



## THE TEN YEAR TRACK RECORD OF THE NORTH AMERICAN FREE TRADE AGREEMENT

# UNDERMINING SOVEREIGNTY AND DEMOCRACY

January 1, 2004 marks the tenth anniversary of the North American Free Trade Agreement's implementation. NAFTA promoters — including many of the world's largest corporations — promised it would create hundreds of thousands of new high-wage U.S. jobs, raise living standards in the U.S., Mexico and Canada, improve environmental conditions and transform Mexico from a poor developing country into a booming new market for U.S. exports. NAFTA opponents — including labor, environmental, consumer and religious groups — argued that NAFTA would launch a race-to-the-bottom in wages, destroy hundreds of thousands of good U.S. jobs, undermine democratic control of domestic policy-making and threaten health, environmental and food safety standards.

Why such divergent views? NAFTA was a radical experiment — never before had a merger of three nations with such different levels of development been attempted. Plus, until NAFTA, "trade" agreements only dealt with cutting tariffs and lifting quotas setting terms of trade in goods between countries. But NAFTA contained 900 pages of one-size-fits-all rules to which each nation was required to conform all of its *domestic* laws — regardless of whether voters and their democratically-elected representatives had previously rejected the very same policies in Congress, state legislatures or city councils. NAFTA required limits on the safety and inspection of meat sold in grocery stores; new patent rules that raised medicine prices; constraints on local governments' ability to zone against sprawl or toxic industries; and elimination of preferences for spending your tax dollars on U.S.-made products or locally-grown food. Calling NAFTA a "trade" agreement is misleading, NAFTA is really an investment agreement. Its core provisions grant foreign investors a remarkable set of new rights and privileges that promote relocation abroad of factories and jobs and the privatization and deregulation of essential services, such as water, energy and health care.

Remarkably, many of NAFTA's most passionate boosters in Congress and among economists never read the agreement. They made their pie-in-the-sky promises of NAFTA benefits based on trade theory and ideological prejudice for anything with the term "free trade" attached to it. Now, ten years later, the time for conjecture and promises is over: the data are in and they clearly show the damage NAFTA has wrought for millions of people in the U.S., Mexico and Canada. Thankfully, the failed NAFTA model — a watered down version of which is also contained in the World Trade Organization (WTO) — is merely one among many options. Throughout the world, people suffering with the consequences of this disastrous experiment are organizing to demand the better world we know is possible. But, we face a race against time. The same interests who got us into NAFTA are now pushing to expand it and lock in 31 more countries in Latin American and the Caribbean through the proposed Free Trade Area of the Americas (FTAA) and five Central American countries through a Central American Free Trade Agreement (CAFTA).

**T**hink of NAFTA as a Trojan Horse attack on sovereignty and democracy: hidden beneath the "free trade" cover was an entire anti-democratic governance system under which policies affecting our daily lives in innumerable ways are decided out of our sight or control. When NAFTA was debated in 1993, few realized that this "trade agreement" included hundreds of pages of non-trade policies to which every signatory country was required to conform its domestic laws — even if Congress or state legislatures had opposed the very policies NAFTA's terms required. NAFTA set limits on domestic meat and produce safety and inspection, environmental protections, service-sector regulation, investment and development policy, and banned many Buy-America and other procurement preferences. Plus, NAFTA established dozens of closed-door committees empowered to set new standards outside the domestic regulatory process — which requires openness and public participation.

NAFTA's vast rules are enforced by powerful trade tribunals that lack even the most basic due process guarantees and operate entirely outside the U.S. court system. One element of this system allows foreign corporations to use closed trade tribunals to privately enforce the new rights and privileges NAFTA granted them by suing governments demanding cash compensation from our tax dollars. Already under this system some 20 cases demanding a total of almost \$14 billion in compensation have been filed. Environmental and health regulations have been a frequent target and, in at least three known cases, companies that challenged public interest policies have received millions in taxpayer funds. NAFTA also limits countries' control over their natural resources, for instance, by locking in "proportional sharing" terms that guarantee access by one country to a percentage of the other's resource.

Consumers and environmental groups raised concerns about NAFTA's unprecedented shift of key policy decisions

away from accountable domestic venues to closed, distant organizations. These groups tried to warn that unaccountable trade negotiators cozy with powerful business special interests were using NAFTA to set U.S. policy on *everything*, with even the worst policies insulated against pressures for change because refusal to comply with NAFTA's top-down dictates results in trade sanctions. Congress, state legislators and government public health, environmental, food safety, local development and small business experts all would be handcuffed by NAFTA's constraints. Most in the press and in Congress, who never bothered to actually read the NAFTA text, simply scoffed at these concerns even as NAFTA's thousand-page implementing legislation (passed when the NAFTA was approved by Congress) literally rewrote large swaths of U.S. law to conform it to NAFTA.

NAFTA shattered the boundaries of past 'trade' agreement by containing such far-reaching non-trade dictates: a watered-down version of the NAFTA model was subsequently used for the WTO and now the full NAFTA governance model is being pushed for both the proposed FTAA and CAFTA deals. Given NAFTA's ten year record threatening sovereignty and undermining open, accountable democratic policymaking in all three countries, the notion of expanding the NAFTA model is insane. Yet with so many powerful special interests pushing FTAA and CAFTA, NAFTA expansion will only be derailed by concerted citizen action.

## NAFTA SETS FOREIGN INVESTORS' PROPERTY RIGHTS IN U.S.

Among NAFTA's many non-trade rules are an extensive set of rights and protections that must be provided to foreign investors operating *within* a NAFTA country's borders. NAFTA imposes subjective standards about signatory countries' domestic policies — simply treating domestic and foreign investors the same is not sufficient. Indeed, under NAFTA, the U.S. must provide foreign investors special rights and protections that exceed the property rights available to U.S. citizens and businesses under the U.S. Constitution. These include compensation for government actions — such as domestic health, zoning or environmental regulations — that undermine foreign investors' expected future profits or that fail to meet a "minimum standard of treatment." Corporate interests in all three countries have used these extraordinary rules to attack an array of national, state and local regulatory policies as NAFTA violations. As described below, foreign investors are empowered to enforce these rules by suing governments in NAFTA tribunals for compensation to be paid in our tax dollars — even though the cases circumvent U.S. courts.

Because no notice is given to Congress or the public when NAFTA investor-to-state (Chapter 11) cases are filed, no one knows exactly how many are underway, but the existence of over 20 is known. Most recently, a Canadian

mining company, Glamis Gold Ltd., filed a claim that their NAFTA investor rights have been violated by California regulations that they argue undermine their ability to mine a southern California site. In another case, the Canadian chemical company Methenex has demanded compensation for California's ban of the gasoline additive MTBE, a suspected carcinogen that renders water foul tasting and undrinkable when it leaks out of gas storage tanks. MTBE was banned in California after numerous cities had to begin trucking in water after their ground water was contaminated, and is prohibited in 15 other states. Residents' property values crashed in contaminated areas, but under NAFTA, only Methenex, which produces a chemical used in MTBE, can demand compensation. (NAFTA supporters are eager to make this politically-explosive case go away and a preliminary ruling suggests that it may well be dismissed on a technicality.)

The record of completed NAFTA Chapter 11 cases demonstrates what is at stake. Canada reversed its ban on a gasoline additive called MMT, which destroys catalytic converters and is a suspected neurotoxin, after U.S. Ethyl Corporation filed a NAFTA Chapter 11 case for \$201 million alleging the public health policy violated its NAFTA rights. Canada also paid the corporation \$13 million in compensation for profits lost when the ban was in place and issued a statement that MMT posed no health threat for U.S. Ethyl to use in advertising. In Mexico, the government was required to pay U.S.-based Metalclad Corporation \$16 million in compensation after a Chapter 11 claim that the denial of a municipal construction permit for a toxic waste facility in an environmentally sensitive zone near the city of Guadalupe violated its NAFTA rights. The Mexican company from which Metalclad bought the land also had been denied the same permit after local residents raised concerns about drinking water contamination and the local government conducted a study.

U.S.-based S.D. Meyers Corporation, which shipped toxic waste from Canada to its Ohio treatment plants, obtained a \$5 million payment from the Canadian government in a NAFTA Chapter 11 case after Canada banned exports of the extremely toxic substance polychlorinated biphenyls (commonly known as PCB). Canada signed an international environmental treaty (called the Basel Convention on the Transboundary Movement of Hazardous Wastes) committing not to trade in toxics and to dispose of such materials domestically. Yet under NAFTA, S.D. Meyers had to be compensated for its lost profits during a period when the U.S. permitted the company to import PCB-tainted waste but Canada had blocked such exports under the environmental treaty.

## NAFTA'S SECRET TRIBUNALS, THREAT TO CIVIL JUSTICE SYSTEM

NAFTA's expansive array of policies is enforced through closed tribunals operating outside the domestic court system. NAFTA's enforcement mechanism has two tracks.

One allows countries to attack each others' policies as falling outside NAFTA's dictates, with countries ordered to change their laws or face trade sanctions without any opportunity for outside appeal. NAFTA's "investor-to-state" dispute resolution, which applies to NAFTA's investment rules empowers private investors and corporations to sue NAFTA-signatory governments in special closed-door trade tribunals for cash compensation. NAFTA supporters claimed that extensive investor protections and their private enforcement were necessary to protect investors from state seizure of private property (i.e. expropriation, nationalization). Yet the majority of NAFTA investor-to-state cases have had little to do with property seizure. Instead, the cases have challenged the basic functions of government — environmental and health laws, zoning and permit policies, procurement practices and even Canada's public mail delivery system.

NAFTA's investment rules demonstrate the pact's back door attack on democratic, accountable governance: the U.S. Congress and Supreme Court have roundly rejected these very constraints on normal government regulatory rights. The U.S. Supreme Court has declined to establish the right of compensation for "regulatory takings" ruling instead that "a mere diminution" of property's value by government regulatory action is not a compensable taking.<sup>1</sup> A proposal to establish "regulatory takings" compensation rights<sup>2</sup> also failed to garner sufficient support in Congress in the mid-1990s. Yet under NAFTA, the U.S. must provide these new property rights to foreign investors.

NAFTA provided a direct means of attack on our nation's ability to operate civil justice systems through its domestic courts. In one NAFTA Chapter 11 case, a Canadian funeral conglomerate called Loewen Corporation demanded \$725 million from the U.S. to compensate for damages assessed in a Mississippi jury trial. Loewen claimed that a country's civil court system was encompassed in the "government actions" that must be compensated for under NAFTA if they result in an investor losing expected future profits. Unbelievably, the NAFTA tribunal agreed, and allowed the claim to proceed to the merits. The jury trial in question concerned breach of contract and tortious interference claims brought by the owner of a local funeral home that Loewen, whose business practices had been subject of a *Time* magazine investigation and action from several states' attorneys general, sought to acquire.

Loewen claimed that its NAFTA rights were violated by the state requirement that it post a bond before filing an appeal, by a Mississippi State Supreme Court ruling that it must follow this normal rule of civil procedure, and by the alleged anti-Canadian bias of the jury. The NAFTA tribunal opened the door for losers in civil cases to demand reimbursement for damages — by accepting many of Loewen's claims, although ultimately Loewen was not granted compensation because it had since reincorporated in the U.S. and thus no longer qualified as a foreign investor.

NAFTA's attack on normal government activity has drawn growing criticism with letters of opposition to the Chapter 11 model issued by the Conference of Chief

Justices; the National Association of State Attorneys General; the National League of Cities; and the National Conference of State Legislatures, among others. Numerous U.S. and Canadian cities have passed resolutions opposing inclusion of Chapter 11-type terms in any future agreements. The three NAFTA governments have issued assorted declarations attempting to blunt the criticism, but remain supportive of NAFTA's expansive investor rights and investor-to-state enforcement — which are at the core of the proposed FTAA and CAFTA.

## U.S. FEDERALISM UNDER ATTACK

Despite little consultation with subfederal elected officials and no right of prior informed consent for them, many of NAFTA's constraints apply to state and local governments and policies. When NAFTA was passed, the agreement's text became U.S. federal law. Under a well-accepted "international preemption" theory, a tribunal operating under the General Agreement on Tariffs and Trade (GATT) has ruled that the U.S. federal government is required to take all available actions — from enacting preemptive legislation to withdrawing federal funding — to forcing subfederal compliance with GATT terms which were incorporated into federal law by Congress's approval of NAFTA. Thus, state laws that provide more food safety protection than permitted under NAFTA terms or that ban certain toxic substances are subject to challenge. In addition, the text of NAFTA — which the U.S. government is bound to implement on pain of trade sanctions — contains many specific provisions specifically applying to all levels of government regarding the regulation of service industries and more.

It is notable that many of the NAFTA Chapter 11 cases have been against state and local policies. Yet state and local officials — such as the attorney general whose state law is being challenged — are automatically excluded from the process unless invited by the official party to NAFTA (the federal government) which might also oppose the state policy. Thus, state and local policies and governments are bound to NAFTA's dictates but subfederal officials have no right to defend their laws from NAFTA attack and had no role in setting NAFTA's terms or agreeing to their imposition — a remarkable attack against the rights and authority of local or state government.

## NAFTA SETS FOOD, OTHER POLICIES

NAFTA includes extensive requirements that the domestic health, safety and environmental policies of each member country be designed in the "least trade restrictive manner" possible. These and other NAFTA requirements put citizens at risk by threatening health, environmental, and worker and consumer safety laws. For instance, U.S. law used to require Canada and Mexico to have meat inspection rules *equal* to those of the U.S. in order to import. But under the NAFTA, the U.S. had to start accepting meat exports processed under different, less safe standards. Government

audits of meat imported from Canada and Mexico have found that U.S. standards are frequently violated even though this meat still gets a USDA sticker and shows up in our grocery stores.<sup>3</sup>

NAFTA rules presume that any domestic standards that provide greater levels of environmental, health or safety protection than industry-favored standards named in NAFTA are illegal trade barriers. Such domestic laws may be challenged before NAFTA tribunals. The defending government must prove that their more stringent law meets an impossible list of tests or else it is judged to violate NAFTA and must be changed or eliminated to avoid sanctions. Just the threat of a trade challenge provides a powerful incentive for governments to lower standards because the defense is costly and hard to win. Outrageously, NAFTA sets a ceiling on consumer and environmental protection that countries cannot exceed, but no base standards that all countries must meet.

Meanwhile, NAFTA established dozens of committees that are busily discussing the rewrite of U.S. regulatory requirements behind closed doors. NAFTA has working groups on auto and truck standards, pesticides, food additives, animal diseases, plant health and invasive species, and dozens of other areas. Yet ten years after NAFTA's implementation, next to nothing is known about these powerful policy groups or their agendas, even though U.S. law requires on-the-record regulatory decision-making with publicly accessible dockets listing proposals, inclusion of all interested parties, the right to submit comments, and the right to sue to challenge final decisions. In the U.S., even the contact information for the government officials coordinating the NAFTA groups which are rewriting our laws has not been published on a web site or otherwise made accessible.

## COUNTRIES LOSE CONTROL OVER THEIR NATURAL RESOURCES

NAFTA includes an outrageous "proportional sharing" provision that grants other NAFTA signatory nations rights in perpetuity to a share of another signatory country's natural resources. Thus, if Canada were to suffer a natural gas shortage (if a pipeline blew, for example), it could not cease or substantially cut back exports to the U.S. in order to give priority to domestic needs — but would have to reduce domestic use and other exports so that the U.S.

would maintain its share of the smaller remaining volume. Giant water corporations are ravenously eyeing Canada's massive freshwater supply held in its lakes, rivers and underground reserves, because if any Canadian province "opens the spigot" by agreeing to sell bulk water to a foreign country, then all Canadian water is automatically considered a traded good, not a natural resource over which Canada has sovereign control.

Mexico did not agree to proportional share guarantees in NAFTA because the nation's energy supply is deemed a "national patrimony" under Mexico's Constitution. Oil is an issue of tremendous historic and symbolic importance to the Mexican people, making it impossible for Mexican negotiators to submit Mexico's state company (Pemex) directly to NAFTA jurisdiction.<sup>4</sup> However, Mexico agreed to other NAFTA provisions that give foreign companies and investors access to Mexico's massive state-run oil sector: changes to Article 27 of the Mexican Constitution permitted limited energy sales by private corporations, and Mexico's foreign investment law was amended to comply with NAFTA to allow contractors and pipeline builders working for Pemex to be majority foreign-owned.<sup>5</sup> Plus, NAFTA government procurement rules require greater foreign involvement in the energy sector.<sup>6</sup>

Mexico also was required to change its constitutional land redistribution policies in preparation for NAFTA and to change the burden of proof in domestic criminal laws to implement punishments for violators of NAFTA's copyright rules. Article 27 of the Mexican Constitution — established at the time of the Mexican revolution in 1917 — forbade foreign ownership of land and had redistributed lands seized from large landowners to a system of *ejidos* under which peasants and indigenous communities were granted rights to small plots of communally-owned land that could not be sold. Yet NAFTA's investor protections include a right for foreign investors to acquire real estate. As a condition for Mexico to enter NAFTA, the U.S. government — at the behest of agribusiness interests — insisted that Mexico's Constitution be amended.

The removal of these constitutional protections, in combination with NAFTA agriculture rules, has resulted in the collapse of the Mexican rural economy under NAFTA. Millions of small landowners have lost their livelihoods, leading to increasingly desperate poverty and more economic refugees attempting the dangerous crossing into the U.S. to seek work.

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<sup>1</sup> Concrete Pipe and Products vs. Construction Laborers Pension Trusts 508 U.S. 602, 1993. (Justice Souter author.)

<sup>2</sup> See John D. Echeverria, "The Real Contract on America," *The Environmental Forum*, July/Aug. 2003, p.28.

<sup>3</sup> These audits, obtained by Public Citizen through a Freedom of Information Act request, found violations of USDAs zero tolerance policies for contaminants including feces, urine and ingesta (stomach contents), as well as failure to meet the U.S. legal requirements that government samples can only be tested in government laboratories. (See 2003 Public Citizen report, "The WTO Comes to Dinner", p.27, documents on file at Public Citizen.)

<sup>4</sup> Richard D. English, "Energy in the NAFTA: Free Trade Confronts Mexico's Constitution," *Tulsa Journal of Comparative and International Law*, Vol. 1 (1), 1993, p.2-32.

<sup>5</sup> Eileen Byrne, "Pemex Goes International: Keeping an Open Mind," *Business Mexico*, American Chamber of Commerce, Jan./Feb.1994.

<sup>6</sup> Eileen Byrne, "Pemex Goes International: Keeping an Open Mind."