barlow, Council of Canadians, January 2001.

Preliminary Analysis of Free Trade of the Americas Text, Hemispheric Social Alliance, October 2001.

## **Living with NAFTA**

The provisions of the North American Free Trade Agreement (NAFTA) came into force in 1994. The FTAA will be modeled closely on that agreement, and is good reason to review NAFTA and its effects on its member countries.

A report written in 2001 by economic analysts from the United States, Mexico, and Canada concludes that: "An evaluation of the North American Free Trade Agreement on its seventh anniversary finds a continent-wide pattern of stagnant worker incomes, lost job opportunities, increased insecurity, and rising inequality." ([NAFTA at Seven: Its Impact on Workers in All Three Nations](#), Robert E. Scott, Carlos Salas and Bruce Campbell, Economic Policy Institute, Washington, D.C, April 2001.)

The authors acknowledge that trade and investment among the three countries has increased greatly during the past seven years, and there has been a period of economic growth. But all three countries have also experienced an increasing gap between rich and poor in their societies.

The pressure on the wages and income for a majority of people has grown in each country, and at the same time government programs that once protected citizens and the environment have been removed.

In Canada, the top 20 percent of families saw their share of pre-tax and transfer incomes increase from 41.9 percent to 45.2 percent by 1998. The bottom 20 percent saw their share drop from 3.8 percent to 3.1 percent. The incomes of salaried Mexican workers fell by 25 percent between 1991 and 1998, while incomes of the self-employed fell by 40 percent. During the 1990s, the minimum wage in Mexico lost nearly 50 percent of its purchasing power. Manufacturing wages fell 21 percent between 1993 and 1999. NAFTA eliminated an estimated 766,000 job opportunities in the United States between 1994 and 2000, and the trade deficit between the U.S.A. and its northern and southern neighbors was greatly increased.

The report's authors warn that the negative effects of NAFTA threaten to be enshrined in the FTAA. "The experience [with NAFTA] suggests that any wider free trade agreement that does not give as much priority to labor and social development as it gives to the protections of investors and financiers is not viable."

These analysts advise, "Rather than attempting to spread a deeply flawed agreement to all of the Americas, the leaders of the nations of North America need to return to the drawing board and design a model of economic integration that works for the continent's working people."

## Canada's Bishops & the Trade Debate

Canada's Catholic bishops have a strong tradition of monitoring social and economic issues, and speaking out when the need arises. The bishops are ever mindful of the Church's responsibility to promote the common good in light of Gospel values.

During the debate on the Canada-U.S.A. free trade agreement, the Canadian Conference of Catholic Bishops did not take sides, but asked probing questions about the proposed agreement in their May 1987 letter, *Free Trade: At What Cost?* A pastoral working instrument was also provided to allow Canadians to make up their minds on the issues involved.

In 1998, the rich nations belonging to the Organization for Economic Cooperation and Development (OECD) were in the midst of negotiating the Multilateral Agreement on Investment (MAI). It was to be an international treaty on investment allowing transnational corporations to invest in an almost completely unfettered way.

The negotiations occurred in secret, but their existence leaked out and engendered international alarm. In 1998, the CCCB Social Affairs Commission sent a letter to Canada's trade minister expressing its "grave concern" about the Canadian government's uncritical support for the MAI. [1] The Commission described it as "a development strategy based on trade liberalization, deregulation and economic privatization." The bishops of the Commission feared that the proposed agreement would further strengthen the influence of large multinational firms "at the cost of weakening that of other actors at the local, regional and provincial levels."

The bishops referred to Pope Paul VI's encyclical *Populorum Progressio*, to remind the Minister that "all rights, including the rights to property and free trade, must be subordinated to the common good." The Commission letter expressed concern about the lack of consultation behind such a potentially sweeping agreement, and they urged the Canadian government to organize a "long-term consultative process" regarding the negotiations. Finally, it asked why an agreement that would eventually be extended to most to the world's countries was being negotiated by only 29 of the richest countries.

In the same year, the CCCB Social Affairs Commission appeared before a Citizens' Inquiry regarding the MAI. The Commission had by then called for a pause in the negotiations. In their presentation, the Commission repeated the Church's concern that economic systems must serve the common good. [2]

The intervention expressed the fear that the MAI, and other proposed trade initiatives, would undermine the principle of subsidiarity, removing decisions from local and national governments. "Removing democratic decision making from elected officials to managers, and a step further removed, to shareholders, is not an enhancement of democracy, nor is it, clearly speaking, subsidiarity." The Commission repeated its concern that a group of rich countries were negotiating a treaty that they intended to force on poor countries. "It is simply unacceptable that some leaders still believe that they can

and even should negotiate a deal and then offer it to (and indeed impose it on) developing nations.”

Talks on the MAI collapsed in October 1998, but the basic elements have been imbedded elsewhere, notably through the World Trade Organization but also in a variety of bilateral and continental agreements, including the proposed FTAA.

### **The Common Good or Exclusion?**

In February 2001, the CCCB Commission for Social Affairs sent an open letter to Canada’s legislators, urging the Parliamentarians to “work for the common good and toward ending economic exclusion.” [3]

The Commission noted that the gap between the richest and poorest Canadian families had widened dramatically, even during years of economic growth. The Commission letter pointed particularly to the enduring poverty among women and children, a poverty that was enhanced “when budgets for social programs are reduced and health and jobs are put at risk.”

The Commission also described increasing ecological destruction, due to the “unbridled search” for industrial gain, and they referred to the continuing indebtedness of poor countries. “Surely, in an increasingly globalized world,” the Commission said, “the common good too must become increasingly global.”

### **Summit of the Americas**

Talks toward the FTAA began in earnest in 1998, and continue to this day. In April 2001, Presidents and Prime Ministers met in Quebec City in a compound made secure by police and a metal fence. An estimated 50,000-60,000 people gathered to protest against the contents of the FTAA and the unremittingly secretive nature of the negotiations.

On April 4, 2001, the Archbishop of Quebec City and Primate of Canada convened a news conference and released a statement entitled *That None Be Excluded*, which had been approved by the CCCB Permanent Council and prepared in conjunction with the Archdiocese. [4]

In its analysis of the proposals for liberalized trade and investment, the CCCB has been fortunate in being able to draw upon a rich tradition of Catholic social teaching, including the Apostolic Exhortation *Ecclesia in America*, published in 1999.

In *Ecclesia in America*, the Holy Father said that under certain conditions globalization can have positive consequences. But he added the following caveat:

“However, if globalization is ruled merely by the laws of the market applied to suit the powerful, the consequences cannot but be negative. These are, for example, the absolutizing of the economy, unemployment, the reduction and deterioration of public services, the destruction of the environment and natural resources, the growing distance between rich and poor, unfair competition which puts the poor nations in a situation of ever increasing inferiority.” [5]

In a similar vein, the CCCB Permanent Council said in their Quebec City statement: “It is evident that the production of greater wealth does not in itself lead to more equitable distribution of that wealth, and that ‘the new economy’ is promoting greater inequality faster than ever before.”

It also said that governments have been entrusted by their citizens to promote the common good, and they should not relinquish their powers to intervene. Should governments do so, they would “render themselves impotent in the face of economic forces that are able to increase production and profits but unable to guarantee the distribution of any resulting benefits.”

The CCCB Permanent Council repeated earlier assertions that the Summit of the Americas would be improved if it were to take place with a greater transparency. Great importance was attached to a “parallel” Summit organized by the Hemispheric Social Alliance. “The citizens of the continent need to be able to contribute more to these crucial debates which determine our common future.”

The statement urged government leaders to address the social and environmental impact of open markets, to emphasize human rights and democratic structures, and to promote development that respects the dignity of individuals and communities.

### **A Constant Presence**

The Church has remained a constant presence in the lives of people throughout the Americas for more than 500 years. Trade and investment are not new to our nations. Indeed, the world experienced an earlier forms of globalization in the 15<sup>th</sup> and subsequent centuries. Economic theories and technologies have changed over the centuries, but for the Church, the questions remain similar – how can the economy assist people to live in dignity and fulfillment, free from want and deprivation?

If, indeed, globalization in some form is now inevitable, then the Church has an essential role to play in humanizing its goals and its ends. As discussion of a Free Trade Area of the Americas proceeds, the church needs to lend ever more ethical reflection to the critical issues involved.

Sources: See [www.cccb.ca](http://www.cccb.ca)

[1] Most Rev. Francois Thibodeau, Letter to Hon. Sergio Marchi, March 1998.

[2] Brief Presented to the MAI Inquiry: A Citizens' Search for Alternatives, Social Affairs Commission, Canadian Conference of Catholic Bishops, Nov. 13, 1998.

[3] The Common Good or Exclusion: A Choice for Canadians, An Open Letter to the Members of Parliament from the Social Affairs Commission of the Canadian Conference of Catholic Bishops, February 2, 2001.

[4] That None Be Excluded, Statement of the Permanent Council of the Canadian Conference of Catholic Bishops on the Occasion of the Summit of the Americas, Quebec City, April 4, 2001.

[5] Ecclesia in America, 1999, section 20.