New barriers to investor–state relations post-NAFTA

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DISCIPLINING GOVERNMENTS

The legal regulation framework imposed by the North American Free Trade Agreement (NAFTA) has undoubtedly influenced investment strategy in North America. The inclusion of Chapter 11 (Investment) was a turning point in company–state relations not only within North America, but also outside the region. The chapter's framework became a model that was reproduced almost identically in new negotiations with other countries. However, this legislation would have lacked power if Chapter 11 had not been accompanied by a dispute settlement mechanism intended to settle claims filed before two extraterritorial courts: the International Centre for Settlement of Investment Disputes (ICSID) at the World Bank, and the United Nations Commission on International Trade Law (UNCITRAL). Thanks to this process, companies gained the right to put governments on trial outside their national courts and to demand compensation from national authorities.

This was an important victory not only for companies, but also for those international agencies that, since the 1960s, had tried to impose an international foreign investment protection regime. This purpose was partially achieved when the United States and Canada, two powerful countries, endorsed NAFTA. Its adoption produced the proliferation of new chapters on investment in other free trade agreements (FTAs).

When companies first filed demands against the three North American governments, both the business community and governments responded with mixed reactions because this process raised the possibility that any of them might be sued. Thus, one of the implicit purposes contained in Chapter 11, originally designed to counteract Mexican nationalism, was successful. Chapter 11 became an instrument for Canadian and US companies who decided to implement a sort of "settling of scores," breaking up the informal partnership they had established while lobbying for the agreement. As well, the payment of a substantial compensation awarded by the companies, but adjusted by the courts, gave investors a new level of certainty.

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CANADIAN MINING: THE BIG WINNER

The protection provided by NAFTA to corporate North America explains the progress Canadian mining companies have made under the new state–investor regime. The same opportunities have encouraged the establishment of Canadian financial activities in consumer banking, the relocation of some operations of the Canadian aviation industry, and growing Mexican investment in key sectors of the US economy.

The FTAs negotiated by Canada with Chile, Peru, and Colombia have reproduced the core NAFTA principles faithfully, although in each negotiation, Ottawa has managed to establish rules to better suit its interests. In addition, it has incorporated new provisions reflecting its political concerns regarding the environment, labour, the protection of human rights, and corporate social responsibility. Canadian post-NAFTA agreements have been politicized due to certain clauses, whereas those negotiated by Mexico and the United States have avoided the inclusion of new provisions that might threaten their companies' freedom.

Although the Canada–Chile Free Trade Agreement (CCFTA) was pejoratively called a "copy of NAFTA," it contains important differences. Perhaps the most evident difference is the growing Canadian presence in speculative investment. While the Canadian presence in the mining sector is considerable, it has been gaining importance in the financial sector and in pension funds, thanks to these new free trade agreements.

GREATER FLEXIBILITY AND NEW BARRIERS

Although the CCFTA is considered successful, the case of Costa Rica represents the weakest link in the agreements negotiated by Canada. Canadian negotiators intended to use this agreement to position Canada strategically in Central America vis-à-vis the United States. The agreement does not include a specific chapter on investment because both countries had negotiated a Bilateral Investment Treaty (BIT) in 1998. One of the main obstacles of the Canada–Costa Rica Free Trade Agreement (CCRFTA) has been the imposition of visa requirements for all Costa Ricans entering Canada. This has discouraged the promotion of foreign trade in Costa Rica and has particularly benefited the US brokers hired to promote the economic interests of Costa Rica in the United States and Canada.

Concerning the Canada–Peru Free Trade Agreement, Canadian negotiators introduced, for the first time, an explicit definition of "indirect expropriation or equivalent." The clear definition was intended to guide the extraterritorial courts and stop the indiscriminate and inaccurate use of the term.

Owing to strong opposition toward a free trade agreement with Colombia, where respect for human rights and labour are contentious issues, Canadian negotiators used article 816 to establish that *"each party should encourage the parties operating within its territory or jurisdiction to incorporate voluntarily international standards of corporate social responsibility within their domestic policies."* Ottawa expects Canadian companies to observe business ethics as set out in the agreement.

CHINESE DIRECT INVESTMENT

The growing presence of Chinese investment in North America is a factor that has directly influenced the investment strategies of the three NAFTA countries. While business executives in Mexico and Canada have decided to invest abroad, Chinese investment in North America reached record levels in 2008. However, the arrival of Chinese investment in North America has not been without controversy.

In 2008, Mexico and China concluded a BIT, and in 2005, Canada initiated a process of analysis and consultation on a possible FTA, or at least a BIT, with China. Reactions in Canada have been largely positive. Provincial chambers of commerce regard Chinese investment as a positive step, and the governments of British Columbia, Alberta, and Saskatchewan have signed an economic partnership that creates the largest interprovincial free market whose major goal is to promote trade with Asia. The first major undertaking of the New West Partnership will be a joint mission to China and Japan in 2010.

Of the three NAFTA countries, the United States is the biggest exporter of capital to China; in contrast, Canadian investment in China (Hong Kong included) represented only 1.5 percent of its total foreign investment in 2009. China has established subsidiaries in North America for two main reasons: to transfer its final manufacturing production process to those countries that impose tariff barriers on Chinese products, and to gain access to domestic markets such as NAFTA.

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SECURITY: THE LATEST NON-TARIFF BARRIER

The United States and Canada have introduced new regulatory restrictions on foreign capital investors. In 2005, Canada initiated an amendment to the *Investment Canada Act* (C-10), which protects certain economic sectors on national security grounds. This amendment was similar to legislation passed by other G8 countries. Parliament approved the Act in 2009, adding section IV.1 (Investments Injurious to National Security). The Minister of Industry is in charge of revising all foreign investment that could threaten Canadian security. It is noteworthy that these changes in Canadian law are attributed to the pressure exerted by the US House Defense Services Committee on the Canadian government to restrict Chinese acquisition of major Canadian energy corporations.

While the US policy to attract foreign investment is very liberal, the process to receive capital is complex because a different government office examines each case according to its assessed economic impact. There is legislation, such as the *Defence Production Act* (section 721), that brought about the Committee on Foreign Investment in the United States (CFIUS) in 1972. Unlike Canada, screening foreign investment is the responsibility of the US president who, thanks to the Exon–Florio amendment (1988), can initiate an investigation of a company if it is suspected of threatening national security. In 1993, the Byrd amendment established that any attempt to merge, acquire, or purchase a US company could be investigated if it were suspected of undermining national security. In 2005, the CFIUS, along with the US Congress, prevented the China National Offshore Oil Corporation's acquisition of the Union Oil Company of California (UNOCAL).

Measures aimed at controlling foreign investment in the United States have continued apace. In 2007, an amendment to the *Defence Production Act* was introduced, and it led to the *Foreign Investment and National Security Act*, which also broadens the scope of federal oversight to the economic field.

MEXICO AT THE MARGIN

Mexico receives much less Chinese investment than the United States and Canada. Mexico is a gateway for Chinese capital not only to the rest of the NAFTA region, but also to Latin America. Despite the fact that Mexico objected to China's accession to the WTO in 2001, Mexico did not adopt similar restrictive measures as Canada and the United States. Although article 30 of the Mexican *Act on Foreign Investment* (1993) contains provisions on investment and national security, the article has not been applied to veto the inflow of foreign investment.

LESSONS LEARNED

NAFTA has standardized the way state–investor disputes are handled, leading to both greater security for investors and greater state-to-state tensions. The presence of Chinese investment in North America has changed the dynamics between the NAFTA partners considerably. US and Canadian concerns about

New barriers, page 41

ocracy. In addition to political coordination and cooperation among the three countries, the IBSA forum has become a model for projects benefiting poorer nations, thus demonstrating in practice that solidarity is not an attribute solely of the rich.

We have also held summits between South American and African countries (ASA), as well as with Arab countries (ASPA). Taking into account their specific complementary natures, we have designed policies and built bridges connecting regions that were far apart. This political move resulted in remarkable progress in economic relations. Brazilian trade with Arab countries grew fourfold in seven years. Trade with Africa increased fivefold, to more than US$26 billion, surpassing trade with traditional partners such as Germany and Japan.

These new coalitions are helping to change the world. In the economic arena, the replacement of the G7 with the G20 as the main international body has reset the course of production and international finance and constitutes evidence that in the absence of emerging countries, decisions regarding the world economy lack legitimacy and effectiveness.

Moreover, in the field of international peace and security, Brazil and Turkey were able to persuade Iran to take on the commitments provided for in the Tehran Declaration. This agreement makes clear that new perspectives and approaches are necessary to tackle issues previously dealt with exclusively by the permanent members of the UN Security Council. Despite initial resistance to an initiative nurtured outside the closed circle of nuclear powers, we are certain that the resulting dialogue will serve as the basis for future negotiations and a final solution for that issue.

Brazil engaged in creating mechanisms for dialogue and cooperation with countries in other regions, based on the perception that international realities could no longer afford the alienation of the developing world.

Good foreign policy requires prudence. But it also requires boldness. It should not be timid or based on an inferiority complex. It is usual to hear that countries should act in accordance with their means, a time-worn phrase that is almost too obvious, but the greatest mistake a nation could make is to underestimate its means.

For almost eight years now, Brazil has acted with boldness and, like other developing countries, has changed its place in the world. Today, such countries are regarded, even by occasional critics, as actors bearing increasing responsibilities, entitled to play a role that is ever more central to the decisions that affect the destiny of the planet.

NOTE

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New barriers

continued from page 39

national security stand in contrast to the pressure on developing countries to liberalize their capital markets. Despite the fact that Costa Rica, Peru, and Colombia have signed agreements with Canada and the United States, the amount of investment in these countries is low. Brazil has not ratified an agreement with Canada or the United States, yet it receives by far the largest amount of investment from global investors who see little need for legal safeguards.

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