

CAFTA & Investment: Will investment grow, or just the risks?

Summary: Investment provisions in the Central America Free Trade Agreement (CAFTA) will prohibit Central American governments from ensuring that foreign investment serves national development goals. In addition, CAFTA incorporates legal mechanisms that could undermine legitimate public health, safety, and environmental protections.

Background: Chapter 10 of CAFTA establishes new rights and privileges for cross-national investors. Its provisions are supposed to encourage investment across the region by clarifying rules and instilling confidence among investors. While increased investment in Central America is desirable, the quality of the investment can be as important as the quantity.

However, provisions of the investment chapter prohibit governments from using policy tools designed to encourage sustainable development, stabilize the economy, promote employment, and to ensure that investment provides maximum benefit to the local communities.

Furthermore, CAFTA's investment rules would subject legitimate environmental, public health, and social protections to challenge by foreign investors. The arbitration mechanism that will address such challenges under CAFTA could create costly new liabilities for Central American – and US - governments. The risk of legal challenge, litigation, and penalties under CAFTA is likely to create a chilling effect on efforts to enact stronger labor, environmental, public health, and other protections in the region.

Investor-state dispute settlement: CAFTA's investment chapter provides special procedures for foreign investors to legally challenge government actions before international arbitral tribunals. The procedures give foreign investors the right to file suit against laws or regulations at the national, state or local levels, even if they are enacted for legitimate public interest objectives, including public health, safety, and environmental protection. A similar mechanism created under NAFTA has resulted in more than two dozen cases against the US, Mexico, and Canada, with billions of dollars in claims.

Investment suits brought under CAFTA will be decided by *ad hoc* tribunals that are neither open to the public nor accountable to democratic processes. CAFTA does not require that claimants exhaust domestic judicial remedies before bringing investment claims to international tribunals. Instead, foreign investors may bypass domestic legal systems by bringing their claims directly to such tribunals. Although CAFTA was intended to strengthen and support democratic institutions in Central America, it may actually undermine the judiciaries in the region.

Allowing foreign investors to bring claims that would be decided by *ad hoc* tribunals not bound by domestic judicial systems violates the Congressional mandate that foreign investors not be “accorded greater substantive rights with respect to investment protections than US investors in the United States.” In the 2002 Trade Act, Congress expressed concern about investor-state mechanisms by directing USTR to seek the creation of “an appellate body or similar mechanism to provide coherence to the interpretations of investment provisions in trade agreements.” To date, no such body has been created, only a promise that parties “shall establish a Negotiating Group to develop an appellate body or similar mechanism to review awards rendered by tribunals under the Investment Chapter...”

It is important to note that while foreign investors are granted special mechanisms to protect their interests under CAFTA, no similar mechanisms are offered for trade unions, farmers, civil society, environmental, human rights, or other concerns.

Performance requirements: CAFTA will prohibit Central American governments from placing performance requirements on investments. Historically, such measures have been commonly used to ensure that investment generates benefits to local communities and the domestic economy. Requirements can include use of local materials, employment and small businesses, as well as technology transfer. A prohibition on performance requirements means that governments have fewer tools to create linkages to the domestic economy and to meet national development objectives.

Much of the foreign investment that flows into developing countries is confined to production enclaves that have few, if any, backwards linkages to the broader domestic economy. The case of Mexico under NAFTA is instructive. While foreign investment flows to Mexico from 1994-2002 reached \$116.5 billion, nearly half of this investment went to manufacturing low value-added goods in maquiladoras along the US-Mexico border. Because these assembly plants largely use imported materials and export to foreign markets, the broader benefit to the Mexican economy has been very limited.

Capital controls: CAFTA prohibits the use of measures designed to stabilize the economy during economic crisis. In recent years, periodic “financial flus” have led to frenzied capital flight from developing countries or regions. Examples include Mexico in 1994, Thailand and Southeast Asia in 1997, and Argentina in 2002. The result can be terrible social dislocation, unemployment and depression. Several countries have instituted safeguards to slow capital flight and prevent panic selling.

CAFTA explicitly prohibits governments from enacting new controls on capital flight. However, even the IMF supports the availability of capital controls as a policy tool and no longer insists on full capital account liberalization as a requirement for its borrowers.

Labor Protections: CAFTA’s text makes the important recognition that attracting foreign investment can create an incentive to compromise workers’ rights. While the text admonishes countries not to weaken their labor laws in order to attract investment, the agreement only states that governments “shall strive to ensure” this objective. There is also no requirement that countries uphold International Labour Organization core labor standards.

The majority of foreign direct investment currently flowing into Central America has been directed towards maquiladoras, assembly plants where cases of labor rights violations are well documented. Many maquiladora owners take advantage of low wages, generous tax breaks, and governments’ lack of enforcement of the existing, inadequate labor regulations. The country with the cheapest labor force and the lowest level of worker rights’ protections wins in this perverse competition, often referred to as “the race to the bottom”. CAFTA’s failure to include strong protections for workers’ rights is a missed opportunity to improve labor conditions, and Central American workers will continue to face significant obstacles to enjoying their rights to organize and join trade unions, have decent working conditions, and fair wages.

Recent investor-state disputes

→ *Glamis Gold Ltd., a Canadian mining corporation, filed a case against the US for \$50 million after the State of California passed a law requiring that the holes created by open pit mining operations be “backfilled” and that the landscape be restored (“recontoured”) upon completion of mining operations. Glamis filed the case under NAFTA investment provisions arguing the California regulations “destroyed” the value of its mining investments in California and that the corporation should be compensated. Glamis’ mine project in the Imperial Valley had been rejected by the US Department of the Interior under the President Clinton, but that ruling was reversed under President Bush.*

→ *In 2003, Harken Costa Rica Holdings, a firm with close corporate ties to Harken Energy of Texas, attempted to sue Costa Rica before an international tribunal for \$57 billion, more than three times the country’s GDP, for denying its oil drilling application. The government had refused to issue permits to the corporation for environmental reasons, as the project could harm critical nesting areas for endangered turtles and coral reefs that are central to the country’s tourism economy. Costa Rica insisted that the case be brought to national courts and Harken was forced to drop the suit, as the government’s action was protected under national law. Under CAFTA, however, Harken and investors like it would be able to bring such claims against governments without restraint.*