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Peru-U.S. "Free Trade Agreement" Would Help Lock In Failed Social Security Privatization in Peru

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Executive Summary

In 2006, the Bush administration negotiated a NAFTA expansion pact with the Latin American country of Peru containing obscure provisions that would chill efforts to reverse the failed privatization of Peru's social security system. These "free trade agreement" (FTA) terms would seem to only benefit one U.S. firm, Citibank, which is 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 as part of the privatization.

Other U.S. firms could also gain rights to service the privatized social security system under the Peru FTA terms, as noted by the Bush administration's Industry Trade Advisory Committee on Services and Finance Industries, who hope to use the Peru FTA as a precedent for expanding the reach of privatized social security systems internationally: "Negotiators for the United States and Peru are to be commended for the substantive and meaningful provisions included on pensions and asset management… U.S. portfolio managers will be able to provide asset management services… including to funds that manage Peru's privatized social security accounts (AFPs)."[1]

The Peru FTA was signed in April 2006,[2] but even before the midterm election, there was insufficient congressional support to implement it. Peruvian labor federations leading the fight to reverse the privatization wrote requesting help from Democratic trade leaders to remedy the problem in early 2007. Similar requests were also made by Peruvian Archbishop Pedro Barreto and U.S. faith and fair trade groups.

Despite Democrats' long-standing opposition to social security privatization and the fair trade mandate of the 2006 elections, the May 10 trade "deal" negotiated between some Democratic leaders and the Bush administration to facilitate passage of the Peru FTA did not remedy the Peru social security privatization problem.

In simplest terms, the problem involves provisions of the Peru FTA that empower foreign investors to demand compensation in United Nations (UN) and World Bank tribunals for government actions that undermine their expected future profits as an investor in Peru. Under these terms, if Peru reversed its privatization, Citibank could use the FTA to seek Peruvian government compensation for its loss of future revenue caused by the "nationalization" of its investment in providing private retirement accounts. The FTA has an exception that would forbid the U.S. government from suing in an FTA tribunal for the loss of financial service market access in private retirement accounts if the privatization were reversed. Thus, while the FTA has safeguards for Peru's *legal* right to reverse the privatization, the FTA undermines Peru's practical ability to exercise those legal rights. This is the case because if Peru acted to exercise its rights to terminate market access in private retirement accounts, it could be confronted with foreign investor demands for major compensation.

The amount that Citibank could demand could be considerable, as the right to provide the private accounts is not time-limited and, under the statute establishing the privatization, licenses can only be removed for cause. Peruvian labor and other civil society figures say that the Peru FTA provisions would 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 a public service.[3]

U.S. law would not allow businesses to obtain government compensation for policy reforms that change financial service market regulations. U.S. law would not allow a business to skirt domestic courts and bring a case to a foreign tribunal. But the Peru FTA's foreign investor rights extend far beyond U.S. law. **Fixing this problem would require nothing more than the insertion of a one-sentence exception to the Peru FTA's "expropriation and compensation" provisions declaring that the reversal of the social security privatization is not subject to investor-state claims for compensation.**

Background: Dictatorships and corporate interests undermine the promise of social security

In President Franklin Delano Roosevelt's 1935 message to Congress promoting his social security plan, he argued that, "Most of the other advanced countries of the world have already adopted it and their experience affords the knowledge that social insurance can be made a sound and workable project… We pay now for the dreadful consequence of economic insecurity – and dearly. This plan presents a more equitable and infinitely less expensive means of meeting these costs. We cannot afford to neglect the plain duty before us."[4] As promised, the public and universal nature of the U.S. social security system has kept costs low and sustained political support for the system, to the point where there is not any serious question of the political or actuarial soundness of the program.[5]

Despite the soundness of the program, financial service sector interests have often pushed for its privatization – not least because of the massive fees they would stand to collect under such a system.[6] The Bush administration made partial privatization of the U.S. social security system a major second term priority, only to have this harmful plan blocked by the advocacy of millions of Americans, as well as congressional Democratic leaders such as Reps. Charles Rangel (D-N.Y.) and Sander Levin (D-Mich.).[7]

While privatization initiatives have been successfully blocked in the United States, other countries have not been so lucky. Under the Pinochet dictatorship, Chile's social security system was privatized – a move that has proved disastrous, raising costs while failing to improve coverage or social equity.[8] (An exposé in the *Los Angeles Times* reported, the Chilean "pension privatization took place figuratively at gunpoint. It is the product of a 17-year dictatorship that claimed an estimated 3,000 lives and forced hundreds of thousands of people into exile.")[9] Despite the failure of that system, the World Bank and International Monetary Fund (IMF) pushed pension privatization onto other Latin American countries both through loan conditionality and research advice throughout the 1990s.[10]

The Chilean model was the original inspiration for Peru's social security privatization. In fact, according to Peruvian officials, the country's pension privatization "might not have been signed into law" if not for the policy advice of Pinochet regime officials.[11] According to a leading study of the period, following the "politically motivated violence, hyperinflation, economic mayhem and a dramatic erosion of state capacity" during the 1980s, the Peruvian administration of President Alberto Fujimori was able to consolidate power and take "advantage of this window of opportunity to include pension privatization in a neo-liberal package of structural reform…. While enthusiastically supported by representatives of the local finance and insurance industry, the reform was strongly opposed by trade unions, pensioners and [public social security system] employees."[12]

As with other countries, Peru was promised that privatization would expand coverage and lead to cost savings. These promises never materialized, but the privatization did provide considerable profits for the oligopoly of private companies that were selected by Peru's government to operate the pension services. A study by World Bank economists found that, "In Peru, for example, recent estimates indicate that between 1998 and 2002, the share of workers' contributions going to fees has remained steady while fund expenses have fallen. As a result, profit rates have skyrocketed." The study concluded that, "Even capable Latin American governments appear to find effectively regulating these oligopolies difficult."[13]

Under the Peruvian model of privatized social security, the Peruvian government (through its Superintendence of Banking and Securities, SBS) grants operating licenses *for an unlimited period* of time to approved private social security fund operators (*Administradores de Fondos de Pensión*, AFPs).[14] In order to receive the license, AFPs must be constituted as public limited companies that operate only to provide social security accounts.[15] They must also meet other reserve and regulatory requirements.[16] Typically, each AFP will have several major shareholders. The SBS can preside over the liquidation of any AFP if a firm breaks the terms of the license, AFP-relevant statute or relevant financial sector law.[17] The SBS can also require that other licensed AFPs take over the assets and operations of AFPs undergoing liquidation.[18] Workers can choose to enroll in the public or the private system, but once they have opted out of the public system, they cannot re-enroll.[19]

According to the U.S. Social Security Administration, which tracks pension developments around the world, Peru's "government originally licensed eight AFPs when it launched its system of individual accounts in 1993, but that number has declined over the years" and now stands at four.[20] Unlike some countries, Peru does not require that AFPs be owned or majority-controlled by domestic investors,[21] so the four AFPs consist of one Peruvian firm (Prima AFP, S.A.), one Dutch firm (AFP Integra, which is owned by the ING Group), one Spanish firm (AFP Horizonte, owned by BBVA), and one U.S.-Peruvian firm called ProFuturo AFP, in which U.S. multinational Citibank owns the largest stake with 42 percent of the company's shares.[22]

May 10 trade "deal" fails to remedy problem: Fair trade sweep swept under Beltway rug

Jumping to the United States, on May 10, the Bush administration and some Democratic leaders announced a "deal" on trade policy to change some provisions of the Bush-negotiated FTAs so as to facilitate their passage by building Democratic support.[23] This "deal" was negotiated in secret, its legal texts have not yet been made public,[24] and no labor, environmental, small business or public health group supports it.[25] Even the deal's limited labor and environmental terms are unenforceable, according to big business groups.[26]

Given that the majority-making freshmen congresspeople campaigned on a fair trade, no-more-NAFTAs platform,[27] the May 10 deal's most significant impact could be to harm Democrats' 2008 election prospects. This could be a repeat of the 1994 elections, when working class voters turned against Democrats, who lost control of Congress after alienating this group by supporting NAFTA in 1993.[28]

Many fair trade groups have pointed out that the problematic "deal" was perfectly avoidable. Fair trade groups approached the Democratic leadership after the midterm election to signal that they wanted to craft a new direction for trade policy that would lift living standards both at home and abroad.[29] And over 90 percent of the freshmen Democratic class signed a letter to senior Democrats indicating that they too wanted to be "able to deliver on the promise we made our constituents to move our nation in a new and improved direction on trade."[30]

But the Bush administration ignored the election mandate by announcing just days after the election that it planned to move forward on a NAFTA expansion agreement to Peru and Colombia,[31] which was then followed by similar pronouncements on pacts with Panama and South Korea.[32] In response, fair trade groups gave senior Democrats a list of eight fundamental flaws in the Peru and Panama agreements, and indicated they would actively oppose any FTA that was not changed accordingly.[33] This list included a few provisions (like enforceable labor and environmental standards) that needed to be put into the Peru and Panama FTAs, but mainly consisted of harmful NAFTA-style investor, procurement, agriculture and intellectual property provisions that needed to be *excised* from the Bush-negotiated FTAs to minimally de-NAFTA-ize them.[34] Fair trade groups also indicated that no trade pact with Colombia would be acceptable,[35] while even many business groups are against the South Korea FTA, which would be the highest dollar trade agreement since NAFTA.[36]

But the "deal" announced on May 10 after months of secret negotiations did not remove the harmful NAFTA-style provisions, while making steps on labor and environment that big business groups say are unenforceable.[37] In addition to replicating NAFTA's harmful provisions that have given foreign corporations excessive rights to trample public interest policy,[38] hindered access to life-saving medicines,[39] and displaced (often into U.S. immigration) over a million Mexican peasants,[40] a key "fix" left unresolved was a little-known provision that would chill attempts now underway by Peruvian labor, pensioner and health groups to reverse the failed privatization of Peru's social security system. What's worse, this provision would appear to only benefit Citibank, a highly politically influential corporation that is a major donor to many prominent Democrats,[41] and as noted is also the only major U.S. investor in Peru's privatized social security system.

The technical problem: How Peru FTA provisions would chill reversal of Peru's failed social security privatization

The hundreds of pages of Peru FTA text are a virtual replica of NAFTA and CAFTA. Electronic comparisons of the foreign investor rights provisions in the Peru FTA and CAFTA have shown that the two are nearly identical as well.[42] The unfortunate replication of the extraordinary NAFTA-CAFTA foreign investor rights is the root cause of the problem the Peru FTA poses for reversal of Peru's social security privatization.

Peru FTA continues, expands NAFTA-CAFTA foreign investor rights

New Democrat Coalition member Rep. Jane Harman (D-Calif.) and other representatives described the CAFTA foreign investor provisions that have been replicated in the Peru FTA:

"We wanted to draw your attention to… the threat that the investor rights rules in the Central America-Dominican Republic Free Trade Agreement (CAFTA) pose to important state and local laws and regulations that protect the environment and public health. Like Chapter 11 of NAFTA, the investor rights provisions of CAFTA give foreign corporations the power to demand payment from the U.S. when public interest protections affect a company's commercial interests. Our state has witnessed the impact of these rules: foreign companies have brought NAFTA suits totaling more than $1 billion challenging a California law phasing out the toxic gasoline additive MTBE and one regulating mining operations to protect the environment and Native American sacred sites. The State of California has now joined state and local government groups in saying that U.S. trade negotiators failed to heed the lessons of NAFTA in their negotiation of the investor rights rules in CAFTA. We hope you will join us in opposing CAFTA."[43]

The NAFTA Chapter 11 provisions that Harman references 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. The United States already has spent millions in legal costs to defend against such attacks.[44] A former member of Congress that served as a panelist on one of the NAFTA investor-state disputes summarized the views of many when he said, "If Congress had known that there was anything like [Chapter 11] in NAFTA they would never have voted for it."[45]

The May 10 "deal" announced by the Bush administration and senior Democrats does nothing to alter the Peru FTA's extreme foreign investor privilege provisions found also in NAFTA and CAFTA. In fact, the Bush administration bragged in a fact sheet that none of the FTA's binding language on investor rights would be changed and that they had not shifted from the CAFTA standard in the Peru FTA.[46]

This has grave implications for the future of social security in Peru, as the heads of Peru's labor and retiree federations noted in a March 23 letter to Chairman Rangel[47] and in a May 11 letter to Speaker Nancy Pelosi (D-Calif.).[48] Additionally, Peruvian Archbishop Pedro Barreto wrote to Chairman Rangel with similar concerns on March 28.[49]

This is the case because the extreme Peru FTA investor rights could allow potentially enormous compensation claims against the government by foreign investors providing private retirement accounts if Peru reverses its social security privatization or affects in any way the expected future earnings of such account operators.[50]

Here's how it works. The Peru FTA's Chapter 12 sets the rules to which the signatories agree regarding financial services. This chapter covers banking, insurance, and pensions, and creates "market access" rights for foreign financial service firms and "products."[51]

Normally, the terms of this chapter would apply to any financial service issue, including social security-related services such as the private retirement accounts.[52] However, the "scope and coverage" section of this chapter includes a provision (Art. 12.1.3(a)) stating: "This Chapter does not apply to measures adopted or maintained by a Party relating to: (a) activities or services forming part of a public retirement plan or statutory system of social security."[53] Also included is an annex further clarifying: "The Parties understand that this Chapter applies to measures adopted or maintained by a Party relating to activities and services described in Article 12.1.3(a) only to the extent that a Party allows its financial institutions to supply such activities and services in competition with a public entity or a financial institution. The Parties further understand that this Chapter does not apply to such measures: (a) to the extent that a Party reserves such activities and services to the government, a public entity, or a financial institution and they are not supplied in competition with another financial institution."[54]

Carving out 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. This would foreclose a U.S. government enforcement action for withdrawal of "market access" if the "market" in private retirement accounts Peru now "offers" is eliminated.

However, by removing the application of Chapter 12 to a public social security system, the Financial Service Chapter Article 12.1.3(a) provision and annex also exposes the renationalization of social security to coverage by the Peru FTA's Chapter 10, which establishes various foreign investor rights, including the right to sue a country directly for compensation if an investment is nationalized.

The Peru FTA Chapter 10 investment rules require signatory countries to 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."[55] The text explains that direct expropriation is "where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure." An indirect expropriation is defined as "an action or series of actions by a [member government that] has an effect equivalent to direct expropriation without formal transfer of title or outright seizure." In determining whether an action constitutes an "indirect expropriation," a Peru FTA-established tribunal would be required to consider "the economic impact of the government action" and "the extent to which the government action interferes with distinct, reasonable investment-backed expectations."[56]

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.[57] **Thus, even if the government in question has the legal right under the FTA to take that action, it must still compensate the private foreign investors for the loss to their expected future profits caused by a change to a policy covered by Chapter 10.**

There are several conflicting provisions in the text regarding how Chapter 10 compensation provisions would apply to the situation of social security nationalization. For instance, the Investment Chapter provisions set forth the relationship of the investment rules to other FTA provisions by stating: "In the event of any inconsistency between this Chapter and another Chapter, the other Chapter shall prevail to the extent of the inconsistency."[58] Thus, to the extent that the renationalization of Peru's social security system is carved out of the application of Chapter 12, there is no inconsistency between the two chapters, because Chapter 12's rules simply do not cover the circumstance.

Consider the difference between how the Investment Chapter treats conflicting jurisdiction relative to the (non-financial) Services Chapter (Chapter 11). The Services Chapter specifically excludes from its coverage all "financial services as defined in Article 12.20 [definitions provision of Financial Services Chapter]."[59] The Investment Chapter contains no parallel language.[60] And indeed, the fix to this entire problem is inserting a sentence into Chapter 10 that makes clear it does not apply to the policies covered by Article 12.1.3(a) and its annex – public social security systems. Chapter 12 itself contains a clause that would control the terms of Chapter 10's application to financial services, but Article 12.1.3(a) and its annex remove the application of Chapter 12 to public social security systems.

Further, Annex II, which lists exceptions to the Investment Chapter, includes exceptions to certain Chapter 10 provisions (such as National Treatment) for social security, reinforcing that in some circumstances social security is covered by the Investment Chapter.[61] If coverage of social security by the Investment Chapter were not possible, then only Annex III, which lists exceptions to the Financial Service Chapter, would include social security exceptions.

The interplay of these conflicting provisions is especially troubling because ultimately resolving the text's conflicts would be left to the interpretation of a World Bank or UN tribunal if Citibank or another foreign investor sought compensation. That is why inserting a specific exception forbidding investor claims for compensation is crucial. Absent such a provision, in interpreting the conflicts, the tribunal would consider that nowhere in the FTA is it contemplated that a government may take an exception from this obligation to compensate foreign investors.

The agreement allows the listing of "non-conforming measures" – domestic laws that a country seeks to exclude from specific FTA obligations. The Peru FTA includes many of the Investment Chapter's other core obligations as possible provisions to which exceptions can be taken, but not the obligation to compensate foreign investors in the case of an expropriation or nationalization. Throughout *all* of the FTA's annexes and lists of exceptions, in no place is the obligation to compensate foreign investors waived. Indeed, the core logic of the agreement is to facilitate and protect foreign investment.

Some experts resolve these provisions to mean that the FTA authorizes a foreign investor to sue for compensation regarding nationalization of social security. However, these sources doubt if the tribunal would rule in favor of the investor. As reported by *The Hill* newspaper, "the House aide said this [successful compensation claim] would be virtually impossible because Citigroup would have to show that Peru had created a compensable expropriation through the partially privatized system. Whether Peru did so would turn on the question of whether Citibank had a 'reasonable expectation' that its investment would not be interfered with in the future. Because social security systems worldwide are so controversial, the House aide said, 'It would be inconceivable to me' that Citigroup could have a reasonable expectation that its license to take part in the Peruvian system would live on in perpetuity."[62] Relying on predictions of how any particular investment arbitral panel might rule in a compensation claim is not a sufficient safeguard from the threat posed.

The final issue regarding application of the Investment Chapter to reversal of Peru's social security privatization is whether the definition of a "covered investment" in the FTA includes the specific investment in question (a U.S. bank holding a 40 percent share in a Peruvian company established to provide private retirement accounts and/or the license issued by the government to provide a service in the government's stead). The Peru FTA's Chapter 10 definition of a foreign investment covered by the FTA's special foreign investor rights is:

> "**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**; bonds, debentures, other debt instruments, and loans; futures, options, and other derivatives; turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; intellectual property rights; **licenses, authorizations, permits, and similar rights conferred pursuant to domestic law**; and other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges."[63] (Emphasis added)

The Peru FTA Investment Chapter also specifies that the scope and coverage of the pact's investment rules apply to "a state enterprise or other person when it exercises any regulatory, administrative, or other governmental authority delegated to it by [the member government], such as the authority to expropriate, grant licenses, approve commercial transactions, or impose quotas, fees, or other charges."[64]

Under the FTA's expansive definition of a covered investment, the partial ownership of an enterprise providing private retirement accounts and the license to do so are clearly forms of "investment" covered by the agreement. The Peru FTA's broad definition of investments subject to compensation claims extends far beyond U.S. law to include claims based on the losing of licenses or other grants of government authority that establish private business rights that meet the definition above.

The next question is whether the Peru FTA includes any exceptions, annexes or other provisions that would foreclose a challenge. No such exception exists, even though, as mentioned above, exceptions are taken for social security for other provisions of Chapter 10.[65]

The Peru FTA (like NAFTA and CAFTA) empowers foreign investors to privately enforce this right of compensation by circumventing domestic courts and domestic law to bring cases based on FTA law directly against signatory governments in foreign tribunals. Called "investor-state dispute settlement," this system uniquely empowers foreign investors to *privately* enforce the terms of a *public* contract between governments (i.e. private enforcement of a government-

government agreement).[66] Cases under this FTA provision are submitted to tribunals that operate in the United Nations (United Nations Commission on International Trade Law, i.e. UNCITRAL) or World Bank (International Center on Settlement of Investment Disputes, i.e. ICSID). These tribunals operate outside of the signatory countries' court systems and enforce FTA (not domestic) property rights law. There is no limit placed on the awards that these foreign tribunals can order governments to pay foreign investors whose FTA rights are deemed undermined.[67]

Because the Peruvian statute establishing the privatization provides time-unlimited operating licenses to provide social security services and only contemplates termination of such licenses for cause (fraud, bankruptcy),[68] ProFuturo and its shareholders (i.e. Citibank) have an expectation to make potentially unlimited profits derived from the user fees that they charge. If Peru reverses the partial privatization of its social security system, it would put ProFuturo and all other private social security account providers out of business.

Under U.S. law, that outcome would be deemed nothing more than the end of a failed policy experiment, from which some fortunate financial service firms profited to the detriment of the public interest. In contrast, under the current Peru FTA rules, Citibank could be empowered to demand compensation from the Peruvian government in an investor-state tribunal for Peru's "expropriation" of its investment, if the social security system were nationalized.

To reiterate, Citibank would decide whether to bring the demand for compensation to a UN or a World Bank tribunal. The cases do not go to domestic courts, nor are they decided according to domestic constitutional or statutory law.

Given the record of the UN and World Bank tribunals ordering massive compensation in similar investor-state cases regarding changes in the terms of privatizations of other public services, this threat is very real.[69] The threat of such a case demanding compensation could have a fatally chilling effect on efforts now underway in Peru to reverse the failed privatization.

Recent history proves real threat of compensation claims for lost profits

Recent investor-state cases under various bilateral investment agreements (BITs) that contain similar expropriation and compensation rights provide a basis for concern about foreign investors claiming compensation relating to failed privatization. In some cases, compensation claims have been filed for government action to change the license terms even when the privatized service is not renationalized.

For instance, a series of investor compensation claims have been filed relating to the privatization of various government services in Argentina following the nation's tragic economic collapse in early 2002.[70] Most of the 30 pending claims involve utility concessions; gas, electricity, water, telecommunications and other formerly public sector operations that either were privatized or for which long-term concession contracts were issued.[71] These foreign firms are arguing that Argentina's peso devaluation and the emergency measures that the government implemented to weather the crisis – such as freezes of utility rate hikes otherwise allowed under the contracts – adversely impacted their profitability and thus constituted an indirect expropriation under the investment provisions of various BITs.[72] The 30 World Bank ICSID cases amount to some $16 billion in claims, and there are reportedly many other cases that have not reached arbitration but are in settlement negotiations with the government.[73]

In 1995, the French company *Compagnie Générale des Eaux* (which subsequently became Vivendi Universal) and its Argentine affiliate *Compañía de Aguas del Aconquija S.A.* signed a concession contract with the Argentine province of Tucumán to develop and operate the region's water service.[74] As part of Vivendi's "cost recovery strategy," the company raised water bills in the impoverished province some 70 percent.[75] Not only were these increased costs far beyond the means of most Tucumán's residents, but they did not yield any significant improvements to the water service.[76] In fact, a year after the concession agreement was signed, heavy manganese deposits turned much of the province's tap water a brownish color – an indication of a potential public health hazard.[77] This sparked massive public protests, a consumer boycott, and widespread civil disobedience as citizens refused to pay their water bills. It also fueled increased government dissatisfaction with the arrangement. The provincial government filed a domestic lawsuit against the company when the water was found to be contaminated, and the concession agreement was finally cancelled by the government in late 1996. By February of 1997, Vivendi had registered an ICSID claim of $300 million in damages[78] against Argentina for alleged violations of the 1991 France-Argentina BIT.[79] Vivendi claims that Tucumán's rate regulation, including its efforts to prevent water-cutoffs due to non-payment, its fines due to poor water quality, public statements by legislators impugning the company and various other actions were tantamount to expropriation and violated its rights as an investor.[80] The case is in ongoing arbitration after 10 years.

More recently, in 2006, the controversial Enron Company's Azurix division sued Argentina for damages for expropriation and other measures resulting from a botched water privatization attempt in 1999-2000. In that case, Azurix won a concession from the provincial government of Buenos Aires in 1999, and immediately tried to start hiking rates – a move that was blocked by government regulators. Later, government officials advised consumers to boil their water following an algae outbreak, which led some consumers to refuse to pay their bills. According to Food & Water Watch, "In October 2001, shortly after parent company Enron announced it would break-up Azurix and sell its assets, the company withdrew its contract in Argentina, accusing the provincial government of 'serious breaches' and filing a compensation claim with ICSID."[81] In June 2006, ICSID ruled that Argentina must pay $165.2 million of Enron's Azurix division's $525 million claim.[82] Argentina has petitioned for an annulment in the Azurix case. This proceeding is still pending at ICSID.

What is being said about the Peru social security privatization problem

Much like the May 10 trade "deal," the Peru FTA's social security-threatening provisions have been blasted by public interest groups, while being praised by corporate interest groups. As the Peruvian labor and retiree federations noted in their letter to Democratic leaders, seeking assistance:

> "It goes without saying that, for a poor country like Peru, the mere existence in the FTA of these excessive rights for foreign investors – coupled with the possibility that they will actually use them to demand enormous compensation if it happened – would chill any effort to reverse the privatization of the national social security system."[83]

Meanwhile, the provisions won praise from the Wall Street interests that dominate the Bush administration's Industry Trade Advisory Committee on Services and Finance Industries, who hope to use the FTA as a precedent for expanding the reach of privatized social security systems internationally:

> "Negotiators for the United States and Peru are to be commended for the substantive and meaningful provisions included on pensions and asset management… U.S. portfolio managers will be able to provide asset management services to both Peruvian mutual funds and pension funds, including to funds that manage Peru's privatized social security accounts (AFPs)…."[84]

Recommendation and Conclusion

Safeguarding 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 is quite simple: a clause must be added to the Peru FTA's Investment Chapter that makes it clear that the FTA's investor-state, expropriation and compensation rules do not apply to instances in which a government social security monopoly is re-established.[85]

This brief insertion would remedy the specific threat to Peru's reversal of social security privatization caused by the extreme NAFTA-CAFTA style foreign investor privileges being extended in the Peru FTA. However, as repeatedly demanded by many Democratic members of Congress since the CAFTA debate, including in the context of negotiations between Democrats and the White House on the pending Bush-negotiated FTAs: the extreme NAFTA-CAFTA foreign investor rules and their private enforcement must not be included in future "trade" agreements. The array of serious threats to basic environmental, health, safety, land use and other common public interest regulatory policies under these investor rights rules extends far beyond the social security problem.

As noted by Peru's labor leaders in their May 11 letter to Speaker Pelosi:

> "Given that a majority of Peruvians reject the FTA, we hope that no NAFTA-style, Bush-negotiated FTA would be ratified by the new U.S. congressional leadership. But if for some reason this total rejection cannot occur, we hope at the very least that these amendments on social security can be included. By rejecting the Peru FTA, the U.S. Congress and Democratic Party in particular can show the world that they can advocate – in not only words, but deeds – in favor of a needed change of course from the privatization agenda and, at the same time, work in favor of an economic future of real well-being and dignity for all of the hemisphere's peoples."[86]

Given Democrats' historic defense of the U.S. social security program – but also the increasing public concerns that Citibank executives are overly influential in Washington policy circles[87] – it seems only politically prudent that Democrats should avoid the appearance of a double standard on privatized social security. This is especially true with the Peru provisions discussed in this report, where Citibank stands to be the only entity that could gain, while millions of elderly Peruvians could lose.

ENDNOTES

[1] *See* "The U.S.-Peru Free Trade Agreement," Report of the Industry Trade Advisory Committee on Services and Finance Industries (ITAC 10), Feb. 1, 2006.
[2] *See* "United States and Peru Sign Trade Promotion Agreement," U.S. Trade Representative Press Release, April 12, 2006.
[3] Ian Swanson, "Critics of Peru FTA call Democrats hypocritical about social security," *The Hill*, June 14, 2007.
[4] President Roosevelt's message to Congress, Jan. 17, 1935.
[5] Julian E. Zelizer, *Taxing America: Wilbur D. Mills, Congress, and the State*, (Cambridge: Cambridge University Press, 2000).
[6] Dean Baker and Mark Weisbrot, *Social Security: The Phony Crisis*, (Chicago: University of Chicago Press, 1999).
[7] Carolyn Lockhead, "Bush's Social Security proposal takes a hit," *San Francisco Chronicle*, March 10, 2005.
[8] David R. Francis, "Pension woes in Chile," *Christian Science Monitor*, July 27, 1998.
[9] Sebastian Rotella, "Taking a Hard Look at Chile's Privately Managed System," *Los Angeles Times*, Dec. 6, 1998.
[10] Raúl L. Madrid, "Ideas, Economic Pressures, and Pension Privatization," *Latin American Politics and Society*, Volume 47, Issue 2, July 1, 2005; Mark Weisbrot and Dean Baker, "The Role of Social Security Privatization in Argentina's Economic Crisis," Center for Economic and Policy Research, 2002; Dean Baker, Testimony before House Ways and Means Committee, June 16, 2005.
[11] Raúl L. Madrid, "Ideas, Economic Pressures, and Pension Privatization," *Latin American Politics and Society*, Volume 47, Issue 2, July 1, 2005.
[12] Katharina Muller and Carmelo Mesa-Lago, "The politics of pension reform in Latin America," *Journal of Latin American Studies*, Volume 34, Issue 3, Aug. 1, 2002.
[13] Indermit S. Gill and Radu Tatucu, "Social Security Reforms in Latin America: What Can the U.S. Learn?" Paper for American Economics Association, at 12.
[14] "La licencia tiene vigencia indefinida y sólo puede ser suspendida o cancelada por iniciativa del Superintendente como consecuencia de un proceso de disolución o como sanción por falta grave en que hubiere incurrido la AFP." *See* Reglamento del Texto Único Ordenado de la Ley del Sistema Privado de Administración de Fondos de Pensiones; Decreto Supremo Número 004-98-EF, Article 14.
[15] "Las AFP deben constituirse como sociedades anónimas. Son de duración indefinida y tienen como único objeto social administrar un determinado Fondo de Pensiones." *See* Decreto Supremo Número 004-98-EF, Article 13.
[16] *See* Decreto Supremo Número 004-98-EF, Article 14-17, 22-54.
[17] Based on extensive interviews with government and international financial institution officials – as well as think tank, legal and academic experts – Public Citizen has determined that the operating license is the only contract-like instrument that the AFPs have with the Peruvian state. The AFPs are regulated in a manner similar to private banks, and do not have contractual concessions with the state to provide social security services.
[18] Decreto Supremo Número 004-98-EF, Articles 68-73.
[19] Attempts by the legislature to allow affiliates to return to the public system were recently defeated in Peru. *See* Asta Zviniene and Truman G. Packard, "A Simulation of Social Security Reforms in Latin America: What Has Been Gained?" Office Of The Chief Economist, Latin America And Caribbean Region, The World Bank Background Paper For Regional Study On Social Security Reform. *See also* Abigail Barr and Truman G. Packard, "Seeking solutions to vulnerability for old age: Preferences, constraints, and alternatives for coverage under Peru's pension system," University of Oxford, 2005.
[20] "International Update: Recent Developments in Foreign Public and Private Pensions," Social Security Administration Publication No. 13-11712, September 2005.
[21] Price Waterhouse study for the Government of Thailand, 1997, on file with Public Citizen.
[22] The attribution of nationality refers only to the domicile of the largest shareholders in the AFPs. *See* Superintendencia de Banca, Seguros y AFPs, at http://www.sbs.gob.pe/PortalSBS/spp/afps.asp?s=3; Rebecca Howard, "DJ Peru Ctrl Bank Raises Pension Fund Foreign Holdings Limit," *Dow Jones*, Nov. 3, 2006; "International Update: Recent Developments in Foreign Public and Private Pensions," Social Security Administration Publication No. 13-11712, September 2005; ProFuturo AFP website at http://www.profuturo.com.pe/portal/index.asp?opc=P_CP_accionistas.htm.
[23] "Schwab, Congress Announce Labor, Environment FTA Deal," *Inside U.S. Trade*, May 11, 2007.
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[27] Chris Slevin and Todd Tucker, "The Fair Trade Sweep," *The Democratic Strategist*, January 2007.
[28] Ruy Teixeira and Joel Rogers, *America's Forgotten Majority*, (New York: Basic Books, 2000), at 82-86.
[29] "Unions Vow To Fight Fast-Track Renewal, Unveil Alternative," *Inside U.S. Trade*, March 9, 2007; John Nichols, "Freshmen Favor Fair Trade," *The Nation Online*, Jan. 18, 2007.
[30] Letter from 39 out of 42 freshmen to Chairman Charles Rangel (D-N.Y.), Jan. 17, 2007. On file with Public Citizen.
[31] Comments by Spokesman Tony Snow at White House Press Briefing, Nov. 10, 2006; "Schwab Says Peru, Colombia FTAs To Come Up In Next Congress," *Inside U.S. Trade*, Dec. 1, 2006.
[32] "Panama FTA Offers Limited Sugar Access; Labor Changes Possible," *Inside U.S. Trade*, Dec. 22, 2006; "Bush Administration Provides Partial Korea FTA To Congress," *Inside U.S. Trade*, April 6, 2007.
[33] Kate Ackley, "Ready to deal on trade," *Roll Call*, Jan. 24, 2007.
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[35] "Unions Vow To Fight Fast-Track Renewal, Unveil Alternative," *Inside U.S. Trade*, March 9, 2007.
[36] "Bhatia Cool To Auto Changes In Korea FTA, Takes On Critics," *Inside U.S. Trade*, April 6, 2007.
[37] "U.S. Congress, government in trade standards deal," *Agence France Presse*, May 11, 2007.
[38] Mary Bottari and Lori Wallach, "NAFTA Chapter 11 Investor-State Cases: Lessons for the Central America Free Trade Agreement," Public Citizen Report, February 2005.
[39] Robert Weissman, "Dying for Drugs: How CAFTA Will Undermine Access to Essential Medicines," Multinational Monitor, Volume 25, Number 4, April 2004.
[40] John Audley, Sandra Polaski, Demetrios G. Papademetriou, and Scott Vaughan, "NAFTA's Promise and Reality: Lessons from Mexico for the Hemisphere," Carnegie Endowment for International Peace Report, November 2003.
[41] Fredrecka Schouten, "Senator walks line between regulation, donation," *USA Today*, May 10, 2007; Alexander Bolton, "Baucus, Rangel form PAC," *The Hill*, April 16, 2007.
[42] Original text can be found at www.ustr.gov; electronic comparisons on file with Public Citizen.
[43] On file with Public Citizen.
[44] Mary Bottari and Lori Wallach, "NAFTA Chapter 11 Investor-State Cases: Lessons for the Central America Free Trade Agreement," Public Citizen Report, February 2005.
[45] Quote from the Honorable Abner Mikva, former U.S. federal judge and NAFTA panelist in the Loewen case. *See* Adam Liptak, "NAFTA Tribunals Stir U.S. Worries," *New York Times*, April 18, 2004.
[46] USTR suggested that "the four pending FTAs (as well as the other FTAs we have concluded in the past five years) fully achieve" the congressional requirement that no foreign investors not be accorded greater rights than U.S. investors operating in the United States. S*ee* http://ustr.gov/assets/Document_Library/Fact_Sheets/2007/asset_upload_file146_11282.pdf
[47] Letter to Chairman Charles Rangel (D-N.Y.) from Mario Huamán Rivera (Secretary General, General Confederation of Peruvian Workers (CGTP)), Julio Cesar Bazán (President, Unitary Confederation of Peruvian Workers (CUT)), Julio Castro Gómez (National Coordinator, Health Forum), and Jorge Salazar (President, National Confederation of Pensioners and Retired Persons of Peru), dated March 26, 2007.
[48] Letter to Speaker Nancy Pelosi (D-Calif.) from Juan José Gorriti, Secretary, General Confederation of Peruvian Workers (CGTP); Julio Cesar Bazán, President, Unitary Confederation of Peruvian Workers (CUT); Julio Castro Gómez, National Coordinator, Health Forum; and Jorge Salazar, President, National Confederation of Pensioners and Retired Persons of Peru, dated May 11, 2007.
[49]Letter to Chairman Charles Rangel (D-N.Y.) from Monsignor Pedro R. Barreto Jimeno, S.J., Archbishop of Huancayo (Peru) and President of the Episcopal Social Action Commission (CEAS), dated March 28, 2007.
[50] Peru FTA Arts. 10.1, 10.7, and 10.28.
[51] Peru FTA Art. 12.1 "Scope and Coverage 1). This Chapter applies to measures adopted or maintained by a Party relating to: (a) financial institutions of another Party; (b) investors of another Party, and investments of such investors, in financial institutions in the Party's territory; and (c) cross-border trade in financial services. "
[52] Peru FTA Art. 12.1 makes clear that generally Chapter 12 sets the rules covering financial service, not the FTA's chapter on services (Chapter 11) or the FTA's chapter on investment (Chapter 10.) Indeed, several provisions of Chapter 10 and Chapter 11 are "incorporated into and made a part of" Chapter 12. (Art. 12.1.2) Moreover, Chapters 10 and 11 include provisions that explicitly give precedence to Chapter 12 for financial service covered by that chapter.
[53] Peru FTA Art. 12.1.3(a).

[54] Peru FTA Annex 12.1.3(a).
[55] Peru FTA Art. 10.7.
[56] Peru FTA Annex 10-B.
[57] Peru FTA Art. 10.7: Expropriation and Compensation, Peru FTA Section B.
[58] Peru FTA Art. 10.2.
[59] Peru FTA Art 11.1.4(a).
[60] This is especially noteworthy, because Chapter 12 incorporates some of the Chapter 10 provisions, including the right for compensation claims by investors, into its text. (Peru FTA Art. 12.1.2) The relevance is not that the FTA contemplates investor-state compensation claims regarding financial services, which is true. Rather, given that these provisions are incorporated into Chapter 12, the absence of a carve-out provision in Chapter 12 parallel to that in Chapter 11 is especially relevant. Either it is a glaring drafting error or it is an intentional avenue for financial service policies to which Chapter 12 is not applicable to be subject to Chapter 10. Either way, the problem needs to be corrected by inserting an exception into Chapter 10 foreclosing investor compensation claims over social security nationalization.
[61] Per FTA Annex II-10: "Sector-Social Services; Obligations Concerned -National Treatment (Articles 10.3, 11.2), Most-Favored-Nation Treatment (Articles 10.4, 11.3), Local Presence (Article 11.5), Performance Requirements (Article 10.9), Senior Management and Board of Directors (Article 10.10); Description-Investment and Cross-Border Trade in Service. Peru reserves the right to adopt or maintain any measure with respect to the provision of law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for a public purpose: income security and insurance, social security, social welfare, public education, public training, health, and childcare. Peru reserves the right to adopt or maintain any measure with respect to the provision of law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for a public purpose: income security and insurance, social security, social welfare, public education, public training, health, and childcare."
[62] Ian Swanson, "Critics of Peru FTA call Democrats hypocritical about social security," *The Hill,* June 14, 2007.
[63] Peru FTA Art. 10.28.
[64] Peru FTA Art. 10.1.2.
[65] Peru's Annex III would apply to Financial Service Chapter exceptions. Except, because the nationalization of social security situation is explicitly not covered by the Financial Services Chapter, but is instead covered by the Investment Chapter, Peru's Annex II becomes relevant and Annex II-10 lists other social security exceptions to Chapter 10 provisions, but not to Art. 10.7 which establishes the compensation rights.
[66] Peru FTA, Chapter 10, Section B, Articles 10.15 -10.27.
[67] Peru FTA Arts. 10.15-10.27.
[68] "La licencia tiene vigencia indefinida y sólo puede ser suspendida o cancelada por iniciativa del Superintendente como consecuencia de un proceso de disolución o como sanción por falta grave en que hubiere incurrido la AFP." *See* Reglamento del Texto Único Ordenado de la Ley del Sistema Privado de Administración de Fondos de Pensiones; Decreto Supremo Número 004-98-EF, Article 14.
[69] *See* Roberto Bouzas and Daniel Chudnovsky, "Foreign Direct Investment and Sustainable Development: The Argentine Experience," Universidad de San Andrés Victoria Paper, May 2004.
[70] Patrice M. Jones, "Argentina Plunges to New Low; Peso tumbles 20% in Spite of Efforts by Government," *Chicago Tribune*, March 26, 2002.
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[72] Luke Eric Peterson, "Path Cleared for First Challenge to Argentine Emergency Laws to Be Heard on the Merits," *Investment Law and Policy Weekly News Bulletin,* IISD, Aug. 1, 2003.
[73] Lucio Fernández Moores, "Criticas Al Tribunal Internacional Donde Se Discuten Demandas Por La Pesificación de Tarifas," *Clarín,* Dec. 13, 2004. Ministerio de Economía y Producción, "Posición de la República Argentina Sobre las Presentaciones Realizadas por Empresas Ante el CIADI," Comunicados de Prensa, Buenos Aires, Oct. 14, 2004.
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[78] *Compañía de Aguas del Aconquija S.A. and Vivendi Universal (formerly Compangnie Générale des Eaux) v. Argentine Republic (Case No. ARB/97/3).*

[79] Decision on Annulment, In the Matter of the Annulment Proceeding in the Arbitration between *Compañía de Aguas del Aconquija S.A. and Vivendi Universal (formerly Compangnie Générale des Eaux) v. Argentine Republic* (ICSID Case No. ARB/97/3), July 3, 2002, at 4.

[80] Decision on Annulment, In the Matter of the Annulment Proceeding in the Arbitration between *Compañía de Aguas del Aconquija S.A. and Vivendi Universal (formerly Compangnie Générale des Eaux) v. Argentine Republic* (ICSID Case No. ARB/97/3), July 3, 2002, at 11-13.

[81] Sarah Anderson and Sara Grusky, "Challenging Corporate Investor Rules," Food & Water Watch and Institute for Policy Studies Joint Report, April 2007, at 15.

[82] "Azurix wins claim against Argentina, recoups portion of its sunk costs," International Institute for Sustainable Development. Investment Treaty News (ITN), July 26, 2006.

[83] Letter to Speaker Nancy Pelosi (D-Calif.) from Juan José Gorriti, Secretary, General Confederation of Peruvian Workers (CGTP); Julio Cesar Bazán, President, Unitary Confederation of Peruvian Workers (CUT); Julio Castro Gómez, National Coordinator, Health Forum; and Jorge Salazar, President, National Confederation of Pensioners and Retired Persons of Peru, dated May 11, 2007.

[84] See http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Peru_TPA/Reports/asset_upload_file209_8983.pdf

[85] Unfortunately, the Peru FTA's Investment Chapter's system for listing non-conforming measures does not list Article 10.7 (Expropriation and Compensation) as a provision from which a country can obtain exemption via an Annex II listing, thus fixing this problem would requires adding a new 10.13: Non-Conforming Measures clause 6. Such a new clause must explicitly state that Peru reserves the right to terminate all private investment opportunities in its social security system without being subject to the requirement to compensate foreign investors for the loss of the investment opportunity now available in this sector.

[86] Letter to Speaker Nancy Pelosi (D-Calif.) from Juan José Gorriti, Secretary, General Confederation of Peruvian Workers (CGTP); Julio Cesar Bazán, President, Unitary Confederation of Peruvian Workers (CUT); Julio Castro Gómez, National Coordinator, Health Forum; and Jorge Salazar, President, National Confederation of Pensioners and Retired Persons of Peru, dated May 11, 2007.

[87] Robert Kuttner, "Friendly Takeover," *The American Prospect*, May 4, 2007.