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***Assessing the Impact of NAFTA on
Environmental Law and Management Processes***

Working Paper

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Through the combination of its substantive provisions, adjudicative processes and enforcement mechanisms, trade law has a significant impact on how governments can take environmental decisions and enact environmental measures.

This paper undertakes a survey of the application of trade law rules to environmental management and decision-making by governments. It correlates five generic stages of environmental management against seven major trade law disciplines that are particularly relevant to measures for the protection of the national environment.

The initial assessment that results from this analysis suggests that most existing and many future environmental measures would not survive trade law challenges since the increase in independent disciplines under NAFTA and the 1994 WTO Agreements. For older measures, the risks of an environmental measure being found inconsistent with trade law in the event of a challenge are high, as most trade requirements simply appear not to have been considered in the course of environmental law-making in the 1970's-early 1990's. However, the risks of a challenge coming about are not high, based on current levels of challenges and the politically constraining fact they must be initiated by governments. In addition, in the event a measure is found inconsistent with trade law, at least under the World Trade Organization process, there is an opportunity to rectify whatever specific failures may be found, and to revise the measure as appropriate.

For new measures, the primary concern is the human and technical capacity to meet the trade requirements in a manner that is also consistent with the environmental management requirements. If the interpretations of the trade disciplines set forth in the paper are accurate, there are no inherent inconsistencies between them and environmental law-making to protect one's own environment. However, meeting all the requirements does require significant expertise sensitive to both the environmental and trade issues. This capacity is currently often lacking. This in turn poses risks of new measures falling afoul of trade disciplines, as well as of proposed measures being stalled in the policy making process due to either a lack of sensitivity to the environmental dimensions of the issues being raised or addressed by trade experts, or a related fear of trade challenges down the road. This dynamic creates a "hidden" risk to environmental protection. In addition, there is a risk that trade disciplines will not respond well to new developments in environmental policy, in particular new approaches to implementing pollution prevention strategies at the product source.

The risks in relation to the investment obligations in Chapter 11 of NAFTA are of a different order. The disciplines are broader and have now been given a wide meaning by

the first arbitral panels to consider them. The dispute resolution process is also initiated by private corporations, without regard for other national perspectives or constraints. Consequently, Chapter 11, if current interpretations continue in future cases, poses significant risks to environmental law-making across North America. The NAFTA Parties, do, however, have mechanisms other than amendments to NAFTA available to address these risks, if they choose to exercise them.

1. Introduction

The relationship between trade agreements and the environment has numerous dimensions. As evidenced in *Assessing Environmental Effects of the North American Free Trade Agreement* (CEC, 1999), the highest degree of attention is generally paid to the physical environmental impacts of trade liberalization and globalization on local, regional or global eco-systems, and to related impacts on human health and welfare. The reason for this is obvious: it is the physical impacts of changing trade and investment flows that, when they occur, are of most immediate concern to citizens, communities and governments.

That increased trade and investment flows can lead to significant development opportunities and resulting welfare gains is beyond doubt. However, a recent World Bank study suggests that maintaining net welfare gains from such development opportunities requires high levels of environmental management capacity to be developed and/or maintained in countries that actually receive such investments. Among the policy conclusions drawn by the authors of the study, a key one is that “the ambiguity of environmental effects of trade liberalization places heavy demands on existing institutions charged with environmental policy formulation and implementation – to

prevent potential problems and respond as negative effects appear.” (Fredriksson, 1999, 11)

Whether the environmental impacts of trade liberalization in general or NAFTA in particular are clear or ambiguous is to be debated elsewhere in this Conference. What this paper is concerned with is the impact of the trade and investment disciplines themselves on the ability of governments to meet the “heavy demands” for environmental policy formulation and implementation trade liberalization can create. Further, as the trade and investment disciplines apply to all environmental laws and policies, not just those developed in response to trade and investment-related stresses, the question must be expanded to include the potential impact of these rules on all environmental policy making and implementation.

This concern is equally relevant for developing and developed countries. The focus of this paper is not on the vexatious issue of the use of trade measures to address environmental problems beyond one’s borders, a form of environmental regulation that has frequently polarized the debate on the appropriate relationship between trade disciplines and environmental law-making. Rather, the focus of this paper is the legal impact of trade and investment disciplines on the ability of a country to protect its own environment and citizens. The question, in simple terms is: *What impact, if any, do trade and investment disciplines have on the ability of governments to protect their environment?*

At least one recent governmental analysis argues that developments in international trade law through the World Trade Organization do “not question the right of each WTO member to establish and implement environmental policies that are appropriate for its domestic context. They require only that the measures applied in pursuit of those policies must be consistent with the obligations assumed under the ...Agreements.” (DFAIT, 1999) Given the consistency of rules between the WTO and NAFTA, this statement would seem equally directed at the latter. It is the questions that arise from this statement that frame the discussion that follows:

- In a legal sense, why is it important for environmental management to be consistent with trade law obligations?
- What is the nature and scope of the trade (and investment) obligations assumed as they relate to environmental management decisions?
- Are these obligations generally consistent with the environmental management processes in the three NAFTA parties, do they require significant changes in those practices, or do they ultimately impinge on those practices?
- Given an understanding of the legal issues, what are the likely risks trade law poses to environmental management and decision-making?
- What different considerations arise in relation to international investment obligations, such as those in Chapter 11 of NAFTA, as opposed to the more traditional domain of trade rules?
- What recommendations might flow from the analysis of the preceding questions?

As a final introductory note, it is important to recognize that the NAFTA *trade* disciplines have yet to be used to base an environment-related trade law case between any of the three NAFTA Parties. Indeed, since the adoption of NAFTA, there have been no trade and environment cases initiated between the three Parties. Consequently, one must turn to the World Trade Organization cases for additional guidance as to the scope of the obligations contained in NAFTA. This cross referencing is quite pertinent not just from an analytical perspective, but also because Parties to the NAFTA have a choice as to whether or not to use NAFTA or the WTO agreements in the event of any challenge to an environmental measure they may wish to launch. (NAFTA, Article 2005) However, as it relates to *investment* disciplines, as opposed to trade disciplines, one does find a number of challenges to environmental measures over the past four years, and a growing body of law emerging directly from the NAFTA.

2. The Constitutionalization of Trade Law: Why Trade Agreements Have Become So Important

Elsewhere, the present author has considered the legal reasons why trade agreements and the obligations (disciplines) they contain have become so critical today. (Mann, 2000, 389-392) In summary form, the reason lies in the emerging constitutional nature of trade agreements. Constitutional laws can be understood to have three basic elements:

1. Constitutions tell governments what they can do and how they can do it, especially vis-a-vis the rights of others;

2. Constitutions contain processes to adjudicate these restrictions on governments;
and
3. Constitutions generally provide processes for sanctioning a failure to abide by the law imposed and/or judicial determinations in relation to them.

Trade agreements today tell governments what they can and cannot do, and how they can or cannot do things, in a wide range of areas. What began largely as a tariff regulation process in 1948 now covers virtually every form of regulation that might impact on trade, including environmental, health and safety, government procurement, cultural protection, and other areas of government activity. This is part of what is included in the process of broadening and deepening the trade disciplines.

Trade law provides for mandatory adjudication of state actions when a complaint is raised by another state party to the agreement, or in the case of investment laws by a foreign investor acting in their own right. Under the World Trade Organization and NAFTA (including Chapter 11 on investment), these processes are now binding in law. This is different from the pre-NAFTA period, when disputes under the General Agreement on Tariffs and Trade (GATT) agreements, had to be adopted on a unanimous basis, including by the Party “losing” the dispute.

Finally, trade law has a sanctioning process, through tariff adjustments or other financial penalties in the form of “damages”. Despite the difficulties that surround enforcement issues today – which are not surprising given the process is just five years old – there is

no denying that the addition of this element completes a legal picture that gives trade law and trade disputes real legal impact today.¹

Because trade law addresses governmental activities (with some exceptions), this combination of features can be understood as creating a new constitutional structure directly applicable to governments that are party to the regimes. In this regard, trade law is arguably the most successful branch of international law in place today. Before decrying the success of trade law as a massive breach of state sovereignty, it should be considered that the ability to set and enforce global rules is the goal of every branch of international law, only few of these other branches have begun to approach the level of success of the trade system measured in terms of breadth of rules and their enforceability.² It is this very success as an international process that gives trade law (and associated investment rules) its critical importance for environmental decision-making and management.

Recognizing the importance of trade law is but the first step in understanding its impacts. Equally important as its legal status is its content: the substantive and procedural obligations that are imposed. In sections 3 and 4, the nature and scope of these obligations is described and co-related to different stages of the environmental management process. An overall “risk assessment” is then undertaken as to whether the

¹ This impact now occurs regardless of the legal status of an international agreement under domestic constitutional law, for example in the United States and Canada, where different legal approaches to the internal status of an international agreement prevail. Because the adjudication and enforcement takes place directly under the international regimes, the domestic status of the agreement is not an impediment to the conclusion that trade law has achieved a constitutional status through its international level of application and implementation. (See also Schneiderman, 1996, on this issue)

obligations pose a significant “threat” to environmental management. Additional considerations relating specifically to the environmental impacts of investment rules under Chapter 11 of NAFTA are then addressed in a separate section. Finally, some “risk management” recommendations aimed at the cooperative, trilateral level are suggested by way of a conclusion.

3. The Nature and Scope of the Trade Obligations in an Environmental Management Context

3.1 The general approach of trade law to environmental issues

Before considering some specific issues, it is important to understand the overall context in which trade rules have considered environmental issues. First and foremost, trade law, including NAFTA, is oriented to the protection of trade and market access, and in particular the right of exporters to access markets. As such, rules for protecting market access have considered environmental and other regulatory measures from the perspective of preventing “non-tariff barriers to trade”. (Fried, 1997: 262-265) Non-tariff barriers can be understood as legal or other barriers to trade that might replace tariffs subject to reduction or elimination under trade agreements. For this reason, and because the trade fora are not intended to and do not have the capacity to generate environmental standards, trade bodies have essentially had a uni-dimensional, trade-impact focus on environmental management issues.

² It should be noted that this discussion in itself does not negate the sovereignty of states. The debate on sovereignty and trade law is not the subject of this paper.

At the same time, trade agreements have recognized the need for Parties to be able to effectively address environmental issues. This is seen increasingly in preambular paragraphs such as those in NAFTA that expressly recognize the need to proceed “in a manner consistent with environmental protection and conservation” and to “Strengthen the development and enforcement of environmental laws and regulations.” (NAFTA, Preamble) It is also seen in specific provisions of trade agreements that recognize, for example, the right to achieve “legitimate objectives” of environmental protection. (NAFTA, Art. 904(2)) The achievement of these legitimate objectives is tied, however, to acting in accordance with the Agreements in question, thereby raising precisely the types of questions this paper has already noted. (E.g., NAFTA, Art. 904(1))

Beyond that, other provisions do create specific exceptions whereby trade rules can be breached for environmental protection purposes. However, according to the Appellate Body (AB) of the World Trade Organization, the right to rely on the environmental exceptions in the WTO context is “a *limited and conditional* exception from the substantive obligations contained in the other provisions of the GATT 1994.” (Shrimp-Turtle case, 1998, para. 157) It is the AB that highlighted the words limited and conditional in this passage. There is little to suggest that the exception provisions in the NAFTA would be approached in any different manner in a trade dispute context.

3.2 Identifying environmental management processes in a trade relevant manner

To the best of this author’s knowledge, there is no comparative analysis between the environmental management systems of the three NAFTA Parties. Indeed, such an

analysis, given the myriad of responsible agencies and jurisdictions at the federal, state and provincial levels, may well be an impossible task. This being said, it is possible to identify for analytical purposes different stages of the environmental management process in a generic form that can be transposed in further, more specific empirical analysis to the actual systems used in different jurisdictions and agencies.

Five key stages of environmental management can be suggested for present analytical purposes:

- ***Identification of a potential environmental problem:*** information on potential problems may arise from a range of sources. Once drawn to the attention of government officials, an initial assessment must be made to determine whether the information suggests an existing or potential problem may exist.
- ***Risk assessment of the problem:*** if it is determined that a problem may indeed exist or have the potential to occur, then a proper evaluation of the risk of the problem materializing, increasing and/or generating an environmental impact and subsequent human health impact is likely to be undertaken as part of an environmental management process, as is an assessment of the magnitude of any potential impacts.
- ***Identification of the appropriate environmental objective to address the risk:*** An environmental objective states what the environmental goal is in relation to the existing or potential problem. It can be defined in general terms or in specific technical terms, or both. For example, ensuring air emissions do not exceed the capacity of the receiving environment to absorb and neutralize them is an objective which can also be translated into specific parts per million emission levels. The

elimination of toxic substances from ambient air may be another goal, one that can be translated into zero emissions levels.

- ***Choosing an appropriate environmental management tool to achieve the objective:*** this can involve a review of several potential management options, ranging from voluntary codes to legislation and regulation. The application of different principles of environmental management, such as pollution prevention and the polluter pays principle, may be relevant in the choice of management tools. The nature and substance of a management option should be geared to the effective and timely achievement of the environmental objective.
- ***Implementing and enforcing the management tool:*** once chosen, the management tool must be adopted, implemented and enforced.

3.3 Identifying the most relevant trade law disciplines

Under trade law, each of these stages of environmental management is subject to specific rules or disciplines. The most relevant of these disciplines are described below in plain, non-technical language. This approach runs the risk of losing some legal accuracy, or at least subtlety. However, the objective here is a general survey of the relationship between the trade law rules and environmental management and decision-making by governments, rather than a comprehensive legal analysis. Thus, it is hoped that any loss of legal specificity is made up for by allowing a more comprehensive picture to be described in the space available.

- ***National treatment and most-favored nation treatment (non discrimination):*** The essence of the principle of non-discrimination is that Parties to trade agreements

should not treat imported products any less favorably than domestically produced products. The objective is to maintain equal opportunities for foreign producers to access foreign markets, or, in the reverse sense, to prevent protectionist measures from being adopted.

- ***No disguised barriers to trade:*** Under trade law, measures cannot be adopted under the guise of environmental protection in order to achieve trade or market-related objectives. This is known as a disguised barrier to trade and is not permitted. Several of the other disciplines below are relevant to assessing whether a measure may be a disguised barrier to trade, including basing a measure on sound science, the use of risk assessment, and comparisons with products having similar risk levels.
- ***Basing measures on sound science:*** Express requirements to base environmental protection measures on sound science differ as between sanitary and phytosanitary measures³ and measures related to protection of the physical environment falling under the technical barriers to trade rules. Under the Agreement on Sanitary and Phytosanitary Measures of the WTO (SPS Agreement), and the similar provisions in Chapter 7 of NAFTA, sound science is a fundamental requirement for taking legislative or regulatory initiatives. Under the WTO Agreement on Technical Barriers to Trade (TBT Agreement) and the similar provisions in Chapter 9 of NAFTA, which cover the great majority of environmental measures,⁴ it is not expressly required. However, as Prof. Worth points out, the absence of a demonstrable sound science

³ An SPS measure is one designed to protect animal or plant life or health from risks arising from the establishment or spread of a pest or disease, or to protect human or animal life from risks associated with food carried pests or chemicals to treat pests, and other food-related treatments. See Art. 724 of NAFTA for a full definition.

⁴ This is subject to the very recent WTO decisions in the *Asbestos* case, which is not factored into this analysis as it is now subject to appeal. In this ruling, the WTO panel held that product bans for

basis can be interpreted as sign a measure is either discriminatory or is not designed to achieve a legitimate environmental objective, or may be more trade restrictive than necessary. (Worth, 1994, 1-3) Hence, even where not specifically required, development of a sound scientific basis may be an indirect requirement.

The idea of basing measures on sound science also provides a trade law structure for linking three different stages of environmental management into a continuum, risk assessment, identification of an environmental objective, and choosing a risk management tool.

- ***Undertaking risk assessments:*** Risk assessments are required in the sanitary and phytosanitary measures context, including the use of internationally recognized assessment processes or scientific protocols for this purpose. But risk assessments are not mandatory for the bulk of environmental measures that would otherwise be addressed under the technical barriers provisions of NAFTA or the WTO. However, under TBT provisions, once a risk assessment is undertaken a failure to apply sound scientific principles and protocols does lead to the potential implication that the process was a “mask” for other non-environmental purposes, or a disguised barrier to trade. Hence, where a risk assessment is employed, there is an implied need to ensure it reflects appropriate standards.

- ***The use of international standards in both procedures and final decisions:*** Under trade law today, the use of international standards in relation to specific environmental measures carries with it an assumption of consistency with trade rules. While this does not mean that the use of a different standard is not consistent with trade law, it does generally mean that the use of a different standard will carry with it the burden of proof to establish why a different standard was used. This will often carry with it the requirement to provide the scientific basis for such differentiation.

The use of international procedures and protocols for conducting risk assessments is addressed under the risk assessment heading.

- ***Acting in a non-discriminatory manner as between similar types of risks:*** Comparisons for purposes of assessing whether a measure is discriminatory have been extended under trade law today to include comparisons between toxic and non-toxic products having similar uses, and to products carrying similar potential risks but which may have no direct commercial substitution relationships. (Australian Salmon case, 1998) The intent here is to assess consistency of treatment of risks in order to determine whether the identification of an acceptable level of risk or an environmental objective in any given case may reflect a “hidden” market-related or protectionist objective that is contrary to trade law.
- ***Applying least trade restrictive measures:*** This is a classic part of trade law as it relates to environmental issues. In the application of environmental measures, in

particular under the environmental exception rules of Article XX of the GATT, 1994 (which are also incorporated into the NAFTA, per Article 2101), the obligation is not to have no trade impacts but rather to have the least restrictive impact on trade consistent with achieving the environmental objective. Here, the disciplines require an assessment of potentially effective tools or measures against each other to determine which, from among those capable of effectively achieving the required result, is least trade restrictive. The discipline does not require the elimination from consideration of any given measure because it does have a trade impact. The risk management capacity of a Party is one relevant factor here. (See, e.g., *Asbestos case*, 2000)

Under NAFTA and the WTO Agreements, each of these disciplines now operates independently of each other. Where the previous GATT law first required a breach of the non-discrimination disciplines before the other disciplines arose, now a complaining Party may base a complaint on any or all of the relevant disciplines.⁵ Hence, all the disciplines have to be met for a measure to be consistent with trade law.

The disciplines noted above apply to all stages of the environmental management process, from the underlying evaluation of a problem to the design and implementation of a measure. This is inherent in the nature of the disciplines, and their relevance to the different aspects of policy making and implementation.

⁵ Again, this is subject to a potential change in the law due to the findings in the *Asbestos* case.

Of major importance is the fact that the disciplines also apply retroactively to measures adopted prior to the NAFTA or WTO Agreements coming into force. This is seen, for example, in the language of the provisions of NAFTA that reference “maintaining” measures subject to the disciplines. (E.g., NAFTA, Article 904)

Trade law has also established that the trade disciplines apply not just where there is an actual impact of a measure on trade, but where there is a potential impact on trade. The purpose of this is to protect the right of market access free of discriminatory barriers. If for example, a measure prevents or restricts access to a market, it cannot be saved because there is no established trade in that product that is demonstrably reduced or eliminated.

4. Are Trade Obligations Generally Consistent With Environmental Management Processes?

Table 1 below provides a summary assessment of the consistency of the trade disciplines to the generic stages of environmental management and decision-making by governments described above.

TABLE 1

As regards the initial stage of *identification of an environmental problem*, the principle objectives of the relevant trade disciplines are to avoid political distortions in identifying

existing or potential issues for further work due to other market-related issues. In short, environment problems should be identified and made subject to initial assessment on their own merits, not on the basis of trade issues. Here, there is no apparent conflict between the two areas. Indeed, the application of the disciplines may actually be useful for environmental managers to avoid political pressures that can distort environmental priority setting based solely on actual or potential environmental risks, and associated human health risks.

In the *risk assessment* stage, it is noted above that the requirement to perform a risk assessment only applies to measures falling under the SPS provisions of trade law. However, the absence of a risk assessment can be seen in a disadvantageous light in relation to other disciplines, such as whether an environmental objective is discriminatory or creates a disguised barrier to trade.

There is nothing inherently conflictual between trade and environmental regimes here. Indeed, a sound risk assessment can help inform decision-making. However, there are legitimate concerns that risk assessments have significant capacity requirements associated with them, which may strain environmental resources. This includes the ability to identify sources of risks, sampling and testing methods, data management, etc.. In addition, several trade cases have argued that risk assessment themselves need to apply accepted international standards and processes in order to be seen as “legitimate”. (E.g., Australia Slamon, 1998, Beef Hormones, 1998) Consequently, while there are no legal

conflicts or conflicts in objectives, the practical consequences, especially in relation to capacity requirements, can be significant.

A related factor is the ability, in the absence of a substantial and comprehensive risk assessment capacity, to apply different types of assessment processes to different potential problems. Inconsistency between levels of assessment can be used as “evidence” of other motivations. Here, the availability of international assessment or assessments from other countries can reduce the burden. However, if the subsequent risk management measures differ from those associated with the risk assessment used, this can raise significant issues requiring further scientific and technical justification.

To the extent that transparency is an emerging process requirement at the international level for risk assessment, this can be a constructive contribution to the environmental management process as long as it is applied to all stakeholders equally.

Setting the environmental objective is a critical linking stage for trade law purposes. In simplistic terms, the environmental risk assessment tells what the risks are and why an environmental objective needs to be set. Setting an environmental objective tells officials and stakeholders in clear terms what needs to be achieved. And the risk management decision tells how the objective is to be achieved. Thus, setting the environmental objective becomes the link between the assessment and management processes. Trade law cases have now clearly established this conceptual chain. (E.g., Australian Salmon,

1998), thus making it especially relevant for environmental managers to consider how this is done.

For trade law, the environmental objective provides a fundamental point for comparison among commercially substitutable products and between differing products having similar levels of risk. Consistency in identifying comparable environmental objectives in relation to comparable risks supports the bona-fides of a measure. Conversely, significant differences in the nature of the environmental objectives for similar risk levels can be used to suggest trade-related motives behind a measure. Understanding the environmental objective is also the critical touchstone for comparing the trade impacts of different tools that might notionally be available to achieve the objective, as seen in the next stage.

Trade law makes it clear that states are entitled to choose their environmental objectives, as long as they are not chosen for protectionist purposes. This serves to highlight the linkage noted above between the risk assessment/sound science disciplines and the setting of the objective. Once chosen, states are entitled to take the steps, including trade restrictive steps, necessary to achieve the objective. (NAFTA, Art. 904(2)) In an important statement, the relationship between the objective and the measures taken was summarized in 1994 by the OECD:

The ultimate goal of trade examinations, reviews and follow-up of environmental policies would be to ensure the achievement of environmental

objectives in ways that minimize undesirable trade effects, by identifying, if necessary, less trade restrictive options that would *equally satisfy the environmental objective*. (OECD, 1994, 19, emphasis added)

Choosing an appropriate environmental objective is clearly not inconsistent with environmental management processes. One area where challenges do arise, however, is the appropriate application of the precautionary principle to this stage. Here, the link with the sound science and risk assessment disciplines is important. How to assess the weight of scientific uncertainty against an acceptable level of risk, and establish an appropriate standard in response is the critical issue, and one which trade lawyers are increasingly recognizing does not belong solely in the hands of scientists. (Fraiberg and Trebilcock, 1998) Here, trade law may well face increased challenges, in particular if precautionary measures are limited to temporary measures, as suggested by some articles in NAFTA (E.g., Art. 907(3)) and elsewhere. (Beef Hormones case, 1998) One limitation on the role of the precautionary principle from trade law that is clear is that it should not be used to “invent” risks, but rather to weigh the importance of uncertainty surrounding risks. If seen in this way, the relationship may be less conflictual than otherwise, as long as precautionary measures are not limited in law to temporary measures.

The *choice of environmental measures* brings into play virtually all of the environment-related trade disciplines. This should not be surprising, as the chosen measure is the most visible manifestation of the management process, and the one with the most legal and trade consequences. In addition to the basic rules on non-discrimination, both as between

the source of origin of a product and products having similar risks, perhaps the most critical disciplines are those relating to not creating a disguised barrier to trade and the least trade restrictive tests. It is also important to recall the linkages between the setting of the environmental objective and the choice of risk management tool.

While different management tools may raise different issues, simply because a trade issue is raised does not mean the measure is necessarily a breach of trade law. Many trade measures can be taken that are fully consistent with trade law. Import bans, for example, may not be GATT inconsistent when they are non-discriminatory, i.e. when they are accompanied by domestic restrictions of equal impact. Similarly, many measures that are not trade measures per se but have an impact on traded products (for example if a ban on computer equipment containing lead solder were to be imposed) are also not necessarily breaches of trade law despite the obvious trade impacts they may have. Further, even if a mechanism would be a breach of trade law, it may fall within the environmental exceptions that allow for breaches to be justified. What trade law does require is an assessment to be made of these potential impacts in each given case, based on a comparison of potential management options. Like the risk assessment discipline, this can create significant resource requirements, often beyond the capacity of agencies to fully meet the requirements.

As a reflection of the key disciplines noted above, the choice of an environmental risk management tool is expected to have as small an impact on trade and market access as is possible to achieve the environmental objective. However, the trade disciplines do not

require that the achievement of the environmental objective be compromised in order to minimize trade effects. This is a critical interpretational point, which if correct and if applied not just in state-to-state disputes but also in internal government decision-making processes, minimizes the actual substantive impact trade law might otherwise have on environmental management tools. Appropriate internal capacity in different departments is likely required to ensure this approach is consistently applied. These capacity requirements remain a significant concern, given the need to have expertise in a combination of environmental and economic fields.

A new issue that is emerging due to the growing levels of industrial concentration is the need to regulate products with hazardous characteristics that are only sourced in foreign countries. Here, the ability to establish domestic comparisons may be limited, or even non-existent. As a result, a premium may be placed on the science/risk assessment disciplines noted previously. References for comparative purposes between different products with similar risk levels may also be important in this regard.

Finally, the stage of *implementation and enforcement* arises. This is critical, in particular given the ruling in the 1998 *Shrimp-Turtle* case, where the Appellate Body of the World Trade Organization made it clear that both the substance of a measure and its implementation are subject to review under trade law. (Shrimp-Turtle, 1998) The critical thread that runs through the disciplines here is one of non-discrimination in terms of access to the decision-making process, to rights of appeal of decisions, in the process of

enforcement, and so on. Due process issues have also been signaled in this area, such as actually having rights of appeal of a decision applicable against foreign producers.

In general, these issues should not pose significant problems in the NAFTA context.

However, if extended globally, significant resource and potentially cultural problems may well arise.

5. Risk Assessment: What are the likely risks trade law poses to environmental management and decision-making?

An initial assessment of the relationships set out in Table 1 and supplemented by the discussion in section 4, above, suggests that most existing and many future environmental measures would not survive trade law challenges since the increase in independent disciplines under NAFTA and the 1994 WTO Agreements. This assessment needs to be divided into measures adopted prior to the agreements coming into force, or shortly thereafter, and new measures adopted more recently or that may be adopted. *And, importantly, it must also be considered in the light of factors that mitigate the risk of actual challenges and the consequences of such challenges in order to reach an appropriate assessment of the risk posed by trade law to environmental management decisions.* (Note that the issues more specific to investment obligations are considered in the following section.)

The risks of an environmental measure losing a trade law challenge are significantly higher for older measures due to the basic reality that trade law factors were usually not

considered in the course of developing environmental measures.⁶ Hence, the specific requirements in trade law today cannot be met because the types of comparisons and processes required were, for the most part, simply not addressed and hence not undertaken. Given the independent and cumulative nature of all the disciplines, and their retroactive application to all preceding measures that are maintained, the chances of most older measures meeting all the requirement are very low.

However, the risk of losing a trade-based challenge does not mean all environmental laws are now jeopardized. First, trade law challenges (excluding the investment rules discussed below) must be brought by other states. This imposes an inherent political constraint on the idea that all laws are at risk. Still, those measures that have a significant impact on export opportunities for a party may well be at risk. Here, the second mitigating factor arises. Under the WTO dispute resolution process the consequence of losing a challenge is the requirement to bring the measure into consistency with the full range of obligations. This allows additional processes to be undertaken and/or adjustments to measures to be made. In other words, the measure must not automatically be withdrawn. (See, e.g., Australian Salmon, 2000, for an example of this response process in action.) This is not as clear in the NAFTA context, where the dispute resolution provisions indicate that the normal resolution after a loss will be the “non-implementation or removal” of a measure. (NAFTA, Art. 2018) However, this does not

⁶ This assessment is based on personal discussions with environmental regulators. As these discussions concerned the actual consistency of their work with trade law, they were conducted on a strictly confidential and not for citation basis. Hence, this “empirical” evidence may be less than a more extensive and detailed analysis on a jurisdiction-by-jurisdiction basis would require, and is certainly not applicable to any specific instance where a trade challenge may occur. However, the present author believes the information received is both credible and sufficiently representative of past practice to establish a general level of risk.

inherently preclude the adoption of a replacement measure in due course, though additional issues would undoubtedly arise and complicate such a process.⁷

In short, while the risks of losing a challenge to an older environmental measure are likely high, the risks of such challenges arising are not high, and other avenues beside the full withdrawal of a measure may also be available in the event of a loss. There are clearly risks to existing measures, but these should not be exaggerated in view of the other relevant factors.

For the adoption of new measures, the risks arise from somewhat different concerns. With the higher profile of trade law issues in internal government processes today, it is difficult to adopt new measures without considering the applicable trade disciplines. Here, a significant capacity issue arises. Extensive human resources are required with the technical, scientific, economic and legal expertise to effectively meet the full range of trade disciplines. Importantly, these human resources must have not just the capacity to address the trade issues, but the experience and capacity to address the combined trade and environment issues in a complementary manner. In Mexico, the indications are these resources are not widely available. This lack of capacity extends into the environmental management agencies in Canada as well, though likely to a lesser extent.⁸ Consequently, trade law can be seen as putting in place requirements that all Parties to the agreements do not have the capacity to meet. When trade law is considered not just in the NAFTA

⁷ One can, for example, expect subsequent challenges to the new measure, as well as a claim for non-violation nullification and impairment of benefits, another legal avenue for claims to be made under NAFTA.

⁸ See note 6, *supra*, re sources.

context but also in the broader global arena, this situation takes on additional dimensions and risks to the environment of developing countries. Significant capacity development will be required to fully compensate for the additional requirements imposed by trade law on environmental law-making.

This situation has also led to the apparent development of a new dynamic within governments: the potential jeopardizing of environmental measures prior to their adoption. Inter-departmental processes in all three countries can place a significant strain on the ability of environment departments to achieve their objectives in the face of trade law objections raised by other departments. If these objections are not equally balanced by relevant environmental considerations when brought forward, and environmental agencies frequently lack the capacity to address them internally to create such a balance, environmental protection measures can be lost or significantly delayed as a result. The response that would seem appropriate here is both an increase in capacity for environment departments to manage the application of the disciplines, as well as an increased awareness and sensitivity to the environmental issues by those providing other trade law inputs.

Closely related to the additional disciplines is the ability to apply those disciplines in the context of changing and advancing environmental protection strategies. Perhaps most important in this context is a potential conflict between pollution prevention as a policy direction of choice and the application of the least trade restrictive discipline to the choice of environmental risk management tools. Pollution prevention approaches are very

closely tied to product life-cycle management, and seek to prevent pollution problems before they arise rather than manage the risks they pose after the fact. This is not only sound environmental practice, but also reflects the polluter pays concept – often through product redesign or other process changes. Examples of such pollution prevention processes include extended producer responsibility, extended product responsibility and integrated product policy. (OECD, 1999) The common linkage among these approaches is that it is producers who are made responsible either to eliminate the cause of the potential pollution or to manage it themselves. Efforts in Europe to eliminate the use of lead solder in computer boards are an example of this, and one that poses serious trade challenges. But there are hundreds of other possible examples of products containing toxic material that could be subject to input substitutions as part of pollution prevention policies.

As trade law and resulting changes in investment promote the consolidation of manufacturing facilities and intra-company manufacturing processes, increased conflicts between pollution prevention as an optimal environmental policy and the goals of trade liberalization may well occur. Initial indications are that trade law can adapt to this, as seen in the result if not the reasoning of the most recent *Asbestos* case. (Asbestos, 2000) However, Canada has announced it is appealing this decision, arguing in part that the ability to manage the environmental risks after they are created is a less trade restrictive option that can achieve the same objectives. It is this type of argument that, if accepted, would raise in a significant way the potential for conflict between trade disciplines and the development of new environmental policies.

One solution repeatedly suggested by the WTO is for bilateral or multilateral negotiation of such issues. As product content issues become more directly involved in environmental management, however, it is unlikely the capacity exists for negotiations on a product-by-product basis. Thus, this area may well be a subject of some importance in the near future, and one where the capacity of trade practitioners to adapt to new environmental management strategies will be challenged.

6. Chapter 11 and the Environment: The Different Challenges and Risks of Investment Rules

Chapter 11 of NAFTA, on investment, was developed for two main purposes: to promote investment into Mexico as part of the NAFTA process by providing enhanced guarantees for Canadian and US investors concerning the safety of their investment; and to help protect those foreign investors from capricious action against them or their investments.

To do this, Chapter 11 provides a series of obligations on governments that in some ways parallel those of trade law, but in other critical ways also exceed trade law. Tied to the obligations is the right of individual investors to initiate an international arbitration proceeding against Canada, Mexico or the US if the investor is of the view that one of the obligations has been breached. Chapter 11 has been described as containing, in practice, the most extensive rights and remedies for foreign investors ever set out in an international agreement. (Mann and Von Moltke, 1999; Horlick and Marti, 1997)

Unfortunately, Chapter 11 provides little guidance on the application of these obligations in the context of environmental management and regulation. This has led to a number of challenges over new environmental laws or administrative decisions. Indeed, to date the exercise of these rights and remedies have been initiated approximately 20 times, with about half of these addressing adopted or proposed environmental laws. (Mann and Von Moltke, 1999, Annex 1, for a summary of the first thirteen cases.) The main obligations in Chapter 11 are noted in Table 2 below, with a note on the associated uncertainties.

TABLE 2

What is emerging from the first set of decisions in the Chapter 11 arbitrations must be seen as particularly concerning from an environmental management perspective. In essence, the uncertainties noted in Table 2 are being consistently resolved in favor of industry positions over environmental management requirements. Given the space constraints here, perhaps the easiest illustration of these concerns can be seen in the recent decision in the *Metalclad v. Mexico* case, released in August, 2000.

A key part of this ruling was the reference to only four NAFTA objectives as underpinnings for the interpretation of Chapter 11. These are transparency in government regulations and activity, the substantial increase in investment opportunities, ensuring the successful implementation of investment initiatives, and to ensure a predictable commercial framework for investors. (Metalclad, 2000, paras. 70-75) What was completely absent was any reference to other objectives concerning sustainable

development, the protection of the environment, and the promotion of sound environmental laws. It is difficult to assess the extent to which the entire ruling in Metalclad is predicated on this one dimensional allocation of underlying principles for Chapter 11.

The tribunal then considered the issue of minimum international standards of treatment, Article 1105 of NAFTA, and ruled that Mexico breached its obligation, in essence, by failing to provide a transparent, predictable framework for business planning and investment, and demonstrating a lack of orderly process and timely disposition in relation to an investor. The tribunal noted, in particular, that the investor had received conflicting assurances from government officials, and the government was under a duty under NAFTA to address any legal confusion the investor had and ensure it properly understood the law. The tribunal then ruled, despite contrary views officially put forward by Mexico, that the local municipality whose acts were in question in this case exceeded their constitutional authority, creating an additional breach of the minimum standards protection. This ruling on the constitutional authority of a municipal body is also of concern. (Metalclad, 2000, paras. 74-101)

Perhaps the most crucial finding is in relation to the protections against expropriation. Here the tribunal ruled that the same actions that lead to the finding of a breach of Article 1105 also lead to a breach of the rules on expropriation, given that no compensation was paid. This is the first time breaches of law-making process have been analogized to expropriation, and makes the scope of what constitutes an expropriation very unclear.

The Tribunal's apparent determination that an act outside the scope of authority of the municipality could itself found an expropriation complaint also raises questions about what limits are pertinent here.

More critically, the tribunal defined expropriation to include a "covert or incidental interference with the use of property". This is, potential, and almost limitless legal notion, encompassing any potential impact of an environmental law on the operation of a business. This expansive scope is enhanced by the tribunal's statement that it "need not decide or consider the motivation or intent of the adoption" of a measure. If this combination of statements holds in future cases, it effectively means the end of the concept of "police powers" as a legal counter-weight to the scope of what constitutes expropriation, whereby government activity to protect its population was legally excluded from the notion of expropriation. Consequently, any environmental law that interferes with the use of an investment to generate profit could fall within the scope of Article 1110, and require compensation. (Metalclad, 2000, paras. 103-111)

Finally, and paradoxically given its focus on transparency in the NAFTA as a fundamental objective, the tribunal expressly limited transparency in its own proceedings to disclosures required by national law applicable to the litigating parties, despite its express recognition that there was no legal provisions requiring them to impose such limits. This view is now being directly challenged in the proceedings in the Methanex case.

It must be noted that the initial interpretations in the Metalclad case are not necessarily correct (Mann and Von Moltke, 1999, s. 3), and remain to be confirmed or rejected by other, ongoing arbitration processes. Still, the risks now generated by this type of expansive reading of the expropriation and other disciplines in Chapter 11 are such as to make new environmental law making extremely difficult. Unlike trade rules per se, the adjudication and enforcement of investment rules can be triggered directly by private companies, thus eliminating the political constraint associated with state initiated actions. In addition, Chapter 11 has its own retroactivity: it applies to all foreign investments and investors of the three Parties prior to the entry into force of NAFTA in 1994, and its operation can be triggered by any new changes in the law impacting any of these investments. In that the breach of any of these disciplines leads to monetary damages rather than an order to rescind the offending measure, what is emerging is a substantial impact that significantly constrains the opportunities for new environmental law-making or other decisions impacting on industrial sectors with any foreign investors. In addition, this impact would, if continued, overturn the central principle of the polluter pays and establish Chapter 11 as an instrument requiring governments to pay the polluter. Further, the risk that this result might occur is beginning to have a substantial chilling effect on agencies charged with environmental protection functions, and has already led to the withdrawal of at least one measure following the initiation of a Chapter 11 proceeding to avoid higher damage awards.⁹

Overturning these initial interpretations, if it can be done, will now take additional time and thus create additional risks and delays for environmental protection processes. The NAFTA Parties, do, however, have mechanisms other than future case law and amendments to NAFTA available to address these risks, if they choose to exercise them. In particular, the

⁹ Again, see not 6, *supra*.

adoption of an interpretive statement under Article 1131(2) of NAFTA is available at any time the Parties may wish to do so, with such a statement legally binding on all pending and future arbitration panels.

7. Risk Management: Recommendations for Addressing Likely Risks of the Impacts of Trade Law on Environmental Management

A balanced assessment of the risks posed to environmental management and law-making by governments as a result of NAFTA and the WTO Agreements suggests a clear need to address capacity development in all countries to harmonize trade disciplines with environmental practices. Based on the interpretations of the key disciplines set out above, there would not appear to be any inherent conflict between the regimes. But ensuring this in practice will require sensitivity and awareness from practitioners and officials in both areas of practice.

What may be useful in this regard is a coordinated effort between the Free Trade Commission and the Commission for Environmental Cooperation to assess the trade disciplines against environmental management practices in the three Parties, and arrive at a common understanding concerning the relative concordance between these practices. This would also assist in ensuring a common understanding of the applicable disciplines, improve mutual awareness and expand opportunities for directed capacity building in all three countries.

As regards Chapter 11, the challenge for trade ministers to respond to the emerging definitions should be understood as a subject of major importance.

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Table 1: Relationships between Environmental management Stages and Trade Disciplines

Environmental Management Stage	Trade Disciplines Applicable	Nature of Requirements/Impacts
Identification of environmental problem	National treatment	Avoid politicization of issues based on related economic issues
	International standards and actions of other countries	Consider issues addressed at the international level or by other countries to minimize trade distortions, but does not limit problem identification to this
Risk assessment	Basing measures on sound science	Risk assessment is a scientific function, requiring the utilization of sound scientific principles and practices; major impact is capacity requirements
	Applying international standards and processes	International processes and protocols should be applied when possible; major impact is capacity requirements; transparency and peer review of assessments are an increasing part of acceptable international process standards
Identification of environmental objective	Basing measures on sound science	Linkages to the risk assessment; creates the need to balance precautionary principle with the scientific basis for a measure
	International standards and processes	Use of international standards creates presumption of consistency with trade law; non-use creates potential burden to justify any differences
	Comparison of risks among different products	Consistency in identification of objective compared to levels of risk; non-discrimination based on country of origin of product/risk
Identification of appropriate environmental management tool	Basing measures on sound science and on environmental objective	Completes linkages among the three stages and related disciplines

	National treatment	Non-discrimination in measures and standards based on country of origin
	No disguised barrier to trade	Measure cannot exceed what is necessary to achieve the objective
	Least trade restrictive	Measure cannot exceed what is necessary to achieve the objective; creates significant capacity requirement to compare potential measures
	Use of international standards and processes	Presumption of trade consistency when used; raises need to justify differences when not used; capacity required to identify such standards
	Comparison of risk management among products with similar risk levels	Consistency in applicable measure compared to levels of risk and environmental objectives; non-discrimination based on origin of risk; capacity requirement, though perhaps less given internal access to comparable regulations and decisions
Implementation and enforcement of management tool	National treatment	Non-discrimination in application of measures
	No disguised barrier to trade	Application not to exceed implementation of the measure; equality of application
	Arbitrary or unjustifiable discrimination	Applies process related tests such as equal access to decision-making, rights of appeal of decisions, equal application of the measures compared to others, etc.; may create additional capacity requirements

TABLE 2: Chapter 11 Obligations and Uncertainties

NAFTA SOURCE	International Obligation	Uncertainties
Article 1102/1103	National treatment, most favoured nation (treat companies in like circumstances the same way)	How to apply this to individual cases, to continued ratcheting up of environmental standards, to possible liability issues that do differ for foreign companies, etc; what does “in like circumstances” mean in changing environmental contexts
Article 1105	Minimum standard of treatment (basic fairness and due process)	Appears to duplicate national treatment and expropriation issues in some respects; recently extended to procedural due process, right to be heard, right of appeal, legal duties on potential host government, etc.
Article 1106	Performance requirements (cannot require an investor to purchase inputs in Canada or sell outputs in Canada or outside Canada as a condition of investment)	Cases have argued that imposing a trade ban or standards having an import restricting effect creates a performance requirement that is illegal; argument not rejected when first heard by an arbitral body in <i>Ethyl</i> case
Article 1110	Expropriation (no expropriation without compensation)	Cases have argued that new environmental laws, especially with a higher effect on one or a few companies, creates an expropriation of their business that requires compensation; <i>Metalclad</i> decision suggests that any incidental interference with use of property for business can found an expropriation claim, and that motive for the measure is not relevant