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ENVIRONMENTAL PROTECTION AND INVESTMENT RULES IN THE FREE TRADE AREA OF THE AMERICAS

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By

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Executive Summary

I. Introduction and Overview of Environmental Impacts

This paper discusses the basis for concerns that FTAA investment rules could undermine efforts to promote sustainable development if those rules are based on the deregulatory model of international investment liberalization typified by the investment chapter of the North American Free Trade Agreement (NAFTA). The NAFTA investment chapter (Chapter 11) is selected for analysis because the NAFTA was negotiated by three of the most economically powerful countries in the region, and is therefore a likely model for FTAA investment rules.

While the NAFTA's investment chapter does not relate explicitly to environmental protection, the rules set forth in this chapter have the potential to restrict the ability of governments to take action to protect and promote the common good and thus to undermine the ability of the public to safeguard the environment. Two provisions of Chapter 11 have broad implications for the environment: 1) rules regarding expropriation, which open up legitimate environmental regulations to challenge from corporations; and 2) rules relating to technology transfer and other performance requirements, which diminish the bargaining power of countries when negotiating the terms on which they will grant corporations access to their economies and natural resources. Concerns about these provisions are compounded by dispute resolution mechanisms that are biased and closed to the participation of the majority of potentially affected members of civil society. Each of these concerns is discussed in more detail in the following sections.

II. Expropriation and Compensation in Chapter 11

NAFTA's Chapter 11 requires its contracting parties to compensate investors for acts, even when taken in the public interest, that expropriate or nationalize a foreign investment and for measures *tantamount to* nationalization or expropriation. This vague language leaves the precise definition of expropriation to the discretion of the court, international arbitration panel, or other dispute resolution body. If such a body were to employ a broad interpretation of expropriation, a government could be required to "pay to regulate" polluters if the body found that an environmental regulation had reduced the value of a foreign investment, either directly or indirectly. The chilling effect of such a legal framework on government efforts to protect the environment could be enormous.

Two cases already brought under NAFTA illustrate the danger. In one case, a United States multinational corporation with Mexican subsidiaries known as Metalclad Corporation brought a claim against the government of Mexico because the Mexican state San Luis Potosi did not grant the company an operating license for a hazardous waste disposal facility. The Metalclad case demonstrates that investors could use an expropriation doctrine under international law to demand that governments allow them to initiate new activities even before government regulators have determined whether the new activities pose a danger to public health or the environment. In another case, the Canadian government agreed to pay the U.S. based Ethyl Corporation $13 million in damages to settle a claim that Ethyl had brought alleging that Canada violated the expropriation provisions of NAFTA by banning the import a gasoline additive, MMT, which is widely believed to create a public health risk. The Ethyl Case demonstrates how vulnerable governments may be to corporate pressures, lacking the legal resources to confront a challenge from lawyers representing large corporations. Under the threat of lawsuits such as these, governments will inevitably become much more cautious about introducing and enforcing regulations that are intended to protect the environment.

III. Chapter 11 and Technology Transfer

Chapter 11 prevents governments from imposing or enforcing any requirement on foreign investors to transfer technology or knowledge in exchange for access to natural resources. Technology transfer is an integral part of the sustainable development plan of action developed during the United Nations Conference on Environment and Development (UNCED), which recognized that the transfer of knowledge, production processes, and technology would play a critical role in building the capacity of developing economies to manage environmental issues locally. If countries are prohibited from including technology transfer requirements in their agreements with investors, they will sometimes be forced to sacrifice their long-term economic interests to their short-term needs because they will be unable to benefit from the sustainable use of their resources. In Suriname, a recent agreement with the pharmaceutical company Bristol-Myers Squibb is allowing the country to benefit from medicinal extracts derived from their forests, and enabling Suriname to refuse offers from foreign logging firms that would have eliminated between 25 and 40 percent of Suriname's forest cover, harming Suriname's environment while providing limited long term economic benefits. This kind of agreement exemplifies the potential of technology transfer to enable countries to develop in a sustainable manner; investment agreements should foster rather than discourage such efforts.

IV. Investor-to-State Arbitration

Investors that believe their rights under Chapter 11 have been violated are allowed to bring a claim for monetary damages against host countries. However, the international arbitral panels established under Chapter 11 do not provide appropriate fora for resolving disputes in a way that balances the concerns of investors with the concerns of neighboring property owners and local communities. Arbitrations take place in secret, without the participation of all stakeholders in a dispute. Private individuals, and sub-national levels of government, are not allowed to present their views during the arbitration or even informed that a claim has been brought although they may be the parties with the most direct interests in the outcome of the controversy. Moreover, rather than setting up an intergovernmental dispute resolution system, Chapter 11 relies on private, for-profit arbitration institutions. The arbitration system lacks safeguards to ensure that arbitrators are trained to understand the risks to human health and the environment posed by inadequate regulation as well as the needs of business.

V. Constructing an Environmentally Sound Investment Agreement

If the FTAA is to encourage environmentally responsible as well as commercially secure investment, the NAFTA model should not be used as a template for the FTAA investment negotiations. This paper concludes with some suggestions for developing an alternative model:

1) an investment agreement should not be linked to a free trade agreement;
2) the clear goal of an investment agreement should be to develop investment rules that promote the goals of sustainable development;
3) governments should assess existing foreign direct investment and proposed multilateral rules to determine impacts on environmental, social, and economic security before these governments design a new investment agreement;
4) expropriation provisions should explicitly limit the definition of expropriation to physical possession of an investors' property and expropriation as defined under the host country's laws, ensuring that such expropriation provisions do not constrain traditional government powers to safeguard health, safety, and the environment and leave the public unprotected;
5) investor-to-State dispute settlement fora should employ legal experts who are trained in public policy, not merely business practice and should be transparent and open to the participation of all interested parties. They should be balanced by mechanisms that permit civil society to hold investors responsible for their actions;
6) technology transfer should be encouraged; and
7) governments should take the opportunity presented by regional investment negotiations to develop an investment regime that ensures that multinational corporations operate according to high environmental standards and do not extract the wealth of a country for the benefit of foreign companies at the expense of future generations.