ActionAid International USA Center for International Environmental Law
Development GAP Earthjustice Friends of the Earth – United States
Institute for Agriculture and Trade Policy Natural Resources Defense Council
Oxfam America Public Citizen Sierra Club Washington Office on Latin America

September 13, 2004

RE: Investment Chapter of U.S-Andean Free Trade Agreement

Dear Members of Andean Parliaments:

As negotiations concerning the United States-Andean Free Trade Agreement (FTA) proceed, we are writing as US-based non-governmental organizations to convey our serious concerns regarding the agreement's chapter on investment (Investment Chapter).
Our organizations have raised a wide range of concerns regarding the US government's approach to trade policy. This letter focuses on investment because we feel it is an issue that deserves more scrutiny, and we hope that our experience with similar provisions in other trade agreements are useful in your deliberations.

Our organizations share the goal of building economies that benefit development and raise the living standard of people worldwide, foster strong democratic institutions, and protect the environment and enhance public health and safety. We believe that investment flows can facilitate sustainable development, but will only be able to deliver on this potential if governments have the policy flexibility needed to appropriately govern investment activities.

Unfortunately, as we describe below, we believe the Investment Chapter of the US-Andean FTA is likely to undermine the ability of your government to promote critical public interest and development objectives. Moreover, according to the World Bank's *Global Economic Prospects 2003* report, there is no empirical evidence that investment rules such as these lead to increased flows of investment to developing countries.

We are particularly concerned about the potential for the US-Andean FTA to include an investment chapter based on Chapter 11 of the North American Free Trade Agreement (NAFTA) and other recent free trade agreements. The investment provisions in the FTA allow foreign investors to use an investor-to-state dispute settlement mechanism to directly bring suits against governments before ad hoc international tribunals.

In these cases, by asserting a violation of any of the broad substantive rights provided to investors, an investor can demand monetary compensation for the impact of governmental actions (including democratically enacted laws and regulations and local government actions) on the business's investment interest. Under NAFTA, cases against Mexico, Canada and the US have involved claims for as much as US$1 billion in compensation, and both Mexico and Canada have already lost investment cases involving public interest protections. Cases under bilateral investment treaties (BITS) have similarly involved challenges to public interest protections and government actions, including tax policies. For instance, Argentina currently faces more than 20

investment arbitration cases from corporations in several countries demanding compensation for the effect of emergency measures the government took to address its recent economic crisis.

We believe these investment provisions pose a threat to democratic governance by allowing foreign companies to completely bypass domestic courts to challenge public interest safeguards. Particularly in developing countries with significant budget constraints, even the threat of expensive arbitration could place a chilling effect on efforts to enact needed laws and regulations and put undue pressure on governments to settle disputes. We note, in particular, that the investment rules do not include the widely recognized international law principle requiring that all reasonably available domestic remedies be exhausted before a case can be brought to an international tribunal.

A number of overly broad provisions in the Investment Chapter could undermine efforts to put in place critical public interest protections. With respect to expropriation, for example, foreign investors can demand compensation if a government action is considered by a tribunal to "indirectly" expropriate the value of a multinational company's investment, or if it has an effect "equivalent" to expropriation. This means that laws, regulations and even court procedures and rulings that indirectly affect the value of an investment can be considered a violation of the trade agreement. In addition, the agreement applies a vague standard of "fair and equitable treatment" that is inherently undefinable, invites international tribunal members to second-guess government policymakers, and allows foreign companies to demand compensation for a government action that the investor merely considers unfair or unfavourable treatment.

In our view, these standards are far too broad and provide greater rights than are available under long standing legal principles enshrined in the laws of many countries that have permitted government regulation in the public interest. For example, we believe that these provisions violate the requirement in the US Trade Act of 2002 that foreign investors covered by investment rules should not receive greater substantive rights than those that US citizens receive under US law. As a result, US multinational companies enjoy greater rights when they operate abroad under these investment rules than those same companies receive at home in the United States. Modifications to some of the investment standards in recent trade agreements negotiated by the US have failed to remedy these problems and have even created some new uncertainties in the text.

We also believe that a number of provisions in the Investment Chapter could impede the development goals of many developing countries. In particular, restrictions on "performance requirements" will hamper the efforts of developing country governments to adopt policies that promote linkages between foreign investment and local development, including technology transfers. We are particularly troubled by the provisions that prohibit a government from making tax reductions or other incentives conditional on investors meeting certain standards, such as local content requirements. In addition, "national treatment" non-discrimination obligations can limit the ability of a developing country government to protect emerging strategic sectors or assist domestic minority groups.

In addition, we believe that the imposition of strict limitations on the use of capital and other financial controls is inappropriate. Many leading economists and the International Monetary

Fund have concluded that capital controls are a policy tool that should be available for developing countries to ensure economic stability. Constraints on such policies, as found in a number of recent FTAs negotiated by the United States, can be harmful to a developing country and ultimately to international financial stability.

Finally, we note that the recent FTAs negotiated by the United States include investment rules that go considerably beyond those in NAFTA. In particular, these agreements have used an expanded definition of investment that explicitly includes intellectual property rights. This means, for example, that a pharmaceutical company that believes its intellectual property rights are affected can use the investment rules to bring a complaint against a developing country government. Further, the recent FTAs negotiated by the United States explicitly allow foreign investors to challenge government decisions about concession contracts and other agreements involving natural resources and other assets controlled by a government. This would allow investors to bring arbitral challenges before international tribunals concerning any aspects of agreements such as oil and gas, mining, and water concession contracts, without any resort to domestic legal remedies.

Given all of the concerns we describe here, we believe that the Investment Chapter of the US-Andean FTA requires close scrutiny. Based on our experience, we recommend considering the following concrete steps at a minimum:

- Reject the inclusion of an investor-to-state dispute settlement mechanism that bypasses domestic legal processes. At a minimum, adopt this mechanism only for the limited time necessary to address concerns regarding domestic legal capacity, setting an explicit phase-out date, after which disputes must be brought on a state-to-state basis.
- Prohibit the filing of disputes until an investor has fully pursued and exhausted all reasonably available domestic legal remedies.
- Ensure in the text of the Investment Chapter that US-based multinational investors will not receive "greater substantive rights" abroad than they receive under US laws at home.
- Limit claims concerning expropriation to "direct expropriation" of property, rather than including "indirect expropriation."
- Include explicit exceptions for critical public interest protections, including for development objectives; health, safety and environment; consumer protection; and other public interest objectives.
- Limit protection under the Investment Chapter to those investments that are made in accordance with the laws, regulations, and policies of the host government.
- Exclude rules on performance requirements, national treatment, or transfer of capital rules that limit a developing country's development objectives.
- Ensure that intellectual property rights are excluded from the definition of investment.
- Reject the application of any investor-to-state dispute settlement mechanism to natural resource and other contractual disputes with a government.

We hope that the concerns we have raised here will prove helpful as the US-Andean FTA negotiations proceed. Please feel free to contact any of our organizations to discuss these issues.

Sincerely,

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