Examination of the environmental consequences of trade regimes in Latin America*

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ABBREVIATIONS

ECLAC Economic Commission for Latin America and the Caribbean
EKC Environmental Kuznets Curve
FDI Foreign direct investment
FTAA Free Trade Area of the Americas
GATT General Agreement on Tariffs and Trade
IISD International Institute for Sustainable Development
MERCOSUR Southern Common Market
NAAEC North American Agreement of Environmental Cooperation (NAFTA's environmental side agreement)
NACEC or CEC Commission for Environmental Cooperation of the NAAEC
NAFTA North American Free Trade Agreement
NGOs Non-governmental organisations
PPMs Processes and production methods
UNCTAD United Nations Conference on Trade and Development
UNEP United Nations Environment Programme
WTO World Trade Organization

INTRODUCTION

Like in most developing countries, Latin American governments have been worried about remaining competitive in world trade and attracting foreign investment as key aspects of their economic development. Nowadays, the region is experiencing a race of negotiations of bilateral free trade agreements in addition to regional trade agreements consolidated during the last decades. However, the process of trade and investment liberalisation raised important concerns about environmental effects. Those effects can be direct as a

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consequence of economic activities or indirect through the influence of trade regimes on environmental policies and management. This latter aspect is analyzed in this paper.

An overview of the liberalisation processes and their main drivers show how trade regimes have been gaining relevance in the national economic and political agendas of the Latin American governments. By the 1980s, economic pressures such as the external debt crisis and the following reduction of international private loans increased the value of foreign direct investment, which in turn led to competition for foreign capital through liberalisation and deregulation of economic activities (Ruiz-Caro, 2005, 13). These concerns were reflected in the macroeconomic reforms, export oriented development strategies and the shrinking of the state in productive activities that occurred in most Latin American countries over the past two decades (Schaper, 2000, 211). As a part of these strategies, trade and investment regimes have been reinforced in the region through different international accords at the multilateral, regional and bilateral levels at an accelerated pace, especially since the 1990s. The governments of the region expected to boost comparative advantages and trade gains as well as increase the inflow of foreign capital to offset the lack of domestic capital and accelerate economic growth. Despite these assumptions, the economic reforms and market integration attempts have not brought the expected benefits. In contrast, there is a great concern that foreign investment is not being channelled according to national and long-term development priorities (ECLAC, 2002 cited in UNCTAD, 2005a, 69).

Since the 1990s, the region experienced an expansion of trade regimes on account of the creation of the Southern Common Market (Mercosur) and the North American Free Trade Agreement (NAFTA), the strengthening of the Andean Community, the negotiation of various bilateral trade agreements within the countries of the region and other continents, and the starting of negotiations of a Free Trade Area of the Americas (FTAA) (Levy-Yeyati et al., 2003, 5). In July 2000 around 20 trade agreements within the Americas[1] were in force, a similar number were under negotiation, in addition to other cross regional agreements (WTO, 2000, 5-Chart 2). More recently, the FTAA negotiations came to a halt ("Uncle Sam visits his restive neighbours;…", 5 Nov. 2005, 65), however, the United States concluded bilateral trade agreements with Chile, the Central American countries and some Andean Community countries. On the Southern Cone, in July of 2006, Mercosur enlarged its jurisdiction with the membership of Venezuela ("Downhill from here; Mercosur's summit", 29 July 2006, 47). In terms of investment, "FDI [foreign direct investment] has received

[1] This refers to regional trade agreements under the following classifications: i*) free trade areas*, which are defined "as agreements among two or more parties in which reciprocal preferences (whether or not reaching complete free trade) are exchanged to cover a large spectrum of the parties' trade in goods"; and ii) *customs unions,* which are defined "as regional trade agreements with a common external tariff in addition to the exchange of trade preferences" (WTO, 2000, 2)

favourable treatment in most Latin American countries as part of a broader free-market and liberalisation policy put in place in the 1990s." (UNCTAD, 2005a, 69). The NAFTA and the ensuing trade agreements accorded by the United States with other countries in the region share in common the inclusion of investor protection provisions. In addition, other bilateral investment agreements have been signed by the countries of the region to an accumulated number of 451 by 2004 (UNCTAD, 2005a, 72).

This process of trade and investment liberalisation raised important concerns about environmental effects. Schaper suggests that trade liberalisation has changed the export and productive structure of the region and that the emerging structure is environmentally more vulnerable (2000, 212). Even though important efforts have been made to strengthen environmental policies and legislation in most Latin American countries during the last two decades, the application and enforcement of environmental laws remained weak and environmental degradation persists (Rodríguez-Becerra and Espinoza, 2002, 1; Schaper, 2000, 220; Larraín, 2000, 230; Acuña, 1999, 51). Given these conditions it can be questioned if there are aspects of current trade and investment regimes that affect the protection of the environment and what the present connotations of this relationship in the Latin American context are.

The hypothesis proposed is the following., In order to favour export oriented sectors and attract foreign investment, current trade and investment regimes in Latin America may: i) Influence environmental policy to reflect the needs of export sectors or converge to some standards of the primary markets; ii) Superimpose investment rights and investment protection measures on to public environmental concerns and open the gates to conflicts between the application of trade and investment norms and national environmental laws; iii) Slow down the capacity of governments and the willingness of decision makers to approach the fundamental environmental problems that result from trade and investment activities and adopt a 'minimalist' approach. The net result is a reduced space for further development of environmental policies in which trade and investment considerations turn into the main drivers of changes, as it is suggested by Zarsky (2002) as the actual worldwide pattern of trade-environment relationship.

Moreover, negative environmental effects of trade and investment regimes can be amplified by the fact that the export structure in the region relies partly on environmentally sensitive industries and those intensive in natural resources (Schaper, 2000, 212; Ruiz-Caro, 2005, 11), and that 15% of foreign investment is concentrated in the primary sector (Ruiz-Caro, 2005, 13). Then, an increase of these activities due to trade or investment flows may require solid environmental policies. Those policies should stimulate internalisation of environmental costs and mitigate or prevent environmental damage by reinvesting revenues of environmentally sensitive industries as well as those that require intensive use of natural resources toward the protection of ecosystems. This is not the current case and there is no sign that there would be political will to exert those changes in the short term.

Some basic concepts need to be clarified. For the purpose of this document, *trade* refers to international trade of goods and services. *Investment* refers to foreign direct investment (FDI). FDI exists when there is "… control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate)." This type of investment "… implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy." (UNCTAD, 2002). *Regimes,* as described by Krasner, are "… sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations." (1982, 186). The negotiation and practice of trade and investment agreements can be considered core to the formation of trade and investment regimes. Those agreements, arranged at the international level, are incorporated into national legislation and constitute a part of the legal and policy framework of trade and investment activities within a country. They express *principles*, *norms*, *rules* and *decision-making procedures*. Thus, for the purpose of this document, those agreements are considered as regimes.

This document focuses on the cases of NAFTA and Mercosur because they are the most influential models of trade and investment regimes in the region. The former has been operating since 1994 and its negotiations were accompanied by an environmental debate that led to an environmental agreement on the side. NAFTA includes a special section dedicated to investment provisions and investor rights and it has been used by the United States as the main precedent for following trade agreements with Central American, Caribbean and South American countries. Moreover, it can be expected that a future Free Trade Area of the Americas may contain similar provisions to NAFTA and other agreements already in force between countries of the region and the United States. The latter, Mercosur, is the most important example of economic integration in the region with a dynamic intraregional market and the biggest economic power in the Southern Cone, its leading member being Brazil. The negotiation of Mercosur did not involve an environmental debate such as that of NAFTA. However, there are many concerns about the environmental implications of intraregional energy and infrastructure projects and the burden of environmentally sensitive industries and those intensive in natural resources. In addition, there is a great deal of uncertainty about how environmental policies will be harmonised within the economic integration process.

The methodology used consists of: i) a review of some of the theoretical approaches to the interface between trade and the environment that are suggested as more adequate for the case of Latin America; ii) a review of studies of the environmental concerns that surround the negotiations and practice of NAFTA and Mercosur; and iii) an analysis of the findings of the two cases. It should be noted that according to the available literature the case of Mercosur is less studied in comparison to NAFTA. This document relies on

secondary sources and does not constitute a comprehensive analysis. Its aim is to identify the general trends of the relation between trade-investment regimes and the environmental management in Latin America.

ANALYTICAL FRAMEWORK

In examining the possible environmental consequences of trade and investment regimes in Latin America some analytical considerations must be taken into account.

The differentiation between the environmental consequences of trade and investment as economic activities, and those related to their regimes should be noted. This differentiation is not always explicit in the debate on free trade and environment. Trade and investment agreements are incentives to allow the expansion of economic activities but they are not the activities as such. It is expected that they influence how such activities evolve; however, there might be a number of other factors that stimulate or constrain trade. Economic activities in general involve processes such as extraction of resources, transformation, production, transportation and consumption of goods and services with consequent impacts to the environment in terms of pollution and resource depletion. Therefore, increases in trade and investment flows may necessarily cause various physical and economic impacts on the environment that can be classified in relation to the products being traded, the scale and composition of production and other effects derived from activities such as transportation (OECD, 1994 cited in UNEP and IISD, 2005, 45-50). These physical impacts need to be differentiated from those caused by the application of norms and rules derived from international agreements and the interaction between trade and environmental laws (UNEP and IISD, 2005, 53). This last set of impacts are the main focus of this analysis.

The interaction of international trade and investment regimes with environmental policies is mediated by an unbalanced reality: the predominance and influence of economic and commercial concerns above other public issues. Firstly, the broadening and deepening of international trade disciplines should be noted. As Mann pointed out, "There is little doubt that 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." (2000, 6). International trade agreements are covering other forms of regulation (including environmental), that might have an impact on trade. In this sense, international trade law and associated investment rules, due to their ability to set and enforce global rules, are conforming to "… a new constitutional structure directly applicable to governments that are party to the regimes." (Mann, 2000, 7). In contrast, there is a lack of this capacity of enforcement in international environmental law, due in part to its inability to sanction governments. Nonetheless, agreements under the World Trade Organization (WTO), at the multilateral level, or NAFTA, at the regional level, establish that environmental policies should be consistent with trade obligations and disciplines. But, "… why is it important for environmental management to be consistent with trade law obligations?" (Mann, 2000, 4)

Secondly, economic policies exert overarching influence over other public realms. As Ekins pointed out, "in all countries, environmental policy is enacted with reference to other policy objectives, of which economic policy objectives are among the most important." (2003, 165). Therefore, "the most difficult environmental policies are those which are perceived to have a negative impact on the economy." (2003, 165). For instance, neo-classical trade economics "… tends to stress the dangers of environmental policy for the trade system rather than the reverse." (Muradian and Martinez-Alier, 2001a, 281). Policy measures that promote exports or trade liberalisation and inward foreign direct investment tend to capture great attention of governments compared to environmental issues. This situation can be more acute in many developing countries due to factors such as a higher dependence on FDI, which "… is now the largest source of development finance for developing countries." (Gentry, 1999 cited in Ekins, 2003, 166).

Any perspective on the environmental policy impacts of trade and investment regimes have to consider the importance of competitive pressures as well as the process of policy harmonisation involved in trade agreements, in particular regional agreements and economic integration processes. Attending to these factors, Zarsky (2002) suggested that environmental policies are "stuck in the mud", referring to the situation in which, "… in the absence of effective multilateralism, economic globalization inhibits innovation in national environmental policy, and thus the rate of improvement in environmental performance." (2002, 19). By economic globalisation Zarsky refers to the dual and interrelated impacts of international economic institutions and markets. The main arguments exposed by Zarsky (2002, 24) are as follows: First, "… the constraints of competitiveness induced by globalization retard the capacity and willingness of *all* nation states to take *any* unilateral measures that imposes costs of good environmental management on domestic producers."; Second, "… the pressures of policy convergence mean that measures that *are* taken will only be those in step with primary competitors."; As a consequence, "… markets become the primary drivers of changes in environmental performance", and in addition, "… environmental managers are pressured to maintain the status quo or to change it only incrementally." This approach has inspired the current analysis of the cases of NAFTA and Mercosur.

Zarsky's (2002) "stuck in the mud" perspective seems to be more adequate to analyse the effects of trade and investment regimes on environmental policies compared to, for example, "… the Environmental Kuznets Curve (EKC) hypothesis, which in crude terms states that environmental quality tends to improve beyond a certain income threshold" (Ekins, 2003, 164), or the "pollution havens" hypothesis which argues that developing countries will attract "… 'dirty' industries because of their less stringent environmental standards" (Mabey and McNally, 1999 cited in Jenkins, 2003, 82). On the one hand, generalisation of the EKC hypothesis is used to argue the positive effects of trade on the environment, assuming that free trade leads to more affluent societies that will request stringent environ-

mental standards. On the other hand, the pollution havens hypothesis reflects the fears of a displacement of industries from developed to developing countries in order to take advantage of lower environmental compliance costs. However, as a review of Ekins revealed "… neither of the positions at the ends of the spectrum of hypotheses about trade-environment relationship can be sustained." (2003, 182). There is even very limited evidence to support EKC and pollution havens hypotheses-the policy community refers to them as consequences of trade liberalisation (Gallagher, 2004, 10).

A study by Gallagher (2004) that analysed the process of trade liberalisation in Mexico between 1985 and 2000 showed that neither the EKC nor the pollution havens hypotheses explain the environmental impacts of trade in this country. Jenkins (2003), in a study that evaluates the pollution havens hypothesis for manufactured goods industries in Argentina, Brazil and Mexico, found two different trends. This author showed that during trade liberalisation in Argentina and Brazil exports remained more polluting than imports suggesting a pollution havens trend that does not occur in Mexico (Jenkins, 2003, 91). However, this analysis was based on changes of economic composition during liberalisation processes, but did not consider changes in environmental policies. Therefore, it is not possible to conclude that an intensification of more polluting industries was due to low environmental standards and not by other factors. Furthermore, a core critique of the pollution havens hypothesis is that the economic costs of environmental degradation or environmental compliance costs in most industries are relatively smaller than many other operating or investment costs that determine comparative advantages or location decisions. (Gallagher, 2004, 11; Zarsky, 2002, 24; Batabyal, 1995 cited in Muradian and Martinez-Alier, 2001a, 283).

Even though the current analysis focuses on the impacts of trade and investment regimes on environmental policy, the consideration of the physical and economic effects of trade and investment cannot simply be set aside. If trade and investment regimes support and create incentives to certain economic and environmental relations, those have to be understood. As Ruiz-Caro pointed out, most exports of raw materials and natural resources have free or reduced tariff access to markets of industrialised countries, and one of the cornerstone ideas of the FTAA and the trade agreements of the United States is the deregulation of energy and natural resources sectors in Latin America (2005, 7). This shows the importance of trade regimes in orienting economic sectors and affecting the environment.

In this respect, a comprehensive and structural critique to the current trade system has been made by Muradian and Martinez-Alier (2001a; 2001b). These authors stress the notion of "environmental cost-shifting" or "environmental load displacement effects" caused by trade and investment flows between North and South (2001a; 2001b). This perspective is supported with some evidence of Latin America among other developing regions.

If one conceives international flows of cheap primary products (or environment-intensive products in gene-

ral) as "ecological flows", that is, as environmental-cost shifting from the importing to the exporting country, then freer trade can promote increasing environmental-load displacement from the importing to the exporting country (2001a, 286)

Thus, environmental problems can be unequally distributed by trade. "At the global level, there is a clear flow of primary commodities from poor to rich countries. …Clearly, the Third World is specialised in exploitation of natural resources." (2001a, 286). This negative trend can be exacerbated by other factors, such as low commodity prices (2001a, 287) and economic adjustment programmes (Guha and Martinez-Alier, 1997, 66) that push developing countries to maintain their revenues by selling growing quantities or increasing the exploitation of natural resources to diminish the burden of macroeconomic policies. Moreover, the world demand of natural resources and primary products is expected to increase faster due to factors such as the accelerated economic growth and urbanisation processes of countries like China and India (Ruiz-Caro, 2005, 16), in this case causing a South to South environmental cost shifting.

If Latin American countries specialise more in natural resources and environmentally intensive industries, the need for stringent environmental policies and sustainable development strategies will become more acute. What are the options and constraints that trade and investment regimes impose on Latin American countries when carrying out environmental policies? In the following sections, the cases of NAFTA and Mercosur will be analysed to track some evidence that expresses the relationship between trade-investment regimes and the performance of environmental policies.

MEXICO AND THE NORTH AMERICAN FREE TRADE AGREEMENT

The establishment of NAFTA in 1994 between the United States, Canada and Mexico, can be considered for the latter as a further step in a process of trade and investment liberalisation already in progress. Mexico started to open its economy in the 1980s and "… transformed itself from one of the most closed to one of the most open economies in the world." (Gallagher, 2004, 1). Between the mid 1980s and the mid 1990s, the average tariff was reduced from over 40% to 14%, and at the beginning of the 1990s the proportion of products covered by non-tariff barriers was less than 4% (Burki and Perry, 1997 cited in Jenkins, 2003, 83). The composition of Mexican exports and foreign investment has profoundly changed during the process of liberalisation. From the early 1980s to the year 2000, crude oil exports transformed its share of total Mexican exports from 80% to less than 10%, while manufactures increased its share from around 15% to close to 85% in the same period (Gallagher, 2004, 1-2). In terms of foreign investment, "… the regulatory framework became less restrictive and in 1989 a new set of rules repealed all previous regulations governing foreign investment and widened the range of operations where 100% foreign ownership was permitted." (Jenkins, 2003, 83-4). The FDI inflow has nearly tripled between 1985 and 1999 (UNCTAD, 2002 cited in Gallag-

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her, 2004, 2). The majority of FDI inflows in Mexico, (60%) has been directed to manufactures and an equal percentage of total FDI came from the United States (2004, 2).

In this context, the project of NAFTA was considered of strategic importance for the Mexican government. "… NAFTA was not simply about maximizing gains from trade, but was also designed to 'lock in'… economic reforms in Mexico. It was designed to convince multinationals that Mexico was an attractive site for foreign investment." (Dunnof, 2000, 258). Economic concerns were at the forefront of the Mexican political agenda when NAFTA was proposed and environmental concerns were seen as obstacles to the liberalisation process.

NAFTA's environmental orientation

The environment gained special political attention during the negotiation of NAFTA, from 1990 to 1994. Conflicting perspectives and interests, "… between the trade community and other sectors of society seeking social and environmental well-being", were reflected in the environmental debate (Various authors cited in Sanchez, 2002, 1373). Within the trade community were those who promoted and defended free trade such as business groups and transnational corporations, professional organisations, trade and economic agencies of the public sector of the three countries (Sanchez, 2002, 1373). The trade community stressed an optimistic scenario in which NAFTA increased incomes, improved environmental protection and widened access to cleaner technologies, in particular for Mexico (Schatan, 2000, 167).

Within the environmental community, "… the links of environmental groups with academic researchers were strong" (Hogenboom, 1998, 142). A range of environmental NGOs from the three countries, in which those in the United States were the more influential, were actively raising environmental concerns about NAFTA with different levels of opposition and political leverage and conducting alliances with other groups such as trade unions (1998, 142-155). Environmental NGOs in the United States "… feared that free trade with Mexico (with its notorious lack of environmental enforcement) would strengthen US corporate demands for less environmental regulation and create more opportunities to evade such regulations." (1998, 152). Thus, the environmental performance and enforcement of the law in Mexico turned into the central preoccupations of the debate. For instance, the creation of an environmental agreement, accompanying NAFTA, was a response to this controversy (Schatan, 2000, 168).

It is noticeable that the discussion of the environment gained importance due to the political leverage of the environment community in the United States that turned the Mexican environmental problem into a domestic political issue. After a long bargaining process, "NAFTA's drafters had to negotiate between including environmental provisions, respecting state sovereignty, and limiting standards and other technical barriers that could be used for protectionist ends." (Sanchez,

2002, 1370). As Schatan (2000) showed, in different periods of the negotiation, from 1991 to 1993, the governments of Bush and Clinton proposed initiatives to address environmental concerns and gain political support and congressional approval of the agreement, concluding with the establishment of the North American Agreement on Environmental Cooperation (NAAEC), also known as environment side-agreement (2000, 168-170). Sanchez (2002) pointed out that, while the United States perceived the institutions of the NAAEC "… as part of its compromise with domestic environmental groups to gain congressional approval of NAFTA." (2002, 1376), "Mexico and Canada did not face the same domestic pressures; for them, the NACEC [Commission for Environmental Cooperation] is part of the cost of NAFTA." (2002, 1377).

The environmental provisions of the agreement (Table 1) and the environment side-agreement (Table 2) were the result of the environmental debate of NAFTA. The central environmental aspects of NAFTA are the promotion of environmental cooperation and the enforcement of the law, an upward harmonisation of environmental standards and to channel public concerns about the performance of environmental policy through various means, including a dispute settlement process between individuals or organisations and governments that fail to enforce the law. Nonetheless, all environmental provisions are tied to the trade and investment objectives of the agreement. According to Hufbauer et al. (2000, 7) and Schatan (2000, 171), NAFTA is less restrictive for governments in terms of establishing own environmental standards and enforcing them on imports, in comparison with the General Agreement on Tariffs and Trade (GATT). Moreover, in case of a conflict with standards, "NAFTA's provisions place the burden of the proof on the complaining nation …" instead of GATT, "… where the offended country has to prove that its policy is consistent with the free trade provisions." (Hogenboom, 1998, 204). In this respect NAFTA seems "greener" than the WTO.

The environmental provisions of NAFTA and the environment side agreement seem to potentially have a positive effect on environmental policies. Nonetheless, there are central environmental issues that are not covered by NAFTA or its environment side-agreement, in addition to contradictions and problems revealed during the implementation. Moreover, a strong opposition from the governmental sector and the trade community to the development of these provisions became more obvious.

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TABLE 1. MAIN ENVIRONMENTAL PROVISIONS OF NAFTA

Preamble
It provides that the agreement should be implemented 'in a manner consistent with environmental protection and conservation', the promotion of 'sustainable development', and the strengthening of the 'development and enforcement of environmental laws and regulations'.
Chapter 1: Objectives
Article 102, about the objectives; does not mention the environmental issues brought up in the Preamble.
Article 104 specifies that obligations under certain international environmental agreements prevail over NAFTA. The list of environmental agreements covered by this article can be extended with the consent of all NAFTA members.
Chapter 7: Agriculture and Sanitary and Phytosanitary Measures
Articles 712.1, 712.2 and 713.3 provide to each party the right to establish its own level of 'protection of human, animal or plant life or health in its territory, including a measure more stringent than an international standard'
Article 715 states that parties should take into account considerations of risk assessment and levels of protection such as relevant scientific evidence, relevant process and production methods, inspection methods and relevant pest and diseases treatments, among others.
Chapter 9: Standards-Related Measures
Article 904.2 provides to each party the right to establish its own level of 'protection of human, animal or plant life or health, the environment or consumers'
Article 907.2 set the limits of the level of protection indicating that it should avoid: a) arbitrary or unjustifiable discrimination; b) constitute a disguised restriction on trade; c) discriminate between similar goods or services for the same use under the same conditions that pose the same level of risk and provide similar benefits
Chapter 11: Investment
The chapter provides investment rights and rules for the resolution of investor-state disputes through arbitral panels.
Article 1106.2 makes possible that countries demand that foreign investors comply with certain technological specification required by domestic environmental standards.
Article 1114 declares that 'it is inappropriate to encourage investment by relaxing domestic, health, safety or environmental measures.'

Source: author based on Schatan, 2000, 170-2; "North American Free Trade Agreement between the Government of Canada, the Government of the United Mexican States, and the Government of the United States of America" 1994.

TABLE 2. MAIN SECTIONS OF THE AGREEMENT ON ENVIRONMENTAL COOPERATION (NAAEC)

Objectives
The *objectives* (Art. 1) include: a commitment to improve environmental protection through cooperation in environmental and economic policies; The improvement of rules and laws that regulate environmental practices, as well as enforcement; An explicit commitment to avoid trade distortions and the creation of new barriers to trade in the form of disguised protectionism
Obligations
Article 2 defines obligations such as the preparation and publication of reports on the state of the environment, promotion of environmental education, and the promotion of economic instruments to pursue environmental goals.
Article 3 allows each member to establish its own priorities and level of environmental protection.
Article 5 defines particular actions to be taken by the parties to enhance and enforce domestic environmental laws.
Article 6 empowers interested persons to request the party's competent authorities to investigate alleged violations of its environmental laws and regulations.
Commission for Environmental Cooperation
Article 8 creates the Commission for Environmental Cooperation, comprised of a Council, Secretariat, and a Joint Public Advisory Committee.
Article 10 defines the functions of the Council. Among the most important is to assist NAFTA's Free Trade Commission in preventing and resolving disputes.

Article 13 entitles the Secretariat to prepare reports of any matter related to the cooperative functions of the agreement. Those reports are publicly available unless the Council decides otherwise.
Article 14 entitles the Secretariat to address the submission from any person asserting that a party is failing to effectively enforce its environmental law. If the submission meets certain criteria, the Secretariat will request a response from the party.
Article 15 entitles the Secretariat to consider if the submission warrants developing a factual record that can be available for the public, in the light of the response provided by the party.
Dispute Settlement Process
Articles 24 and 34. In cases where a party is alleged to have persistently failed to effectively enforce its environmental law, the Council can establish an international arbitrary panel to report, provide a remedial action plan, and levy monetary fines.
Article 36 establishes that in the event that the fines are not paid and the enforcement problem is not corrected, the parties (except Canada who avoids this obligation) have the power to impose trade sanctions.

Source: author based on Schatan, 2000, 170-4; Sanchez, 2002, 1371-2; "North American Agreement on Environmental Cooperation between the Government of Canada, the Government of the United Mexican States and the Government of the United States of America" 1993

Limitations and problems of NAFTA's environmental approach

There are a number of issues from the environment-trade debate that NAFTA and its environment side-agreement do not consider or treat ambiguously. In relation to the environmental provisions there are various concerns. Some of these provisions tend to be very weak in practice. For instance, there are no mechanisms such as trade sanctions for the enforcement of a country's environmental law, while upward harmonisation principles of environmental standards, even if included, are not mandatory (Hogenboom, 1998, 205). Schatan (2000, 178-9) identified various other aspects that are not covered by NAFTA: i) There is an emphasis on pollution control while natural resources and conservation related issues are not considered. "Hence, the dispute settlement regime cannot deal with unsustainable natural resource management, leaving some of the most pressing environmental problems apparently unattended." ; ii) The "polluter pays principle" does not seem to be included in the NAAEC. "The fine that may be levied on the party at fault (…) is not calculated on the basis of the cost involved in the environmental damage." Moreover, "… the fine is paid not by the polluting industry but by the governments, therefore it is not the polluting agent who suffers financially." ; iii) The NAAEC avoids dealing directly with "processes and production methods" (PPMs), or the way in which a product is made, which is a definitive issue in looking at the environmental footprint of production.

Other problems arose during the implementation of NAFTA. A detailed analysis by Sanchez (2002) showed the conflicts between NAFTA and the Commission for Environmental Cooperation, which impeded a satisfactory implementation of the latter. "The creation of NAFTA's environmental side agreement and the NACEC [Commission for Environmental Cooperation] led to expectations that the NACEC would become a key interface between the environmental and trade

communities." (2002, 1373). However, this scenario did not occur, in part because the opposition of the trade community to consider and discuss some of the negative consequences of trade on the environment, and the lack of political and economic support to the NACEC from federal environmental agencies (2002, 1373). Although an important duty of the NACEC is to assist NAFTA's Free Trade Commission, "… the two commissions have not met in 8 years …" (2002, 1374). This is "… a manifestation of the opposition of the trade community to allowing environmental issues to affect enforcement of free trade." (2002, 1374). A study by Blair (2003), that revised the citizen submission process established on the NAAEC, illustrated the fierce political opposition of the governments to this mechanism of public participation, because of the fact that it opens the gate to critics.

> This reaction underlines a basic design flaw in the NAAEC. There is an inherent conflict in a process that is intended to place governments under public scrutiny in potentially embarrassing ways but that is also open to control by those same governments (Blair, 2003, 318)

It should be noted that environmental provisions of NAFTA might not be very welcome by the environmental authorities, in particular those of Mexico. If they decide to raise environmental standards to very high levels what does it imply? Mexican firms, especially small and medium firms, would have a large disadvantage compared to American and Canadian ones in order to comply with the norms and implement technological changes. Therefore the government will face opposition. In addition, higher standards may imply greater efforts in terms of enforcement of the law that will require extra capacity and economic resources. In this hypothetical situation, a possibility is that environmental authorities would prefer to slow down the pace of new environmental standards or favour those which require less enforcement or are voluntary. This kind of situation can explain the "minimalist" approach to the interpretation of the provisions of the NAAEC by the three governments.

The impact of investor rights under Chapter 11

Foreign investment was a central issue within the political debate surrounding NAFTA. On the one hand, "the Mexican government recognized the need to attract and maintain foreign investors…" (von Moltke and Mann, 2001, 106); on the other, this was an opportunity for the United States to include the minimal standards required by American firms and liberalise the investment regime in Mexico (Morales, 1999 cited in Sanchez, 2002, 1382; von Moltke and Mann, 2001, 106). In this respect, the purpose of foreign investment in NAFTA negotiations was to provide "… 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." (Mann, 2000, 25). Thus, Chapter 11 of NAFTA incorporates an ambitious set of provisions regarding investment that has two components (2001, 106):

Section A sets out the obligations, or disciplines, on the three NAFTA parties in relation to foreign investors from the other two parties. It includes provisions for most favored and national treatment, it proscribes 'performance requirements', and has strong protections against direct or indirect expropriation. Section B provides, for the first time in a multilateral trade or investment agreement, a formal dispute resolution system that private sector foreign investors from one of the parties can initiate against the host government if they believe that one of these disciplines has been breached to their detriment, known as the investor-state process.

The main environmental concern results from the fact that the use of investor-state disputes of Chapter 11 has speeded up since NAFTA started to operate until now, and from 13 known cases initiated 8 are related to environmental protection or natural resource management (von Moltke and Mann, 2001, 110-1). Using the dispute resolution process, foreign investors "… avoid the use of domestic courts to address whatever legal issues are at the heart of the dispute, and go directly to the international arbitration process." (2001, 107). Moreover, this international arbitration process "… is largely devoid of the safeguards that exists in domestic courts to ensure a proper balance between private rights and the public interest." (2001, 107). The central problems for environmental policy and regulation have been identified by various authors and organisations that analysed the dispute process of NAFTA (Oliver, 2005; von Moltke and Mann, 2001; Mann, 2000; IISD and WWF, 2001). The most salient of these problems, as identified by Von Moltke and Mann (2001) are: the ability of the investor-state dispute settlement process to bypass domestic legal procedures, the inadequacy of commercial arbitration to deal with public concerns, the lack of transparency, impartiality and accountability of these types of processes and the giant costs of claims for governments.

The use of the dispute resolution system of Chapter 11 has been demonstrated to be a challenge for environmental policies of all NAFTA countries. A study of Oliver (2005) that analysed two cases of investor-state dispute of Chapter 11 showed the practical problems for environmental policy. For example, there is a potential source of conflict between NAFTA and precautionary-principle measures of environmental policies. Due to the fact that the terms of NAFTA established that regulatory action to ban certain substances or processes has to be based on credible scientific evidence, but a national or subnational authority decides to choose a precautionary approach to define the policy action, "… this action may be reversed by a NAFTA tribunal, or the member nation may have to pay reparations to corporations for lost revenues as a result of the regulatory action." (2005, 67). This author observed that multilateral trade agreements "… have the potential for eroding the sovereignty of nations, especially in regard to environmental and public health regulation." (2005, 67). The investor-state process seems to have been used as a "strategic offensive tool" of foreign investors that challenge public measures, instead of its intended role as a "defensive investor protection mechanism". (von Moltke and Mann, 2001, 108).

Two major factors can restrain governments' adoption of new environmental mea-

sures in the light of the conditions and actual use of NAFTA's Chapter 11: on the one hand, the insecurity and unpredictability of the fact that any measure can be challenged by foreign investors in an external legal system, and on the other, the risk of the costs of investor-state claims. According to Von Moltke and Mann (2001, 109), "the existing claims under Chapter 11 range in value from $10m-750m US."

> … if this agreement requires compensation to foreign investors for new environmental measures, this would significantly increase the costs of undertaking such measures, risking a freeze in existing laws regardless of how warranted new measures may be. This is directly contrary to the stated goals of NAFTA to operate in a context of the promotion of sustainable development, in a manner consistent with environmental protection, and to strengthen the development and enforcement of environmental laws (von Moltke and Mann, 2001, 109)

In the same vein, Dunoff argued that (2000, 258):

> NAFTA will understandably be reluctant to upgrade environmental standards if doing so can be deemed a compensable expropriation. While NAFTA negotiators devoted substantial efforts to ensure that the Agreement would not result in *lower* environmental standards, NAFTA's investor protection provisions may have inadvertently made it more difficult for NAFTA parties to *increase* their levels of environmental protection

MERCOSUR

The creation of the Southern Common Market (Mercosur) between Argentina, Brazil, Paraguay and Uruguay in 1991 was the result of previous attempts to initiate an economic integration process, especially between Brazil and Argentina (Tussie and Vásquez, 2000, 187). These two countries have encouraged trade and investment liberalisation since the 1980s. Between the mid 1980s and the mid 1990s, the average tariff in Argentina was reduced from over 50% to 14% and in Brazil from over 80% to 13%; the proportion of products covered by non-tariff barriers by the early 1990s was less than 1.5% in Brazil and 0.2% in Argentina (Burki and Perry, 1997 cited in Jenkins 2003, 83). From 1989 onwards, Argentina abolished restrictions on foreign investment in various economic sectors and by 1994 had totally deregulated FDI (Edwards, 1995 cited in Jenkins, 2003, 84). The aperture to foreign investment in Brazil was less rapid than in Argentina. The Constitution of 1988 imposed more controls on foreign firms, nonetheless, during the 1990s the Constitution was amended to allow further liberalisation policies towards foreign investment (Chudnovsky and López, 1997 cited in Jenkins, 2003, 84).

According to Tussie and Vásquez (2000, 187), the end of military regimes that led to democratic rule and the impulse towards market oriented economies in the region are the two pillars of the Common Market. "Mercosur could be understood as a means for member countries to expand outward towards foreign markets and attract foreign direct investment, in a context of unilateral and multilateral trade liberalization." (2002, 188). Under the Treaty of Asunción of 1991 member countries of Mercosur compromised on: i) liberalising trade among them; ii) creating a common

external tariff; iii) establishing a common trade policy in relation to other countries; iv) coordinating macroeconomic and sectoral policies; and v) harmonising national legislation. "Unlike NAFTA, Mercosur still lacks commitments on free trade in services or, on such controversial issues as intellectual property and government procurement. Nor do agreements allow free movement of labour." (2000, 189). Unlike the European Union, Mercosur does not conform to a supranational authority, but an intergovernmental association based on the consensus of its members (von Moltke and Ryan, 2001, 1) At the moment, Mercosur can be considered a customs union, but not a common market, with most intra-regional trade of goods liberalised and a common external tariff subject to a list of exceptions (Ryan, 2000, 251). In terms of foreign direct investment, two agreements can be regarded as the FDI policy of Mercosur:

> The Protocol of Colonia de Sacramento of December 1993 requires national treatment and prohibits the use of performance requirements regarding foreign investors from the region, and includes provisions for compensation in case of expropriation. The Protocol on Promotion of Investment from States Not Members of Mercosur allows member countries to pursue their own foreign-investment policy towards non-member countries, lays down some principles for fair treatment, and provides a dispute-settlement procedure. (van Dijck, 2002, 10)

Environmental aspects of Mercosur

In contrast to NAFTA, the negotiation of Mercosur did not stimulate an environmental debate. For instance, "… the group's path is mainly drawn by agreements between the government and the private sector, with little input from other actors in the society." (Tussie and Vásquez, 2002, 188). The region has a conflictive history of management of shared ecosystems and natural resources, in particular regarding rivers. Thus, a geopolitical view of the environment prevails (2002, 191). Nonetheless, during the preparatory phase of Mercosur, from 1991 to 1994, "the environment was a side-issue, hardly among the hierarchy of priorities." (2002, 190). The environment emerged as an official issue in 1994 with the formal launching of Mercosur at Ouro Preto, however, there is not a proactive agenda in this matter (2002, 190). The mention of environmental concerns in the preamble of the Asunción Treaty can be understood as the recognition of a dimension other than trade. However, the rest of the treaty lacks provisions related with the environment. A number of political declarations related to the environment have been raised by the group (Table 3) but no profound changes have occurred.

The preparation of a Protocol on the Environment, intended as a complement to the Treaty of Asunción raised high expectations in scholars and experts (von Moltke and Ryan, 2001, 3; Tussie and Vásquez, 2000, 197; Ryan, 2000, 253). This legal instrument has the power to turn environmental considerations into constitutive elements of Mercosur, hence, environmental principles and norms will permeate all the regime. Instead of the Protocol, which has not been agreed, Mercosur members signed a Framework Agreement on the Environment (2001) that synthesises previous declarations and general initiatives.

TABLE 3. DECLARATIONS ON THE ENVIRONMENT IN MERCOSUR

Asunción Treaty (1991)
It set the framework for the preparation of Mercosur. It specifies, in its preamble, that the integration of the national markets and the resulting creation of a common market had to be achieved '… by the most effective use of the resources available… [and] the preservation of the environment …'
Nonetheless, none of the articles or annexes of the Treaty refers to environmental issues.
Las Leñas Presidential Summit (1992)
In this summit the Specialised Meeting on the Environment (REMA) was established with the aim to give advice on environmental matters to the Common Market Group (GMC), the executive organ of Mercosur.
Canela Declaration (1992)
A joint statement of Mercosur members presented at the Rio Conference on Environment and Development.
Taranco Declaration (1995)
Legal harmonisation of environmental regulation, as a goal to be achieved, was included in the agenda of Mercosur for the first time. The Declaration stressed the need to harmonise production and process methods (PPMs) that might have an environmental impact on shared ecosystems.
Interest in revising the impact of ISO 14000 standards on the competitiveness of Mercosur.
Interest in a common strategy for international negotiations.
REMA was upgraded to become a technical subcommittee (TSC 6)
Framework Agreement on Environment (2001)
Summarises previous initiatives and promotes environmental cooperation
Additional Protocol on Environmental Emergencies Assistance and Coop. (2004)
Interest in managing environmental emergencies such as floods, oil spills, mercury contamination of rivers, etc.

Source: author based on Mercosur, 2006; Tussie and Vásquez, 2000, 195-7; Von Moltke and Ryan, 2001, 2-4.

Ryan (2000) argued that the harmonisation of environmental norms has focused narrowly, with some exceptions, on technical provisions (for example those to remove specific obstacles to trade), however, it is not the consequence of any common regional strategy directed towards sustainable development (2000, 252). While market forces have been increasing the environmental problems, "forward movement [on environmental orientation and strategy] has generally come as an after-effect of closer political ties and trade liberalization, rather than a conscious institutional effort …" (Tussie and Vásquez, 2000, 197). For instance, the harmonisation of environmental norms of production processes has not yet occurred (Ryan, 2000, 252); though it was announced as an environmental objective of the group in 1995.

The prospect of unsustainable integration

In order to accelerate the path of economic integration, the improvement of transport links, infrastructure and energy projects, became a priority for the governments of Mercosur. This aspect has turned into a policy priority with the support of international institutions such as the Inter-American Development Bank (IADB). "According to Enrique Iglesias [ex-president of the IADB] … the main challenge in trying to sustain economic growth within MERCOSUR is the promotion of investment, primarily in the energy sector and then in the transport sector." (Gudynas, 2000, 241). Nonetheless, local communities and NGOs have been objecting most of these projects, such as waterways, railways, highways and roads, oil and gas pipelines and shared dams, showing important environmental concerns (Gudynas, 2000).

A typical characteristic of the region is the existence of Transboundary watersheds of great ecological value that

are subject to grave risks from the impact of economic growth. … The Hidrovía (Waterway) Project is an excellent example of a major engineering project that poses a potentially difficult environmental and social dilemma in the MERCOSUR (Salinas, 2002, 300)

This physical integration requires strong environmental policies, environmental impact assessments and strategic assessments, in addition to effective control of external capital that to a large extent funds energy and infrastructure projects of Mercosur (Gudynas, 2000, 248). Moreover, the membership of Venezuela and the association of Bolivia and Chile to Mercosur, all these countries with specialisations in environmentally sensitive and intensive in natural resources economic activities, impose a greater challenge on the environmental management of the region.

Another aspect of concern is the so-called "dual production pattern" between intra-regional and domestic production and production for other markets (Tussie and Vásquez, 2000, 198). This pattern reveals how markets can shape the decisions made regarding environmental management, but also the need for coherent and enforced environmental policies to correct environmental externalities of trade and investment.

A case in point is the upgrading efforts of Argentina's petrochemical and paper industries. Petrochemical firms are motivated by a concern not to be excluded from foreign markets. Local subsidiaries of foreign petrochemical firms are also transferring their more rigorous home standards. In the paper sector, pressure from customers in export markets has been an important factor influencing regional incorporation of clean technologies and sustainable production methods (Tussie and Vásquez, 2000, 198)

The steel industry in Brazil and Argentina has undergone a similar process. … Exports soared in the last decade, forcing the largest firms to build new plants to respond to increasing foreign demand. These incorporated more modern environmental technology, but outdated production lines are still used to supply the less stringent environment standards of the local market (2000, 198)

However, the net effect of trade and investment flows on the environment has proved to be negative. Jenkins (2003) suggested that the manufacturing sectors of Argentina and Brazil, due to "… the combined effect of increased levels of trade and changes in composition, led to an increase in pollution …" since trade liberalisation has been operating (2003, 90). Another critical sector has been agriculture, in which the increase in trading is leading to the intensification of unsustainable practices (Tussie and Vásquez, 2000, 199)

Because there has not been environmental harmonisation from the beginning of the process of integration, the differences in environmental standards between members create "artificial" trade advantages based on the externalisation of environmental costs. While market forces are already operating and exerting an impact on the environment and natural resources of the region, the process of establishing an operative environmental strategy and the harmonisation of environmental laws and policies is following a very slow path.

CONCLUSIONS

The present analysis reveals some general tendencies of trade regimes. Further research is necessary to identify deeper aspects between trade policies and environmental policies at different levels. For instance, to identify more conclusive evidence of the trade-environment policy interface, a detailed study of the environmental policy performance in Latin America needs to be conducted. Nonetheless, this brief study of NAFTA and Mercosur, as the most important trade and investment regimes operating in Latin America seems to corroborate the proposed hypothesis.

Firstly, those regimes tend to influence environmental management to reflect the needs of export sectors or converge on some standards of the primary markets. During the negotiation of NAFTA an important issue in the United States was the fear of "pollution havens" in Mexico. Because of its political and economic power, the US can influence Mexican policy making to converge on some standards, in this case environmental. Thus, NAFTA and its environmental side-agreement reflect these concerns in its environmental provisions. However, these provisions and the institutions of the environment side-agreement are understood as a cost of NAFTA by the trade communities of the three countries, in particular Mexico. Thus, there is no high political commitment of the governments to environmental matters and the approach tends to be very limited.

The regime of Mercosur is encouraging a "dual production pattern" led by market forces. Some evidence shows that companies oriented on external markets tend to converge on the standards required by those markets, while domestic production and intra-regional trade tolerate low environmental standards. This pattern clearly shows how market forces are turning into the main drivers of environmental change. However, the uncontrolled forces of the market seem to cause net negative environmental effects in the region. Hence, stringent environmental policies are required.

Secondly, investment regimes superimpose investor rights on to public environmental concerns. The case of NAFTA and its Chapter 11 clearly shows how the excessive enforcement of investor rights can be used to weaken public concerns and the further development of environmental actions and policies. Decision makers face uncertainties when producing any new environmental measure, in addition to the risk of expensive investor-state claims.

In Mercosur, the emphasis on physical integration and projects of infrastructure and energy, most of them funded through foreign investment, is causing great concerns on the environmental community. Those mega-projects and the arrangements between investors and the states of the region need to be carefully observed in order to avoid and diminish social and environmental impacts. Moreover, the fact that there is no regional environmental strategy or policy creates uncertainties about how this issue will be pursued by governments.

Both regimes seem to slow down the capacity of Latin American governments and the willingness of decision makers to appro-

ach the problems that result from trade and investment activities. Furthermore, during the negotiations of both regimes public environmental concerns were perceived by governments as obstacles to trade and investment or transaction costs of the agreements.

NAFTA's institutional approach seems to be friendlier to the environment; however, governments show reticence when tackling the main environmental problems that result from the operation of the regimes. The cooperation effort under the NAAEC to enforce the Mexican environmental law will probably benefit the capacity of environmental authorities; however, the environmental pressures at both the physical and policy level of NAFTA seem to exceed any effort. In fact, the Chapter 11 has challenged equally environmental authorities of the United States, Canada and Mexico.

Harmonisation of environmental laws is occurring on technical issues such as sanitary and phitosanitary measures, to remove obstacles to free trade, but important environmental concerns are avoided. The environmental provisions of NAFTA and the environment side agreement seem to potentially have a positive effect on environmental policies. Nonetheless, there are central environmental issues that are not covered by NAFTA or its environment side-agreement, in addition to contradictions and problems revealed during the implementation. Moreover, a strong opposition from the governmental sector and the trade community to the development of these provisions has become more obvious. The case of Mercosur is also salient. As an economic integration process the governments have the possibility of designing a common environmental policy that fits the needs and environmental problems of its members. However, the tendency is to let the market operate and reduce the policy action on environmental matters. For instance, both regimes avoid tackling the central issues of processes and production methods, and management of natural resources. Environmental principles such as "the polluter pays principle" or the "precautionary" approach seem to be sacrificed.

The governments of the region have a great responsibility if they sacrifice public interest and environmental issues to the benefit of market access, foreign investment and the interest of trade communities. In the current "race" for the negotiation of bilateral trade agreements and investment treaties with multiple countries the risks for environmental policy are higher.

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