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# NAFTA AND THE FUTURE OF ENVIRONMENTAL REGULATION

Patricia E. Perkins

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While NAFTA contains more “green” language than any previous trade pact, the agreement is also unprecedented in the freedom it allows investors and the extent to which it curtails government policy flexibility — important areas of concern for the environment. Especially in Canada, where environmental policy is primarily a provincial responsibility, questions have arisen about the workability and constitutionality of federally-negotiated international agreements like NAFTA which may have broad impacts on the ability of provincial governments to regulate and set environmental policy. Without embarking on constitutional questions in detail, this paper briefly explores some of the environmental policy issues raised by NAFTA.

In order to facilitate trade in goods, NAFTA sets out limitations on the types of standards which countries may legitimately use to ban the import of goods for health, safety, or other reasons. NAFTA’s rules apply to all standards that “may, directly or indirectly, affect trade in goods or services” between the NAFTA countries (Article 901). Many environmental regulations fall into this category — both those relating to traded products themselves (such as allowable levels of pesticides on fruit) and to production processes (such as smelter emissions standards), since compliance with these environmental standards affects the producers’ costs and the price of the traded goods.<sup>1</sup>

Jurisdictions are expected, under NAFTA, to base their standards on international ones, and to work toward harmonizing their standards with those in the other NAFTA countries (Articles 905 and 906). This may lead, in principle, to pressure on jurisdictions to accept a lowest common denominator as the acceptable

standard, despite language designed to reduce the downward impact of standards harmonization. Currently, a wide range of types of environmental regulation exist in different jurisdictions for a variety of ecological, political, and historical reasons. Adoption of international standards could set back hard-won environmental and health advances in some countries. Such provisions also threaten the progressive evolution of environmental policy, since any jurisdiction which takes the lead in a particular regulatory direction could be more likely to face a trade challenge.

In the event of a standards-related trade dispute, the onus would fall on the country with higher standards to prove that they are intended to meet a legitimate objective, that they do “not operate to exclude imported goods which meet that legitimate objective,” and that they do not discriminate between foreign and domestic firms (Articles 904 and 301). A NAFTA panel of trade experts decides any dispute which may arise, and if a standard is deemed to violate NAFTA, it must be rescinded or revised, or else the offending jurisdiction faces trade sanctions approved by the NAFTA panel (Articles 2004, 2018 and 2019).

NAFTA states that, like the standards themselves, jurisdictions are to harmonize their standards enforcement procedures. The agreement sets out detailed rules concerning how standards should be enforced (Articles 906 and 908). The North American Agreement on Environmental Cooperation similarly focuses on national enforcement of national laws and regulations, and on procedures for harmonizing rules and their enforcement. Thus, many aspects of the operations of government agencies charged with

overseeing compliance with environmental regulations may also be affected by NAFTA's implementation. This has a wide range of budget implications and could skew government allocation of funds for environmental protection.

More than previous trade agreements, which deal almost exclusively with trade in goods, in general NAFTA emphasizes investment, trade in financial and other services, "intellectual property" rights, and access by individual investors to dispute settlement procedures. Investment shifts associated with NAFTA are likely to bring environmental protection measures under increasing pressure in all NAFTA countries.

NAFTA's Investment Chapter contains a provision which states that the three NAFTA countries should not waive or weaken their existing environmental measures as a means of attracting investment (Article 1114). This clause is the principal attempt in NAFTA to address the possibility that investment shifts following NAFTA's implementation could lead to the growth of "pollution havens" (jurisdictions with relatively lax environmental laws, where costs are lower but goods can be freely exported to the other markets). The non-binding language used in Article 1114 gives it little clout. Moreover, it does not address pre-existing differences in the environmental policy framework among the NAFTA countries.

Any increase in trade associated with NAFTA implies that more goods are transported farther than before. Increased transport of goods places new strains on existing transportation infrastructure and causes increased energy use, pollution, resource depletion, waste generation, and climate change. It also increases political pressures for the development of transportation infrastructures, and decreased regulation and taxation of transportation. For similar political reasons, wider demand for raw materials may set back conservation initiatives and/or lead to more rapid depletion of resources.

International environmental agreements often use trade sanctions against non-signatories to encourage compliance. NAFTA permits several such pacts — including the Montreal Protocol on ozone-depleting substances, the Basel Convention on waste transfers, and the CITES agreement regarding endangered species — to supersede NAFTA if conflicts arise. All NAFTA parties would have to agree before any future international environmental agreements would be allowed to take precedence over NAFTA (Article

104). This, effectively, could allow any one NAFTA party to veto its trading partners' flexibility to become active partners in future agreements designed to address global environmental issues ( e.g. biodiversity, forestry, climate change, or Arctic pollution).

NAFTA's energy chapter, from which Mexico negotiated an exclusion, prohibits nearly all quantitative restrictions on energy exports (Articles 603 through 607, and Annexes to Chapter 6). The "proportionality clause" of the Canada — U.S. Free Trade Agreement is continued in NAFTA (Article 605). This clause states that even in an energy supply emergency, NAFTA countries must continue to export an amount proportional to the average of exports to total energy production during the three preceding years. All NAFTA parties but Mexico may thus be prevented from acting to meet domestic needs first in an energy crisis. Other goods, apparently including water, are covered by the same rules (Article 315).

Government action is central to virtually all efforts to internalize environmental costs of production and implement the widely-accepted "polluter pays" principle, thus making economies more sustainable. In Canada, it is primarily provincial governments which face this challenge. The chilling of progressive environmental policy because of fiscal contraction and fear of trade disputes may be NAFTA's broadest and longest-term negative environmental legacy.

The argument that trade-induced economic growth will make more financial resources available to devote to environmental protection has been contested by many environmentalists, who argue that tax revenues are unlikely to rise in Canada due to competition for investment dollars and to declines in personal income tax revenues.<sup>2</sup>

Instead, NAFTA weakens the capacity of governments to impose regulations on private investors — such as environmental taxes, standards, and emissions controls — since firms can play jurisdictions off against each other in new ways, producing in and exporting from the jurisdiction where production costs are lowest. NAFTA disciplines go beyond those of GATT in restricting the use of traditional trade sanctions to defend standards and other environmental regulations against erosion.

As an example, let us consider a hypothetical provincial regulation concerning allowable lead emissions from a smelter, as measured in parts per

million of lead detected at a high-volume air filter near the smelter over a certain period of time. In Canada, regulations of this type are enacted pursuant to a provincial *Environmental Protection Act*; some federal standards and regulations pursuant to the federal *Environmental Protection Act* may also apply to smelter emissions. In very general terms, a challenge to either the federal or the provincial regulation could arise under NAFTA on any of several different grounds (relevant references from the texts of NAFTA and the North American Agreement on Environmental Cooperation are listed in footnotes to each):

- 1) If it were regarded as lenient in comparison with emissions standards in effect in some other NAFTA jurisdiction, the lead regulation could be cited as a government incentive for metal exports or a discouragement of imports from other countries where lead standards were more stringent.<sup>3</sup>
- 2) On the other hand, if the regulation were regarded as stringent in comparison with other NAFTA jurisdictions, the provincial standard could be challenged as a restriction on metal exports.<sup>4</sup>
- 3) Again, if it were regarded as relatively stringent, the regulation could be cited as a deterrent to investment in the Canadian province because, for example, it might require the prospective investor to employ pollution control equipment or technologies not used in the investor's home jurisdiction or in other NAFTA jurisdictions.<sup>5</sup>
- 4) The regulation, whether relatively lax or stringent, could be viewed as constituting a disguised restriction on trade in goods or services.<sup>6</sup>

It remains to be seen, of course, whether any of these positions would be found convincing by a NAFTA dispute panel or investment tribunal (composed of experts in international law and investment).

As noted, a defense of the provincial emissions standard under NAFTA would have to show that the standard is adopted in pursuit of a "legitimate objective" (Article 904.2) and that its implementers avoid "arbitrary or unjustifiable discrimination against goods or services" (Article 907.2), and/or that the regulation is based on relevant international standards, affording other NAFTA countries national treatment and most-favoured nation status.<sup>7</sup>

In contrast to the Canada-U.S. Free Trade Agreement, which specifically exempts provinces from the standards chapter, NAFTA states that the federal government must "seek, through appropriate measures, to ensure observance" of the bulk of the standards chapter by provincial and state governments and by non-governmental standardizing bodies. It is unclear what the federal government would need to do to satisfy a NAFTA panel that it had complied with this provision, in the event of a challenge by another NAFTA party involving a Canadian provincial measure.

In none of the situations cited above would the North American Agreement on Environmental Cooperation be particularly relevant. That agreement sets out dispute proceedings for use when domestic laws are not being effectively enforced by local authorities, but does not address dispute resolution in cases where different jurisdictions simply have different regulations.

In conclusion, NAFTA's effects on the future of environmental regulation may be summarized as follows:

- 1) The ambiguities in NAFTA regarding allowable types of environmental regulations and enforcement procedures make challenges likely as dispute settlement precedents are established. This can be expected to have a chilling effect on jurisdictions' creativity and initiative in making environmental policy.
- 2) Private firms have new options for challenging or evading government policy due to NAFTA's emphasis on investment and financial services. This has implications for both government fiscal capacity in general and environmental policy in particular.
- 3) The allocation of government funding for environmental protection may be skewed by NAFTA's requirements, especially those regarding harmonization of standards and enforcement procedures.
- 4) Transportation and primary materials development subsidies are likely to receive an impetus, influencing overall environmental policy strategies away from conservation and throughput-reduction.

- 5) NAFTA parties have less flexibility than other countries to comply with international environmental agreements which include trade measures as an enforcement mechanism.

Taken together, these considerations cast a significant pall on the statement in NAFTA's preamble that the parties see NAFTA as a way to "promote sustainable development" and "strengthen the development and enforcement of environmental laws and regulations." □

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#### Endnotes

- Many environmental standards are also covered by NAFTA's section on "Sanitary and Phytosanitary Measures," or policies covering the safety of foods and animal feedstuffs, as well as pest and disease control measures. NAFTA's rules in this regard, found in Chapter 7, Section B of the agreement, are somewhat different than the Standards rules.
- Bruce Campbell, "Globalization, Trade Agreements, and Sustainability" in Canadian Environmental Law Association, *The Environmental Implications of Trade Agreements* (Toronto: Ontario Ministry of Environment and Energy, 1993) at 60-61.
- NAFTA Articles 1902.1, 901.1, 904.4, 309, 315, 905, 907, Annex 2004, and NAAEC Article 3. GATT rules, in contrast, as found in the Technical Barriers to Trade agreement, apply to characteristics of traded goods themselves (not to production process standards). The GATT panel decision on the tuna-dolphin case underscores this distinction. See Sandra L. Walker, *Environmental Protection versus Trade Liberalization: Finding the Balance* (Brussels: Publications des Facultés universitaires Saint-Louis, 1993) at 87-96.
- NAFTA Articles 309, 315, 904.4, 905, 907, and Annex 2004. GATT contains no similar language regarding investment or financial flows.
- NAFTA Articles 1106, 1108, and Annex 2004.
- NAFTA Articles 904.2, 907.2, and Annex 2004.
- The dense language of the Standards chapter makes it likely that disputes will proliferate until some clarity is provided by successive dispute panels. This, in turn, may discourage jurisdictions from exploring creative new environmental policy approaches or simply from making progressive improvements in their regulations to maintain or improve environmental quality.

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