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Peru NAFTA Expansion Free Trade Agreement Could Chill Efforts to Reverse Peru's Failed Social Security Privatization

Democrats Must Not Impose on Peru Bad Policy They Fought At Home

The Bush administration made partial privatization of the U.S. social security system a major second term priority. The Bush plan would have established for-profit Private Retirement Accounts that financial service corporations would offer in competition with the public system; similar plans abroad have both limited retirement benefits (as private providers skim off profits) and undermined public systems' solvency.¹ Congressional Democratic leaders, with the support of millions of Americans, saved us from that proposal.² Unfortunately, the Bush-negotiated Peru "free trade agreement" (FTA) poses a significant obstacle to efforts underway in Peru to reverse that country's failed partial social security privatization – which is also premised on having for-profit accounts competing with the public system. Although a Peruvian archbishop, both labor federation presidents, and other civil society leaders asked Democrats to address this FTA problem, the May 10 "deal" to facilitate passage of the Peru FTA struck between the administration and some Democratic leaders did not. **Democrats must not help lock in for Peru a bad policy that they fought at home. The failure of the May 10 "deal" to remedy this problem means that the only way to avoid this damage is to oppose the Peru FTA.**

A Major Campaign Is Underway in Peru to Reverse the Partial Privatization of Social Security Because Its Outcomes Were What Democrats Predicted for Bush's U.S. Proposal: Lower Returns for Retirees and Higher Costs

After the dissolution of the Peruvian Congress, the autocratic Peruvian President Alberto Fujimori privatized Peru's social security system.³ While enthusiastically pushed by representatives of the finance and insurance industry, the privatization was strongly opposed by unions and pensioners.⁴ **The Peruvian system sets up private retirement accounts run by for-profit financial service firms to compete with the government system – similar to what President Bush sought for the United States.** Contrary to proponents' promises, Peru's social security privatization raised costs while failing to improve coverage or social equity.⁵ Even World Bank researchers have admitted that the corporations running Peru's privatized system were difficult to regulate and pocketed massive profits despite their low returns to retirees.⁶

The FTA Could Empower Citibank, a Provider of Private Accounts, to Demand Compensation for "Nationalization" if Social Security Privatization is Reversed

The Peru FTA contains various conflicting provisions that could empower foreign investors (providing the private retirement accounts authorized under the privatization) to demand large amounts of compensation from the Peruvian government in UN and World Bank tribunals for

government actions that undermine their expected future profits as foreign investors in Peru. The FTA text contains an Annex that removes a renationalized social security system from the obligations of the FTA's Financial Services Chapter.⁷ The carving out of public social security systems from the coverage of the FTA's Chapter 12 Financial Services chapter has various effects. The good news is that it allows Peru to eliminate financial service "market access" rights in Peru's private retirement accounts if the system is renationalized without violating the obligations of Chapter 12. However, by removing the application of Chapter 12 to a public social security system, the renationalization of social security is exposed to application under the FTA's Chapter 10 rules. Unfortunately, that chapter, on investment, does not include an exception for the reversal of social security privatization.

The Investment Chapter establishes various foreign investor rights. This includes a requirement that signatory countries compensate foreign investors if the government "expropriate[s] or nationalize[s] a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization."⁸ These rules apply to: **"every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include: an enterprise; shares, stock, and other forms of equity participation in an enterprise... licenses, authorizations, permits, and similar rights conferred pursuant to domestic law..."**⁹ (Emphasis added)

The Investment Chapter includes the right for affected *foreign investors to directly sue* governments in foreign tribunals if the profitability of their investment is affected by government action.¹⁰ Thus, even though the Peruvian government has a legal right under the FTA to reverse its social security privatization, it must still compensate the private foreign investors for the loss to their expected future profits caused by the policy change.

Under these trade deal terms, if Peru reversed its privatization, Citibank – the largest shareholder in ProFuturo AFP (one of the private retirement account providers authorized to compete against the Peruvian government's public social security system)¹¹ – would be empowered to seek compensation from the Peruvian government for its loss of future revenue caused by the renationalization of formerly-private retirement accounts.

Peruvian Religious, Labor and Other Civil Society Advocates Leading the Campaign to Reverse Social Security Privatization Asked Democrats to Fix the FTA Provisions Because a Large Compensation Demand Would Chill Their Efforts

The amount that Citibank could demand could be considerable. Under the Peruvian privatization statute, *ProFuturo's right to provide the private accounts is not time limited and its licenses can only be removed for cause.* That means that Citibank has expectations for considerable future profits.

Peruvian labor and retiree groups – as well as the Peruvian Archbishop Pedro Barreto and U.S. faith and fair trade groups – wrote to Democratic trade leaders in early 2007 explaining that the Peru FTA provisions could severely chill their ability to win reversal of the privatization because the government could not afford to pay a huge fine for the right to restore the public system. Despite these pleas, **the May 10 "deal" does not address the problem.** Here is what concerned groups from both countries are saying:

- "For 25 years, Peru's governments have faithfully implemented neo-liberal policies supported by Washington. While essential services have been privatized, and institutions that are so important to people's health and retirement security – like social security – have become harder for people to access, income per person in Peru has scarcely grown in a generation. The Peru-U.S. FTA not only

does not get us out of this socioeconomic hole, it gives corporations like Citibank the tools to make sure we're forced to stay there," said Julio Cesar Bazán, president of the Unitary Confederation of Peruvian Workers (CUT), one of the country's two labor federations.

- "A broad coalition of Democratic and progressive leaders fought successfully to resist the Bush administration's efforts to privatize [social security], despite massive pressure from hard-line conservatives and corporate special interests. Now the same corporate forces that tried to destroy our Social Security, under the guise of 'free trade,' are trying to destroy the social security system in Peru. Congress rejected Social Security privatization in 2005 and should reject it again in 2007 – whether it's for Americans, Peruvians or Canadians. The promise of a secure retirement shouldn't stop at America's borders," said William McNary, President of USAction, a U.S. social security group.

This Is Only One Threat Caused by the Failure of the May 10 "Deal" to Address the Bush-Negotiated FTA's Extension of the NAFTA-CAFTA Foreign Investor Rules

To safeguard the right for Peru to reverse its failed social security privatization without being subject to massive compensation claims under the Peru FTA's investor-state dispute resolution would have been quite simple: during the renegotiations to add improved labor and environmental standards to the FTA, a clause needed to be inserted clarifying that the Peru FTA's Investment Chapter's investor-state expropriation and compensation rules do not apply to instances where a government social security monopoly is re-established.

While inserting such as exception would safeguard against an investor-state FTA challenge related to the reversal of Peru's social security privatization, absent changes to the underlying foreign investor rules and the investor-state enforcement system, other important non-trade policies would be exposed to such challenges. **As demanded by Democratic members of Congress, hundreds of state legislators, state Supreme Court Chief Justices and Attorneys General and Democratic base groups, the far-reaching NAFTA-style investor rights provisions now incorporated into the Bush-negotiated FTAs with Peru, Panama, Colombia and South Korea must be altered or removed.**

Under NAFTA, these provisions have resulted in nearly 50 challenges of federal and state laws, leading to over \$36 million in taxpayer funds from NAFTA nations paid to corporations.¹² The United States paid over \$3 million just to defend one such challenge and has six cases now pending – one for \$300 million in compensation demanded by Canadian cattlemen to compensate for lost sales when the United States stopped imports during the height of the mad cow disease crisis.

ENDNOTES

¹ Dean Baker, Testimony before House Ways and Means Committee, June 16, 2005.

² Carolyn Lockhead, "Bush's Social Security proposal takes a hit," *San Francisco Chronicle*, March 10, 2005.

³ Raúl L. Madrid, "Ideas, Economic Pressures, and Pension Privatization," *Latin American Politics and Society*, 2005.

⁴ Katharina Muller and Carmelo Mesa-Lago, "The politics of pension reform in Latin America," *Journal of Latin American Studies*, 2002.

⁵ David R. Francis, "Pension woes in Chile," *Christian Science Monitor*, July 27, 1998.

⁶ Indermit S. Gill and Radu Tatucu, "Social Security Reforms in Latin America: What Can the U.S. Learn?" Paper for AEA, at 12.

⁷ Peru FTA Annex 12.1.3.

⁸ Peru FTA Art. 10.7.

⁹ Peru FTA Art. 10.28.

¹⁰ Peru FTA Art. 10.7: Expropriation and Compensation, Peru FTA Section B.

¹¹ See http://www.profuturo.com.pe/portal/index.asp?opc=P_CP_accionistas.htm.

¹² "NAFTA Chapter 11 Investor-State Cases: Lessons for the Central America Free Trade Agreement," Public Citizen Report, 2005.