

NORTH AMERICAN FREE TRADE AGREEMENT

**CANADIAN
ENVIRONMENTAL
REVIEW**

EXECUTIVE SUMMARY

October 1992

Canada¹¹

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Également disponible en français

Cat. No.: E74-54/1-1992

ISBN: 0-662-59341-3

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Government
of Canada

Gouvernement
du Canada

THE NORTH AMERICAN FREE TRADE AGREEMENT

The North American Free Trade Agreement (NAFTA) defines the rights, obligations and disciplines of Canada, the United States and Mexico in investment, trade in goods, services and intellectual property. Negotiations for the Agreement began in Toronto in June 1991. Negotiations concluded with a handshake on the North American Free Trade Agreement in Washington in August 1992.

The text was initialled by trade ministers from Canada, the U.S. and Mexico on October 7, 1992 in San Antonio, Texas. The initialling enables Canada to commence the domestic approval process. The Agreement is expected to enter into force on January 1, 1994.

Before negotiations began, the Honourable Michael Wilson, Minister of Industry, Science and Technology and Minister for International Trade, announced that the Agreement would undergo an environmental review.

The review is an analysis of the potential environmental effects of Canada's participation in the NAFTA. The NAFTA is the first major government policy initiative and the first trade agreement to undergo such an environmental review.

ENVIRONMENTAL REVIEW

MANDATE

In its Green Plan, the Government of Canada set this objective: "To secure for current and future generations a safe and healthy environment, and a sound and prosperous economy."

In 1990, the government announced reforms to strengthen the federal Environmental Assessment and Review Process. The reforms included a new, non-legislated assessment process established by Cabinet for new federal policies or programs that could affect the environment. The purpose was to integrate environmental considerations into the policy-making process of the federal government.

The interdepartmental committee established to conduct the environmental review had two objectives. The first was to work closely with Canada's NAFTA negotiators to ensure that the potential environmental effects of the various negotiating options would be considered. The second objective was to document the potential effects of the Agreement on Canada's environment.

The government pledged to release a public statement outlining any anticipated environmental effects of its policies. In light of the high level of interest by Canadians in the potential environmental effects of the NAFTA, the government subsequently decided to release the full environmental review.

A POLICY REVIEW

An environmental "review" of a policy differs from an environmental "assessment" of a project. A policy such as a free trade agreement cannot be subjected to the same type of quantitative analyses associated with the assessment of a project such as construction of a dam, a mine or a factory. In fact, the potential environmental impacts of certain policies can be neither appraised nor fully anticipated in advance. The environmental effects of the NAFTA will depend on the trade action and investment decisions taken as a result of the Agreement.

The process of reviewing policies for their environmental implications is in its infancy. In fact Canada is one of only a few countries that has such a requirement. Consequently, unlike projects, there are no commonly accepted methods for conducting such a review. However, the review can be used to examine, in a qualitative way, the potential environmental impact of the policy, and to provide a framework for addressing future environmental concerns.

PROCEDURES

The review focused on the environmental implications for Canada alone. Each of the NAFTA countries is responsible for its own environment and thus for making its own review. The environments of the U.S. and Mexico were considered only in relation to transboundary issues for Canada, such as industry migration.

CONSULTATIONS

Federal and provincial ministers and officials met regularly to discuss the status of the NAFTA negotiations, including the environmental content of the discussions. The provinces provided valuable input into the development of the environmental provisions of the NAFTA.

Representatives of industry, environmental organizations, labour and academia were consulted through the government advisory groups: the International Trade Advisory Committee and the 15 Sectoral Advisory Groups on International Trade. The consultations ensured that the environment was considered in all aspects of the NAFTA negotiations.

Other environmental organizations expressed their views and recommendations through workshops and discussions with government representatives and NAFTA negotiators. The Environmental Review Committee considered submissions on NAFTA and the environment from environmental and public policy groups in Canada, the U.S. and Mexico. Committee members had open and continuous contact with the negotiators during all phases of the negotiations.

FRAMEWORK FOR THE ENVIRONMENTAL REVIEW OF THE NAFTA

The review examined four areas related to the NAFTA:

- **Environmental Provisions:** The likely consequences of the environmental provisions of the Agreement.
- **Environmental Screening:** The impact of the NAFTA on Canada's air, water, land and natural resources.
- **Industry Migration:** The possibility of industry and investment leaving Canada for Mexico for environmental considerations.
- **Follow-Up Mechanisms:** Future action on environmental co-operation.

The findings and conclusions of the NAFTA Environmental Review Committee in each of these areas follow.

ENVIRONMENTAL PROVISIONS

ISSUE

Whether a trade agreement such as the NAFTA is judged to have a positive or negative effect on the environment depends greatly on its specific provisions. When the NAFTA negotiations began, all three partners agreed to address trade-related environmental considerations in the Agreement. That commitment is reflected in several key environmental provisions in the NAFTA (see Annex A).

FINDINGS

Extraterritoriality

- Extraterritoriality occurs when one country unilaterally attempts to extend, directly or indirectly, the reach of its policies into the jurisdiction of another country.

Such a policy would not be a long-term advantage for Canada's economic or environmental interests. Canada could not expect to impose its policies on other countries unless it allowed other countries the right to impose their policies on Canada.

Sustainable Development

- Sustainable development is defined as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs."
- The Preamble identifies the commitment of the three NAFTA countries to meet the economic and trade objectives of the Agreement in a manner consistent with environmental protection and conservation.

The Preamble calls upon the partners to promote sustainable development and to strengthen the development and enforcement of environmental laws and regulations.

Relationship to International Agreements

- Canada has signed certain international environmental and conservation agreements containing trade obligations. Three of these contain provisions which affect trade in endangered species, ozone-depleting substances and hazardous wastes. If any action taken under the NAFTA is inconsistent with the international agreements, the international agreement will prevail. In other words, in certain instances, environmental considerations take precedence over trade.

The NAFTA is the first trade agreement to give precedence to the trade obligations contained in international environmental and conservation agreements.

Relationship to the General Agreement on Tariffs and Trade

- The General Agreement on Tariffs and Trade (GATT) regulates international trade. The GATT allows for exceptions to the trade rules for measures which are related to the conservation of exhaustible natural resources or are necessary to protect human, animal or plant life or health. However, there are no specific exceptions for environmental measures. Nor does it specifically cover living and non-living resources.

The NAFTA confirms and expands these exceptions to explicitly include environmental measures. It specifies that these exceptions include any necessary environmental measures to protect human, animal or plant life or health, as well as measures related to the conservation of both living and non-living exhaustible natural resources.

- Incorporating the environmental exceptions allowed by GATT into the NAFTA permits any resulting disputes to be resolved using the dispute settlement mechanism contained in the NAFTA.

The NAFTA dispute settlement mechanism provides important opportunities for presenting the environmental implications of a trade dispute to a panel set up to resolve a dispute.

Standards

- Chapter 9 of the NAFTA defines Standards-Related Measures as technical regulations, standards and procedures used to test whether or not the regulations or standards are met.
- The chapter protects the rights of governments in Canada to determine their own levels of environmental protection in areas such as pollution controls, emission levels, and the transport and disposal of hazardous waste.
- The Agreement also permits each jurisdiction to set higher levels of protection than recommended by international bodies.
- The NAFTA countries would be free to select the most appropriate levels of sanitary and phytosanitary protection, i.e., standards to safeguard human, animal, or plant life or health from foreign contaminants, disease or pests.
- The Agreement prohibits a lowering of environmental standards to the lowest common denominator or the middle ground of the member countries.

The NAFTA will guarantee the right of governments in Canada to select the level of environmental protection appropriate to Canadian environmental conditions and priorities. The NAFTA countries will be required to work jointly on improving the level of environmental protection on a continental basis.

Dispute Settlement Mechanism

- The NAFTA provides three mechanisms for placing environmental concerns before dispute settlement panels when and if disputes arise.
 - Environmental considerations could be included in submissions.
 - A panel could seek technical advice from any person or body.
 - A panel could request a written report of a scientific review board on any factual issues concerning environmental matters.
- In the event of a trade dispute involving an environmental regulation or standard, the NAFTA gives the burden of proof to the NAFTA country challenging the consistency of an environmental measure with the provisions of the Agreement. If there is a doubt remaining, the environmental considerations win out.

A NAFTA dispute settlement panel could seek information, technical advice or a scientific review on environmental matters from any person or body it deemed appropriate. This recognizes the importance of taking environmental considerations into account in the settlement of trade disputes.

Publication and Public Comment

- The Agreement contains extensive provisions requiring that the citizens and government of a NAFTA country be notified of the laws, regulations, procedures and administrative rulings of any NAFTA country.
- Canadians would have an opportunity to comment on all proposed environmental regulations related to standards-related measures in any NAFTA country. The country would be obliged to take those comments into account when drafting a new or modified standard.
- A trilateral Committee on Standards-Related Measures would be responsible for enhancing co-operation on the development, application and enforcement of standards-related measures. The Committee could include or consult with representatives of non-governmental organizations.

Extensive provisions for notification and clear and open regulations would allow Canadians to influence the environmental standards of all NAFTA members.

Tariff Reduction

- The NAFTA will require that all tariffs on imports of pollution abatement and monitoring equipment be removed within 10 years.

Canadian environmental equipment and service capabilities are recognized internationally. Canada's export interests in Mexico would include solid waste disposal technology, sewage and waste-water treatment and environmental rehabilitation.

Other Provisions with Environmental Implications

- New provisions on temporary entry facilitate the ability of Canadian business persons and professionals providing environmental equipment or services to work in other NAFTA countries.
- Mexican bus and trucking companies may begin replacing their aging fleets with less polluting units made in Canada and the U.S.
- Auto and surface transportation committees will work toward improving motor carrier standards, including emissions standards.
- Expenditures to meet environmental abatement requirements would be eligible costs when calculating the North American content of a product. (Such calculations on certain products are necessary to determine if the product may be imported duty-free or at reduced tariff rates.) Therefore, companies that spend heavily on the environment are fully compensated in the calculation.

CONCLUSIONS

The NAFTA establishes a new benchmark for environmentally sensitive international trade and economic relations. The environmental provisions of the NAFTA would go well beyond those of any previous free trade agreement.

ENVIRONMENTAL SCREENING

ISSUE

By altering the terms of trade among the member countries, the NAFTA could affect the volume and location of goods and services traded in North America. The degree and impact of the environmental effects depend on two principal factors. The first is the quality and size of the new commercial activity, and the second is the importance of the net changes to the environment that result from that activity.

FINDINGS

The review found that:

- Economic growth is not automatically detrimental to the environment. As a result of co-operative government-industry efforts, sulphur dioxide emissions have decreased from 6.9 million tonnes per year in 1970 to 4.6 million tonnes in 1980, and to 3.7 million tonnes in 1990. Emissions decreased despite growth in the Canadian economy.
- Mexican tariff and other trade barriers against some Canadian products have been significant. The gradual removal of these barriers during the next 15 years is expected to result in gains for Canadian exporters. A 10-fold increase in exports to Mexico would have a modest impact when compared with Canada's overall production of goods and services.
- The evidence available suggests that any increase in the production of common airborne pollutants in Mexico or the southern U.S. due to increased commercial activity would be washed out of the atmosphere prior to reaching Canada.
- The NAFTA is not expected to result in a significant increase of persistent airborne pollutants such as insoluble organochlorines in Canada's atmosphere. However, co-operative environmental monitoring and research should be maintained to determine sources and effects of such pollutants.

CONCLUSIONS

The NAFTA is not expected to have a measurable impact on Canada's environment, given the anticipated volume of trade between Canada and Mexico. The NAFTA is unlikely to significantly increase environmental pressures on Canada's air, land, water or natural resources or add to its generation of toxic substances and wastes.

INDUSTRY MIGRATION

ISSUE

Concern has been voiced frequently that the NAFTA could result in a migration of industry to the country with the lowest environmental standards or the least stringent enforcement of its pollution laws. Such migration would result in:

- the creation of a "pollution haven" and
- pressure to lower standards or to relax enforcement in other NAFTA countries.

FINDINGS

The fundamental question is whether the costs of complying with environmental laws are such that differences in standards and enforcement would provide sufficient incentive for companies to relocate. There is little or no empirical evidence of industries relocating to take advantage of possible reduced costs of complying with lower environmental standards. Research indicates a number of reasons for this finding:

- Environmental requirements are only one of several factors that determine the location of an investment.
- Pollution abatement and control costs for the majority of industries average only about 1 per cent of the costs of production.
- Import tariffs are generally already low for industry sectors with high costs for environmental compliance.
- Environmental standards are expected to become even more stringent in the future: companies that become more innovative will enjoy a competitive advantage. (Strict environmental regulations in Japan, Sweden and Denmark resulted in innovative products which are exported worldwide.)
- There is not a significant difference in environmental standards among the NAFTA countries.
- Mexico has given notice that it is upgrading its enforcement activities and will not tolerate polluters.

There is a misconception that Mexico seeks to attract investment by polluting industries. Mexico has some of the most stringent environmental laws in the world. In the past, enforcement of those laws has been a problem but Mexico is focusing its attention on improving enforcement.

The research suggests that before businesses consider migrating four conditions must be met:

- Environmental compliance costs would be extremely high;
- There would be a significant change in relocation incentives;
- Start-up costs for new investment would be lower than current environmental compliance costs; and
- Projected environmental compliance costs would be significantly lower.

The review determined that relatively few businesses would meet all these conditions.

Related Provisions of the NAFTA

The NAFTA contains a number of provisions that would reduce the likelihood of industrial migration.

- Chapter 1 (General) acknowledges that trade restrictions taken to enforce environmental obligations contained in international environmental and conservation agreements dealing with endangered species, ozone-depleting substances and hazardous wastes take precedence over the NAFTA.
- Chapter 7 (Sanitary and Phytosanitary Measures) permits NAFTA countries to take measures to protect human, animal or plant life or health within their respective territories.
- Chapter 9 (Standards-Related Measures) will require NAFTA partners to enhance co-operation on environmental regulations and enforcement.
- Chapter 11 (Investment) recognizes that NAFTA countries should not lower health, safety or environmental standards for the purpose of attracting investment. These are important precedent-setting provisions that would establish new principles from which there would be no turning back.

CONCLUSIONS

Canadian business generally does not anticipate that new environmental regulations will adversely affect its overall competitive position in the future. In fact, business representatives have told the Review Committee that environmental concerns are now an integral part of their decision-making processes. Good environmental policy is good business policy. In view of the research and the environmental provisions contained in the NAFTA, there is likely to be minimal, or no, relocation of Canadian industry due to the projected differences in pollution abatement costs.

FOLLOW-UP MECHANISMS

ISSUE

What mechanisms will ensure there is appropriate follow-up to the NAFTA?

FINDINGS

The NAFTA itself is a major initiative for ensuring that the relationship between trade and the environment will continue to be addressed following implementation of the Agreement. That obligation is outlined in at least three chapters of the Agreement.

- The chapter on Standards-Related Measures obligates the NAFTA partners to work together to enhance environmental standards and to improve compliance with those standards.
- The Investment chapter provides for formal consultations to be held if one NAFTA country believes that another country has lowered or offered to lower its environmental standards in order to attract investment.
- If a disagreement involving environmental issues arises, the Dispute Settlement chapter allows a panel to seek the advice of either environmental experts or a scientific review board.

In 1990, Canada and Mexico launched bilateral co-operation on the environmental front when they signed the Canada-Mexico Environmental Co-operation Agreement. To date, Canada has provided in excess of \$1.9 million in funding for a series of environmental projects (see Annex B).

In Washington, in September 1992, the environment ministers from Canada, the U.S. and Mexico launched an historic process for ongoing trilateral co-operation on the North American environment. For the first time and as a direct result of the NAFTA, the three countries will be working together to improve the continental environment. The Canadian government will consult with Canadian environmentalists to ensure their effective and ongoing participation in the planning process. The ministers will meet again, early in 1993, when they will review a series of proposals for formalized trilateral environmental co-operation.

Canada is an active participant in the international discussions and initiatives involving the inter-relationship between trade and the environment currently under way through the United Nations, the GATT, and the Organization for Economic Co-operation and Development.

CONCLUSIONS

The review concludes that following the signing of the NAFTA, the concerns of Canadians on the inter-relationship between trade and the environment will continue to be addressed through the NAFTA as well as through both trilateral and international initiatives.

OVERALL CONCLUSIONS OF THE ENVIRONMENTAL REVIEW

The NAFTA is the first trade agreement to undergo an environmental review. The NAFTA will not have a significant negative effect on Canada's environment. Rather, the environmental outcome will depend on the trade and investment decisions taken as a result of the Agreement.

The current limited volume of trade between Canada and Mexico makes it difficult to quantify the likely environmental effects of the NAFTA on Canada. Even a 10-fold increase in these exports would not have a significant effect on Canada's environment. In fact, as the improvements in the acid rain problem reveal, environmental improvements can accompany economic growth.

However, from a policy perspective, the NAFTA can be readily assessed for its sensitivity to the environment. The environmental provisions go well beyond those of any previous free trade agreement. The Agreement explicitly protects the fundamental right of Canadians to set and maintain their own high environmental standards.

To date, empirical studies are virtually unanimous in their conclusions about the threat of industry migration to escape stringent environmental standards. The research indicates that differences in costs associated with complying with environmental laws do not provide sufficient incentive to prompt such migration. Furthermore, enforcing environmental laws and regulations has become a priority of the Mexican government. Companies would be ill-advised to expect that the weaker standards or lax enforcement that may have existed in the past will continue in the future.

Given the economic, trade and environmental considerations described in the review, it is unlikely that the NAFTA will have a significant impact on the environment of Canada.

There is a heightened awareness of the continental environment as a result of the NAFTA. The NAFTA negotiations served as a catalyst to significantly increase bilateral and trilateral co-operation. On September 17, 1992 the environment ministers from the three NAFTA countries met and agreed in principle to the creation of a North American Commission on Environmental Co-operation.

The review concludes that, as a result of the NAFTA, future economic development will be implemented with greater environmental awareness. It will be subjected to increased environmental monitoring and enforcement. In turn, the additional resources that would flow from increased economic activity should enhance efforts to address environmental concerns in North America.

ANNEX A

KEY ENVIRONMENTAL PROVISIONS OF THE NAFTA

- The **Preamble** to the Agreement explicitly identifies sustainable development and environmental protection and enforcement as fundamental objectives of the Agreement.
- **Chapter 1 (Objectives)** acknowledges the general primacy of trade restrictions taken to enforce environmental obligations in international environmental and conservation agreements that deal with endangered species, ozone depleting substances and hazardous wastes.
- **Chapter 7 (Sanitary and Phytosanitary Measures)** permits NAFTA countries to take measures they consider appropriate to protect human, animal and plant life or health within their respective territories.
- **Chapter 9 (Standards-Related Measures)** explicitly protects the rights of Canada's federal, provincial and local governments to determine the level of environmental protection that they consider appropriate for their own circumstances.
- **Chapter 11 (Investment)** recognizes that NAFTA countries should not lower health, safety or environmental standards for the purpose of attracting an investment. These are important precedent-setting principles.
- **Chapter 17 (Intellectual Property)** allows the Parties to exclude from patentability plants, animals or inventions that could cause serious prejudice to biodiversity or to the environment.
- **Chapter 20 (Dispute Settlement)** provides a specific mechanism for the submission of environmental concerns to dispute settlement panels so that panels take such concerns into account when making a decision.

ANNEX B

CANADA-MEXICO ENVIRONMENT AGREEMENT

Canada-Mexico Environmental Co-operation

On March 16, 1990, Canada and Mexico signed an Agreement on Environmental Co-operation. The Agreement is very broad, permitting co-operation on environmental issues of importance to both countries.

On March 18, 1992, the government announced a \$1-million program, under the Canada-Mexico Agreement, to help Mexico improve its environmental monitoring and enforcement practices.

The chosen projects are tailored to meet Mexico's needs and will assist Mexico's Secretariat of Social Development to enforce the tough environmental laws which that country passed in 1988.

Approximately 20 projects involving Canada's and Mexico's private and public sectors are being implemented in the following areas:

Compliance Monitoring

- Acquisition of a mobile laboratory;
- Training seminars in Mexico and Canada; and
- Software acquisition.

Management of Hazardous Substances and Waste

- Creation of technical standards and regulations; and
- Comparative analyses.

Air Pollution Control

- Creation of technical standards; and
- Study of emissions inventories.

Environmental Impact Assessment

- Environmental impact assessment manuals for specific sectors.

In addition, projects on the monarch butterfly and environmental education are being developed within this \$1-million program.

In total, Canada has committed in excess of \$1.9 million for environmental projects in Mexico since 1990.