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## **An U.S. Perspective on the North American Free Trade Agreement and the Environment: The Competitive Aspects of Mexico's Accession to an Enlarged Free Trade Agreement**

*Edith Brown Weiss\**

**A**s we meet to discuss the impact of environmental regulation, I am reminded of a story that takes place a long time ago in the Midean desert in what is now southern Jordan:

Out of a burning bush God appeared to Moses and said, "I have good news for you and bad news for you. Which do you want to hear first?" Moses responded, "God, please tell me the good news first." God said, "You will lead your people out of Egypt. The Red Sea will part, and you will lead your people across. You will wander the desert for forty years, and then you will then come to the Promised Land." Moses was overwhelmed and said, "God, that's wonderful news . . . but what is the bad news." God said, "First you will have to file an environmental impact statement!"

Tonight, we are concerned with environment and trade issues in the context of the North American Free Trade Agreement ("NAFTA"). Our goal must be environmentally sound economic development: improving the welfare and the well-being of people over the long term. Trade is an instrument by which we achieve economic development. Environmental sustainability becomes a boundary around the processes by which we achieve economic development. Not only does environmental sustainability serve both as a constraint on trade practices and as a trade incentive, but trade practices can either facilitate or hinder environmental sustainability. The interaction between environment and trade is two-way.

Historically, trade law goes back many years. In response to the trade wars which erupted between the two World Wars, countries wanted in the immediate post-World War II period to set in place a regime which would guard against the recurrence of trade wars, liberalize trade and facilitate operation of the principle of comparative advantage. To do this, countries tried to establish an International Trade Organization as the central international institution. However, when these negotiations collapsed, the General Agreement on Tariffs and Trade

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The following text was compiled from the transcript of the remarks made by Professor Brown Weiss at the Conference.

("GATT") became the main framework governing trading relationships. Today the GATT framework includes several codes and dozens of related agreements.

By contrast, before 1970, there was little international environmental law. The handfuls of agreements that existed were primarily concerned with protecting certain animal species, international rivers or marine areas. Environment did not become a topic of public concern until the mid-to-late 1960s.

The National Environmental Policy Act of 1969 was the first major piece of environmental legislation in the United States. The first international intergovernmental conference devoted to environment, the United Nations Conference on the Human Environment, was held in Stockholm only twenty years ago. In the more than twenty years since, almost all countries have enacted one or more pieces of environmental legislation. Today, there are over 870 international legal instruments that either are devoted entirely to international environmental issues or that have at least one or more important environmental clauses,<sup>1</sup> but there is still no comprehensive international environmental law regime comparable to the GATT system.

This historical context, in which there is a well developed trade law framework and only highly fragmented international environmental legal instruments, contributes to the current perception that environment and trade issues must appropriately be viewed through the trade lens. It also means that environmental concerns have until recently been largely overlooked or dismissed in trade discussions.

The focus tonight is on the effects of a free trade agreement on the environment in the context of NAFTA. There are both direct and indirect effects.

Some of the direct effects on imports are obvious. For example, there are voluntary limits on the number of Japanese automobiles imported into the United States. As a result, the more expensive automobiles are exported to this country; for the most part, these use more gasoline than the cheaper vehicles. Eliminating such limits could lead to imports which are more environmentally efficient. A similar point applies to agricultural products. Imports from some countries may use fewer inputs in the production process and in that sense are more environmentally sustainable.

There are also indirect effects of a free trade agreement on the environment. These include more money earned, potentially higher standards of living and better education, which we hope will lead to greater consciousness of environmental issues, particularly for those who live in the cities, and a greater willingness and more resources to prevent or reduce environmental degradation.

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<sup>1</sup> EDITH BROWN WEISS ET AL., INTERNATIONAL ENVIRONMENTAL LAW: BASIC INSTRUMENTS AND REFERENCES (1992).

Some economists explain the relationship between a country's economic development and its interest in the environment by using an inverted U-shaped curve. As a country develops and raises its standard of living, it may degrade the environment until it reaches a point in its economic development where it has enough resources to care about the environment. At that point, there is a sharp increase in attention to environmental sustainability. Before this point, it is difficult to devote the resources needed for environmental protection. If one accepts this theory and applies it to Mexico, one finds indications that the country has reached this pivotal point in the inverted U-shaped curve where it can be expected to show much greater concern for environmental protection. An important indirect effect of NAFTA may be, thus, to bring economic growth and with this growth to enhance significantly the capacity for environmentally sustainable development.

Are there harmful effects from the proposed NAFTA on the environment? The most frequently mentioned harmful direct effect is the potential relocation of industries to take advantage of lower environmental standards or laxer enforcement of them, but there is as yet little evidence that investments have relocated to countries for this reason. The one study that has documented modest relocation is that of the U.S. Government Accounting Office, which reported that one to three percent of wood furniture manufacturers in the Los Angeles area migrated to Mexico between 1988-1990, because of lower wages, lower rates of workers' insurance and less stringent air pollution standards.<sup>2</sup>

Why is there so little evidence of industrial migration to take advantage of lower environmental standards or laxer enforcement? For multinational firms, an increasingly important factor is that they are adopting worldwide or uniform standards within the firm which apply to the firm's plants in different countries. This gives greater efficiency in the operation of the multinational firm and forestalls future environmental liabilities. Therefore, the incentive for complying with environmental standards of a host country or even adopting stricter standards than those of the host country comes from the needs of the multinational firm. This counters any inducement to move a plant to another country because of lesser environmental standards.

Studies conducted by Patrick Low of the World Bank have indicated that the amounts allocated to compliance with environmental regulation as a percentage of total output are relatively low.<sup>3</sup> On the average, this percentage ranges from around 0.5 percent to about 3.2 percent. Thus, it is dubious that lower costs of compliance with environmental measures offers much of an incentive to a corporation considering reloca-

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<sup>2</sup> U.S. GENERAL ACCOUNTING OFFICE, PUB. GAO/NSIAD-91-191, U.S.-MEXICO TRADE: SOME U.S. WOOD FURNITURE FIRMS RELOCATED FROM LOS ANGELES AREA TO MEXICO (1991).

<sup>3</sup> See Patrick Low & Raed Safadi, *Trade Policy and Pollution*, World Bank Symposium on International Trade and the Environment (Nov. 21-22, 1991) (mimeo).

tion. Even if the costs were more significant, they may not be important in relation to other factors in the production process, such as labor and transport costs.

The question that still needs to be addressed in the NAFTA context is whether there are significant differences in the environmental standards between the United States and Mexico that would serve as trade barriers.

In April 1991, a group of ten attorneys from the United States Environmental Protection Agency (including Regions 6 in Dallas and 9 in San Francisco) and the Department of State visited Mexico to work cooperatively with officials from SEDUE<sup>4</sup> (Mexico's Environmental Protection Agency counterpart) in studying Mexican environmental laws, regulations and standards, assessing compliance monitoring and enforcement, and sharing information on U.S. environmental laws and practices. The group visited factories and interviewed environmental lawyers and nongovernment people. The group found that Mexican environmental laws, regulations and standards as drafted are in many respects comparable to those in the United States. Mexico's 1989 General Law of Ecological Balance and Environmental Protection (the General Ecology Law) embodies some of the same principles enacted in the United States, such as the environmental impact assessment. Also, many of the technical standards implementing the regulations are comparable to those in the United States. For example, both countries require ambient air quality standards for specific pollutants. Mexican authorities have issued these standards for almost the same pollutants as the United States under its National Ambient Air Quality ("NAAQ") Program and the health-based standards are the same, or nearly the same, in the two countries.<sup>5</sup> There are, of course, aspects of the U.S. regulatory regime which have no Mexican counterpart, such as the Superfund cleanup legislation and the regulation of underground storage tanks.

An important problem is the difference in the degree of compliance monitoring and enforcement. While major Mexican industrial facilities have permits, about ninety percent of all industrial facilities, particularly the smaller ones, still did not have permits as of last year. Although Mexico has indicated its plans to establish more extensive monitoring networks, such networks would cover only about sixty percent of the population. Moreover, Mexico had the capacity as of last year to treat only eight percent of the total waste water, with only four percent

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<sup>4</sup> The full name is *Secretaria de Desarrollo Urbano y Ecologia*. SEDUE has three sub-secretariats, one of which covers environmental issues. Note that in May 1992, SEDUE was reorganized into the newly created Secretariat of Social Development (SEDESOL).

<sup>5</sup> Mexico does not have secondary air quality standards designed to protect the public welfare, however, as are called for under the U.S. NAAQ Program. See OFFICE OF GENERAL COUNSEL, U.S. ENVIRONMENTAL PROTECTION AGENCY, *EVALUATION OF MEXICO'S ENVIRONMENTAL LAWS AND REGULATIONS: INTERIM REPORT OF EPA FINDINGS* (August 5, 1991).

treated. Thus, the problems in bringing existing sources into compliance with environmental policies and standards are serious.

From a trade perspective, a key concern is with the treatment accorded new sources. SEDUE has stressed that it intends to stringently enforce environmental regulations and standards on new sources and has made efforts to do so. If carried out, this should reduce any incentive that might otherwise exist for an industry to relocate to benefit from differences in compliance monitoring and enforcement.

Enforcement of environmental standards in Mexico has been noticeably more vigilant within the last year or so than in previous years. Mexico has added to its previous staff of nineteen inspectors some fifty inspectors in Mexico City and fifty inspectors along the border, with plans as of April 1991 for adding a hundred more. Within the last two years, authorities have closed at least 900 facilities, some permanently and others temporarily until a compliance plan and schedule could be negotiated. Closures are now published in the newspaper, which has produced a ripple effect in securing voluntary submissions of compliance plans.

Some policy makers have suggested that acceptance of pollution through less stringent environmental regulations and standards or lax enforcement should be viewed as a subsidy. If the goal is to raise environmental standards in a country, then labeling these a subsidy is a clumsy way to accomplish this. There are much more efficient, direct ways to achieve this goal, including sound environmental regulation and the use of market mechanisms as incentives. It is also not very practical to treat a difference in environmental regulation as a subsidy. There are many factors in the production process, so it is difficult to isolate and quantify the modest effect of a difference in environmental regulation on production cost. In many instances, moreover, the problem would be lax enforcement. To determine whether this constitutes a subsidy in a particular sector would raise many difficult problems.

Stricter environmental regulations than the norm can also raise trade issues. These arise when a country adopts stricter standards than previously adopted or when a governmental subdivision adopts stricter standards than the national ones. From the perspective of the trade community, the concern is that the stricter standard not be a disguised barrier to trade. From the environmental perspective, it is crucial not to deprive areas of the ability to protect their environment to the extent necessary. We could address this concern by having binational or multilateral consultations as countries develop stricter regulations in order to clarify their scientific basis and to ensure that they are not disguised barriers to trade. It may be appropriate to have the burden of proof in such consultations be borne by the party challenging the environmental regulation.

The issue then is how to treat environmental issues associated with NAFTA. The United States Government has stated that the environ-

mental issues and NAFTA would be developed on parallel tracks. As a step toward greater environmental cooperation, the United States and Canada have developed an environmental protection plan for their common border, called the Border Plan. Other steps are possible. Still, there are some environmental issues that are integral to NAFTA.

First, there will need to be a provision for environmentally related exceptions to the trade provisions. GATT contains such a provision in Article XX, as does the Canada-U.S. Free Trade Agreement. Notably, the later Canada-U.S. agreement refers explicitly to environment, while the GATT provision references natural resources, plants, animals and health.

Second, it would be useful for NAFTA to affirm that investments should be made in an environmentally sustainable manner. This would represent an explicit linkage of environment and trade in a framework of sustainable development.

Third, when disputes involving environment and trade issues arise under NAFTA, it is important to include environmental expertise on the panels that address them. This raises the further issue of the appropriate relationship between dispute resolution mechanisms that may be established under NAFTA, which could include environmental expertise, and those dispute resolution processes available under GATT, which do not incorporate such expertise.

There are other steps that could be taken to address environmental issues associated with a free trade agreement. These could be addressed in separate arrangements. For example, it might be useful to hold regular meetings of countries party to the agreement to review the compatibility and comparability of environmental laws, regulations and standards, to enhance cooperation on monitoring and compliance, and to review progress toward environmental protection goals. Communities could also become more involved in environmental protection efforts, for example, by inviting their participation in environmental emergency planning and by providing them with information on the toxic releases in their area. The 1986 community right-to-know legislation in the United States has led to the development of a sophisticated computerized toxic release inventory available to local communities.

Environmentally sustainable development is good for innovation and competitiveness. Reportedly, the Japanese have a five percent competitive edge over the United States on some products, because they use fewer resources in the production process. Moreover, there are strong markets worldwide for environmental pollution control technology. About seventy percent of U.S. air pollution control technology is reportedly purchased from abroad, with much of this coming from Germany. Thus, environmental protection, free trade and competitiveness can be consistent.

Environment and trade issues are here to stay. As noted at the out-

set, it is almost an historical accident that trade issues arose first, and that only recently have we begun to confront environmental concerns. We must now address both issues in a coherent framework as we work for economic development that is environmentally sustainable for both present and future generations.

