
Green Herrings

NAFTA and the Environment

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Most of the controversy about the North American Free Trade Agreement (NAFTA) signed by the United States, Canada, and Mexico has centered on issues peripheral to its commercial content. This is surprising since the debates surrounding a trade accord usually involve commercial matters such as phase-out periods, rules of origin, and the flow of goods and services. Nevertheless, critics of NAFTA have focused on potential job losses, respect for human rights, issues of cultural identity, and, most prominently, the environmental impact of free trade.

The environmental dispute over NAFTA is highly sensitive and complex. NAFTA is unparalleled among trade arrangements in its attention to environmental issues and in the degree to which it subordinates commercial considerations to environmental concerns. Despite the unprecedented extent of NAFTA's provisions to protect the environment, many environmental groups in the United States continue to argue against the agreement.

Focusing on trade between the United States and Mexico, this article evaluates the principal environmental arguments against NAFTA and shows that, while they may have intuitive support, both logic and evidence prove them unfounded. The article also suggests how NAFTA will contribute to a healthy environment, especially in Mexico.

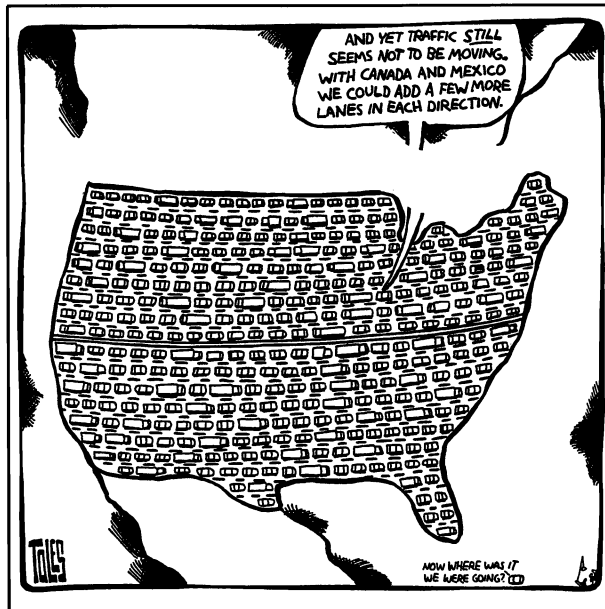
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The Greenness of NAFTA

NAFTA makes a broad commitment to trade policies consistent with sustainable development and environmental protection. In the preamble of the agreement, the three signatory governments pledge to “undertake [trade liberalization] in a manner consistent with environmental protection; . . . promote sustainable development; [and] strengthen the development and enforcement of environmental laws and regulations.”

The specific provisions of NAFTA are fully in accord with those goals. Article 104 gives international environmental accords such as the Convention on the International Trade in Endangered Species of Wild Fauna and Flora precedence over any potentially conflicting provisions of the agreement. Thus, NAFTA does not overturn those treaties' prohibitions on trade in certain items. Article 904 provides that a signatory may prohibit another signatory from exporting a good that does not comply with the importing signatory's environmental standards. Furthermore, Article 905 allows federal, state, provincial, and municipal governments to fix their own norms of environmental conservation and protection, even if they are stronger than international standards.

Article 1114 explicitly allows a signatory government to impose environmental requirements “to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.” The same article provides that the parties “recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures.”



One of NAFTA's major environmental benefits will be to increase cooperation of the United States, Canada, and Mexico in solving environmental problems such as the cross-border movement of toxic waste, wastewater treatment, and ecosystem interdependence. To facilitate such cooperation NAFTA's signatories created the North American Commission for the Environment, an agency that will coordinate technical and technological assistance. The North American Fund will finance transborder environmental projects.

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The United States and Mexico have already instituted the Integrated Border Environmental Plan, a three-year initiative to minimize cross-border environmental deterioration. Funded by \$1 billion from the United States and \$460 million from Mexico, the plan aims to augment investment in raw sewage treatment in the main border

cities. The plan will also improve the enforcement of environmental regulations along the Rio Grande River.

The Green Herrings

In principle the economic goals of NAFTA are consistent with the promise to promote a healthy environment. The logic is simple: more trade generates economic growth, which stimulates the demand for a healthier environment and thus leads to sustainable development. But the environmentalists' case against NAFTA presumes that trade-driven net economic growth is incompatible with an Earth-friendly society. They contend that economic activity necessarily causes environmental degradation.

Opponents of NAFTA on environmental grounds offer five fundamental "green herrings" to obfuscate our understanding of what NAFTA will actually mean for the environment. The first, perhaps the most prominent in policy discussions, is that NAFTA will drive large numbers of U.S. firms south of the border to reap the advantages of lax environmental regulations and enforcement. That is the famous "Mexico as pollution haven" argument. While there is some evidence that Mexico's Ministry of Social Development (SEDESOL) is unable to enforce the requirement that firms file environmental impact statements, those isolated cases do not represent a general trend. The key question is whether the costs of complying with environmental standards represent a sufficient condition for relocating an industrial operation. I argue that for environmental compliance costs to influence relocation decisions, at least four conditions must exist: environmental protection costs must be a significant part of total costs of operation; existing trade barriers must be high; relocation costs must not be so high that they offset the savings from reduced requirements to protect the environment; and the differences between the two countries' environmental regulations must be high now and must be expected to remain high for a long time.

Most U.S. industries do not simultaneously face those four conditions. For example, U.S. firms' environmental compliance costs are a relatively low percentage of value added, according to a review supervised by the U.S. trade representative. That review also shows that only 11 out of 442 U.S. industries have to contend with both high environmental costs and high trade barriers.

Moreover, because companies with higher environmental compliance costs are generally capital-intensive “smokestack” industries, they have large fixed investments in plant and equipment and thus face high relocation expenses. Finally, the claim that Mexico has significantly more lax environmental standards than the United States is false. Mexico modelled its 1988 Law of Ecological Equilibrium on U.S. legislation. In some instances the Mexican law is more stringent than U.S. laws. For example, SEDESOL requires ecological impact assessment for new environmentally sensitive foreign investment projects. Moreover, Mexican authorities enjoy greater leeway than their American counterparts in closing plants for failing to comply with environmental regulations; since 1988 SEDESOL has shut down some 1,200 plants. That has led some Mexicans to label SEDESOL’s activities “ecoterrorism.”

Mexico’s problem with environmental protection is not its low level of regulation; rather, the problem is Mexico’s financial inability to implement its high environmental standards. But Mexico’s economy stands to gain from participating in NAFTA. In fact, Mexico will enjoy greater income gains than will the United States or Canada. A 6 percent real annual growth rate is realistic and realizable in the context of free access to the largest market in the world. Such economic growth will enable Mexico to allocate more resources to environmental enhancement and enforcement.

The second green herring is the claim, advocated by the Sierra Club and Public Citizen, that NAFTA’s settlement mechanisms will compromise U.S. health, safety, and environmental regulations. Opponents of the agreement cite the controversial case of the U.S. embargo on Mexican tuna because Mexican tuna fishermen killed more dolphins than U.S. law permits. Although the General Agreement on Tariffs and Trade tribunals overruled that U.S. action on two occasions, the embargo still prevails.

The second green herring reflects a distorted reading of the clauses governing NAFTA’s dispute-resolution mechanism, which were crafted to balance two serious, conflicting concerns. The first concern was that a member nation not gain a trade advantage by failing to take appropriate measures to protect the environment so as to cut costs. The second concern was that a member nation not impose environmental regulations as disguised trade barriers designed to protect vested interests.

We can see how NAFTA balances those concerns by looking at the agreement’s provisions regarding member nations’ regulating food safety and purity as well as health, safety, and environmental or consumer protection. Articles 755 and 905 explicitly authorize signatory nations to maintain such regulations, including those that are more stringent than international standards. Thus, NAFTA in no way attempts to reduce national standards to a lowest common denominator.

The agreement does, however, seek to limit the ability of signatories to use such regulations as surreptitious protectionist devices. NAFTA states that member nations must base regulations protecting food safety and purity on “scientific principles” and must not “arbitrarily or unjustifiably discriminate” between their goods and similar goods of another member nation where “identical or similar conditions prevail.” On member nations’ regulations relating to health, safety, and environmental or consumer protection, NAFTA’s language is somewhat looser. It provides that signatory countries “should not”—as opposed to “must not”—use such standards as trade barriers.

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To ensure that signatories observe that modest discipline, NAFTA establishes special dispute-settlement procedures under which one country’s government can challenge a particular regulation or action of another country’s government. Those procedures place the burden of proof on the complaining party. Further, NAFTA’s dispute-resolution mechanism allows settlement panels to appeal to established international scientific authorities in resolving environmentally sensitive trade disputes. By stipulating a neutral method of cross-country selection for forming trade panels, NAFTA minimizes the potential for arbitrariness and unilateralism and encourages a regional approach to trade disputes.

We should note, however, that NAFTA's dispute-settlement procedures cannot "force" a signatory government to change or repeal measures found to be in violation of the agreement. A government found in violation can refuse to change its policy. In that event NAFTA simply allows the complaining government to retaliate with trade sanctions equivalent in magnitude to the violation.

The third green herring is the suggestion that NAFTA's trade liberalization will force the United States to weaken its "clean" environmental standards to increase its competitive advantage. That claim is extremely odd in the face of the evidence that over the past twenty years rising trade flows have coincided with increasingly rigorous environmental protection. Besides, it is a fallacy that poor countries have some kind of "unfair" competitive advantage over rich ones. The Ghanas and Bangladeshes of the world are certainly not out-competing the United States, Japan, and Western Europe, which account for 75 percent of world trade. Moreover, Mexico—with a labor-intensive

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economy just one-twentieth the size of the U.S. economy and a gross domestic product equal to that of New Jersey—has had the opportunity to reduce U.S. competitiveness during the past seven years of aggressive, two-way trade liberalization. In fact, the opposite has happened: the United States currently has a \$9 billion trade surplus with Mexico.

The last two "green herrings" are closely intertwined. One is the claim that free trade will bring about greater environmental degradation in Mexico. The other is the contention that the increase of economic activity along the U.S.-Mexico border will intensify the already grave problems of cross-border pollution. The latter objection is a special case of the former. Again, neither is supported by theory or evidence.

Theory suggests that the economic gains from free trade will increase the demand for cleaner environmental conditions and therefore reduce the amount of pollution generated by industry and commerce. To see the fallacy of the claim that NAFTA will degrade Mexico's environment, we simply need to examine the record of the past several years during which trade between Mexico and the United States has been substantially liberalized.

Although Mexico still suffers from air pollution and hazardous waste disposal problems, the past four to six years have brought a significantly heightened awareness of the needs to overcome ecological ills. Legislation introduced in 1988 that requires environmental impact statements is more stringent than comparable U.S. law. In addition, the Salinas administration has labored to strengthen enforcement of environmental regulations and to introduce more stringent environmental regulations. Beyond closing polluting plants, the Mexican government has required that the largest polluting industrial firms in Mexico City either relocate or reduce hazardous emissions by up to 90 percent and has mandated catalytic converters for all vehicles in Mexico City and Monterrey. Mexico now has a policy of "directed development" with strong tax incentives for industrial and commercial relocation away from Mexico City. The program is founded on the premise that greater economic integration will facilitate relocation of industries around middle-sized cities, which will relieve crowded conditions in the Mexico City Basin and on the U.S.-Mexico border.

In addition to increasingly restrictive environmental regulation, the Salinas administration has enacted a variety of liberalization and privatization measures that promise to improve environmental quality. For example, the Salinas administration has issued new legislation to privatize the management of Mexico's water resources. That landmark reform will encourage the responsible conservation of those resources. Other legislation encourages sustainable uses of water by requiring permits for the discharge of residual waters and internalizing pollution costs by stipulating that water users pay for costs of decontamination related to their activities.

The Salinas administration's initiative to reform Mexican agriculture also has important environmental ramifications. That reform assigns rural peasants the legal guarantees to farm rural land as they deem fit, as well as to buy, sell, or rent

parcels. The privatization of agriculture will create incentives for landholders to take care of the long-term value of the land. Thus, they will adopt sounder irrigation and fertilizing practices and will guard against soil depletion and deforestation.

The evidence of the past several years does not support fears that trade liberalization will worsen Mexico's environment. As a result of the Mexican government's initiatives, deterioration of air quality has come down significantly, and emissions of automobile contaminants are decreasing by as much as one million tons per year. In Mexico City the concentration of lead has come down by more than 50 percent. With the participation of private capital in water allocation, the government has been able to increase the availability of potable water to an estimated three million citizens per year in the past four to six years. Thus, environmental improvements have accompanied trade liberalization.

The last green herring is the claim that cross-border pollution will worsen along the Rio Grande zone as economic activity increases. Admittedly, increased trade flows in the area—the fastest-growing worldwide—have created severe environmental difficulties, for instance a 3,300 percent increase in hazardous waste traffic. But that is an example of a problem requiring greater transborder cooperation, which NAFTA will bring and already is bringing about. Moreover, regionalized commerce will encourage dispersal of economic activities from the border region. By expanding duty-free privileges to the entire nation, NAFTA undermines the advantage of setting up factories close to the border. In addition, the provisions liberalizing land transportation services will enable parties to ship cargoes directly to established destinations, thereby easing congestion problems along the border, where much loading and reloading must now take place. That will help decrease air pollution in the border region.

Conclusion

NAFTA enjoys greater popularity in Mexico than in the United States and Canada, despite Mexico's long history of state-controlled enterprises and import-substitution policies. NAFTA is a cornerstone of Mexico's program of economic stabilization and the basis of sustainable economic growth. Yet in the relatively free market economies of Mexico's northern neighbors, critics attack NAFTA on grounds peripheral to the agreement's commercial content.

It is also ironic that critics attack NAFTA on environmental grounds, since the agreement places environmental matters before commercial matters in many of its provisions. Clearly, it is in Mexico's interest to comply with the environmental provisions embedded in the treaty because of the huge economic gains that NAFTA promises.

NAFTA grants formidable trading privileges to Mexico's undercapitalized economy. While regional competition will increase, Mexico will gain immediate duty-free treatment for 7,300 of its goods—the equivalent of 84 percent of its domestic production available for export. Also, Mexico will immediately be able to import high-tech equipment and machinery duty-free so that it can further modernize its productive plant. By eliminating quantitative nontariff restrictions on almost all Mexican products, NAFTA will stimulate the mass development of economies of scale and specialization.

The environmental provisions of NAFTA form a necessary condition to reap the vast commercial benefits of market access and increased capital investment flows.

Those trends are already apparent. In 1992 two-way trade between Mexico and the United States was estimated at \$75 billion, and Mexico surpassed Japan as the United States' second largest trading partner in manufactured items. NAFTA will considerably expand the process of integration since it brings together a consumer market of 360 million people with an annual regional output of \$6.2 trillion.

The environmental provisions of NAFTA are designed to ensure that the signatory countries pursue the advantages of open trade in an environmentally sensitive manner. Those provisions form a necessary condition to reap the vast commercial benefits of market access and increased capital investment flows. Hence, Mexico must play by established environmental rules. That provides a tremendous incentive for Mexico to behave in a sound environmental fashion and to aggressively seek the green technology available north of its border.

There is a danger, however, that parallel environmental accords to NAFTA will destroy that incentive. If the United States places excessive

emphasis on the environmental purposes of the agreement, it will reduce Mexico's opportunity to develop a cleaner environment by way of expanded growth. The problem is that such an emphasis will tend to invite protectionist forces to seize on environmental policy to generate new, more sophisticated trade barriers such as "green" antidumping and countervailing duties. Such an outcome could short-circuit the liberalization process in NAFTA and thereby the welcome environmental impacts associated with an increase in new economic output, stable regional cooperation, and upward harmonization of environmental standards.

President Clinton's call for an environmental rider to NAFTA is an unnecessary roadblock to an agreement for which the environmental clauses already provide all the guarantees necessary that NAFTA will not compromise continuing improvement of North American environmental standards. NAFTA, as it stands, will result in a North America that is richer *and* cleaner.

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