

# Fair Trade or Free Trade? Understanding CAFTA

## Investor Rights or Human Rights?

*By Washington Office on Latin America and Action Aid; for more information, contact Vicki Gass at (202) 797-2171*

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The investment rules in CAFTA will be similar to those included in NAFTA and the proposed Free Trade Area of the Americas (FTAA). Many of the proposed investor rights will conflict with the obligations of states as duty bearers to fulfill the basic rights of their own citizens, and undermine the ability of states to pursue their own national development plans. According to UNCTAD, “free trade agreements today are often also free investment agreements”<sup>1</sup> under which foreign investors are able to operate unencumbered by conditions on their investments.

### Investment for Development?

Proponents of CAFTA argue that improved investment rules will attract greater Foreign Direct Investment (FDI), leading to increased economic growth and per capita income. While there is little doubt that FDI can play an important role in enhancing social development, the question is: under what conditions? Several studies on the experience of NAFTA indicate that FDI can actually be harmful unless national policies strategically use FDI to promote and protect priority sectors. Ten years after the implementation of NAFTA, it is estimated that over 90% of the Mexican banking market is in foreign hands and the largest share of FDI, 62.9%, is geared to the export– manufacturing sector.<sup>2</sup> In this sector, foreign-owned export companies import materials from their parent company for assembly in the developing country and later re-export the products. This type of industry has few links to the rest of the economy and can actually depress local industries. In Mexico, workers saw the real value of their wages drop by 18% between 1993 and 1999. And for the newly unemployed, the promise of new jobs created by NAFTA promoters has not been fulfilled.

### Investor Rights or Human Rights?

The proposed investment provisions in CAFTA are potentially devastating. Governments will not be able to determine how to use foreign investments for development purposes. Instead, investments will be left to the dynamics of the market and will be based on profit maximization principles. To the extent that investment rules are modeled after those in NAFTA and the FTAA, there are five potential areas in CAFTA that will directly impact development and human rights:

➤ **National Treatment:**

National treatment is a provision that stipulates that foreign investors be treated at least as well as domestic investors. That is to say, governments will not be able to discriminate against foreign investors, but must give them consideration equal to that which domestic companies receive. Governments would have a one-time opportunity to negotiate which sectors should be exempted for national treatment, but thereafter would not be allowed to protect emerging strategic sectors or assist minority groups. Governments would be unable to support nascent domestic industry or to require foreign investors to act in a socially responsible way.

➤ **Lack of Performance Requirements:**

Performance Requirements are obligations required of foreign investors to help create forward and backward linkages within a country’s economy. Such obligations include requiring investors to purchase supplies locally, employ specific populations (i.e. youth or women), or transfer a determined amount of technology to a sector. CAFTA, as currently proposed, will prohibit the use of performance requirements, again reducing a government’s ability to determine and implement national development strategies.

- **Lack of Capital Controls:**  
Traditionally most governments have used various types of macroeconomic regulations and controls to regulate the flow of foreign investments, particularly short-term speculative capital flows. Too much capital flowing into or out of a country at one time can have adverse effects on national economies. However, the agreement on investment that most analysts expect to see in CAFTA will limit a government's ability to impose regulations on foreign investors.
- **Investor-State Dispute Mechanisms:**  
Modeled on the highly controversial Chapter 11 in NAFTA, the dispute settlement mechanism in CAFTA would allow foreign corporations to sue signatory governments for perceived violations of their rights and loss of potential profits. Arbitration for these disputes takes place in secret tribunals and often results in costly compensation paid by cash-strapped and indebted governments. Under proposed rules, professional standards that have a perceived profit-reducing impact on foreign companies (such as public interest laws, national licensing, certification standards, or government contracting rules used to raise pay and protect workers' rights) could be weakened or challenged with lawsuits by foreign investors.
- **Liberalization of Services Markets:**  
Similar to the General Agreement on Trade in Services (GATS) being negotiated at the World Trade Organization, the proposed CAFTA agreement will require developing countries to allow foreign corporations to compete in their domestic services markets, including such essential public services such as water and electrical utilities, and public health and education. This will limit the control of local and national governments over essential public services that are fundamental to meeting people's basic rights, and risk the forced privatization or deregulation of these services. The results could be cuts in services, increased fees and limited access to public health care, education and water for citizens.

### Recommendations for Policy

Stronger policy language in trade agreements that protect economic, social, and cultural rights is needed. Such policy options include:

- The rights established under international human, labor and environmental conventions and agreements should take precedence over investor rights.
- Governments must maintain the policy flexibility and autonomy they need to pursue their countries' development goals and to regulate in the public interest.
- Governments must be able to restrict the types of assets that foreign investors can acquire, specify the structure of ownership and lay down requirements for the future operations of foreign investors (such as employment of local workers, use of local materials and export requirements).
- Trade agreements must allow for performance requirements in order to support emerging sectors or meet community development goals, create forward and backward linkages with local economies, and encourage skills and technology transfer.
- CAFTA must restrict the use of national treatment in order to allow domestic industries to compete at an international level. Essential public services should be exempt from "national treatment" standards.
- Governments must maintain the sovereign right to rule out foreign investment proposals that do not adhere to national development policies or that pose a threat to health or the environment.
- Developing country governments must be able to impose capital controls to protect their economies and citizens from destructive flows of speculative investment in times of economic crisis.
- Any trade agreement should reject investor-state lawsuits and require foreign investors to work within the laws and court systems of the host country. Disputes between countries should be resolved in an accountable and transparent manner, and with the participation of all affected parties.

<sup>1</sup> United Nations Conference on Trade and Development, "FDI Policies for Development: National and International Perspectives." 2003 World Investment Report. Page xvii.

<sup>2</sup> Arroyo Picard, Alberto et al, "Balance of Free Trade Agreement in Mexico: Lessons for the Free Trade Area of the Americas negotiations," Mexican Action Network on Free Trade, pages 42-48, December 2001.