

NAFTA's Chapter 11

Written by Chris Bailey

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CHRIS BAILEY, DEC 22 2007

When the North American Free Trade Agreement (NAFTA) was negotiated between Canada, the United States, and Mexico, Chapter 11 of the treaty was included to protect investors from state appropriation or 'taking' and, in theory, requires that the same treatment be given to foreign companies as domestic companies. In American law, the Fifth Amendment to the Bill of Rights prevents the government from seizing private assets without due compensation. A 'taking', also referred to as eminent domain in Californian law, is a legal principle that governs how and why the federal, state, or local government can 'take' private property. This provision is often used to build highways and schools, which requires the property owners to receive the 'fair market value' of the seized property in compensation. Chapter 11 contains a similar provision, yet protects not just physical assets, but expected future profits from new regulations, at any level of government, that could be construed as a 'taking' of property. In case of a dispute between a government and an investor, investors could take their case to a World Bank or United Nations trade tribunal instead of using national courts. State/provincial and local governments in the three countries do not take part in the tribunal process, and instead must rely upon their national governments to defend their interests if their laws are being challenged. These tribunals meet in private and are composed of three judges. Investors and the defending country are allowed to each appoint one of the judges, who in turn appoint the neutral third judge. This process in effect gives foreign investors greater rights than those allowed to domestic investors, who must rely on the traditional court system. The tribunals cannot change a law, but do award damages, and the decision of a tribunal does not set a future precedent. This allows companies to take similar cases to arbitration at will. While federal governments are liable for investor losses, they can put pressure on state/provincial and local governments to change their regulations via control of federal funding. This has led the American consumer advocacy group Public Citizen [<http://www.citizen.org/publications/release.cfm?ID=7076>] and *The Nation* columnist William Greider [<http://www.thenation.com/doc/20011015/greider>] to argue that Chapter 11 will bankrupt democracy. With regard to the concept of regulatory takings and the ability of state/provincial and local governments to make their own regulations, it could potentially displace democracy with market demands.

Greider alleges that Chapter 11 is part of a wider plan by 'property rights' advocates in the United States to change

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property rights law to include the concept of regulatory takings, fundamentally shifting the rights of citizens, business, and government. He fears that a change in the composition of the Supreme Court would allow the re-interpretation of the Fifth Amendment governing acquisition of property by the government to include regulatory takings, thus giving American companies the same avenues to challenge regulations as enjoyed by Mexican and Canadian firms. NAFTA was ratified through the US Congress through 'Fast Track' provisions, which prevented amendments or debate and required an up or down vote. Chapter 11's wide scale implications largely went unnoticed at the time. Yet the negotiators of NAFTA, many of whom are part of the 'revolving door' in Washington between government and business appointments, had very clear objectives in the creation of Chapter 11. Daniel Price, the head US negotiator, claimed Chapter 11 would "check the excesses of unilateral sovereignty." He offered Congress the explanation that Chapter 11 would protect American investment in Mexico from a corrupt court system. Price is now a partner in a major DC law firm that brought the first Chapter 11 case against Mexico. Other members of the revolving door of Chapter 11 include C Boyden Gray, George HW Bush's White House counsel during the NAFTA negotiations, then a law firm partner, and now the US Ambassador to the European Union, and Chip Roh, the former assistant US Trade Representative that negotiated NAFTA, and now head partner in an international litigation firm. Many of Chapter 11's proponents have benefited from the litigation opportunities it offers, and would further benefit if the Supreme Court were to change its position on regulatory takings.

Chapter 11 has a specific impact on state/provincial and local governments, where the 'bankruptcy of democracy' has the best chance to occur. Canada, the United States, and Mexico each have federal systems that allow substantial policy autonomy to their constituent states/provinces to establish their own regulations or policies. State/provincial governments tend to be closer to citizens than national governments, and thus are more in tune with the views of their residents. Many states and provinces offer their citizens the opportunity to vote on referendums. Perhaps the best example of direct democracy is California's. After decades of influence by the 'Big-Four' railroad companies and corporate trusts on the state government during the 'Gilded Age', a reformist Republican governor named Hiram Johnson was elected in the early 1900s with a campaign pledge to break the power of the railroads and trusts. He proposed granting the citizens of California the rights of referendum, initiative, and recall. The exercise of these three rights has come to have a fundamental impact on the daily lives of Californians. The recall was most famously applied in 2003 when Governor Grey Davis was replaced by Arnold Schwarzenegger. Initiatives have been used to among others: place term limits on California state politicians, require that state budgets and tax increases be passed by a two-thirds majority of the state legislature, mandates for what proportion of state spending must be devoted to education, clean water and regulation of toxic substances, requirements for automobile fuel efficiency, end state affirmative action, allow the medicinal use of marijuana, 'three strikes' sentencing for repeat felons, requirements that state gasoline taxes must solely be used for transportation and not diverted to other state

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programs, raising the minimum wage, public ratification of appointments to the state Supreme Court, the establishment of English as the state's official language, end bilingual education, increase tobacco taxes, fund stem cell research, super-majority requirements to raise local taxes, and strict limits on the amount property taxes can be increased. Many of these initiatives, regardless of where they fall on the political spectrum, would have very little chance of passing in a system based solely on elected representatives. This system allows Californians to pick and choose what they want to be 'liberal' or 'conservative' on. Some approved initiatives have been rejected by federal courts, including mandating open primaries, immigration issues, and setting term limits for California's representatives to the federal House of Representatives and Senate. But environmental and business regulations have largely stood as long as they did not affect interstate commerce, a power reserved to the federal government under the constitution. California's initiative system was designed to prevent the abuses that occur in a system that allows measures like Chapter 11 to come into law at the behest of special interests that a majority of the population would oppose. And Chapter 11's concept of the taking of property by regulation is designed to prevent the 'excesses' of local and state democracy. Chapter 11 cannot change the outcomes of democratically determined policies, but it could attach a hefty price tag for enjoying them. Federal governments, with the power of the purse and national Supreme Courts, can place mandates on states and influence their behavior. No federal law requires the drinking age in the US must be 21. But any state that lowers its drinking age would lose a portion of its federal highway funding. Chapter 11 essentially gives the same ability to companies from another NAFTA country to challenge regulations and environmental standards.

According to the most recent figures on Chapter 11<!--[if !supportFootnotes]-->[1]<!--[endif]-->, 15 of 46 reported cases involved state/provincial and local governments as defendants. Of these, all but one are pending, failed, or have been dismissed. In this one case (the one brought by NAFTA negotiator Daniel Price), the Mexican government paid undisclosed damages to a US waste management company that challenged a decision in the state of San Luis Potosi. The other 5 cases where damages were awarded or a settlement reached involved a case against Canada's banning of a gasoline additive, a ban by Canada on the export of toxic materials, a Canadian lumber export quota, a case involving Canada Post, and a case involving Mexican taxes on cigarette exports. The US has not yet paid any damages or settlements as a result of federal or state/local regulations (and has even had some legal costs recouped), while Canada has paid out C\$27 million and Mexico US\$18.2 million. Most of the cases have involved environmental regulations, natural resources, and health/safety regulations. In addition, in Greider's piece, he reports how Chapter 11 is having a pre-empting effect on new environmental or safety regulations in Canada. Chapter 11 could easily have a chilling effect on federal regulations as governments seek to avoid a legal fight. And many state/provincial and local governments could be vulnerable to this pressure as well. Essentially, investors have gained the power to discipline the decisions of a foreign government.

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Chapter 11 and the new interpretation of 'property rights' hoped for by DC business interests within the country would challenge the current distribution of constitutional powers of the United States. Using Stephen Gill's theory of New Constitutionalism, it would involve locking in broad property rights at the federal level by the bloc of business interests and government appointees. Even after Chapter 11 was 'clarified' by the NAFTA governments, investors still have the ability to challenge regulations that could involve future takings of expected earnings. One company would be able to obtain 'property damages' from an environmental law voted for by 30 million Californians to protect themselves or their state from dangerous substances and pollution, indirectly blackmailing the state into compliance or bankruptcy. Massive payouts by the federal government would surely lead to a popular backlash, against either the offending state or the company, or perhaps both. If these property rights were to be embraced by a US Supreme Court majority for domestic US companies, it would further blatant attempts to sidestep democracy.

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