

**Marginalizing Environmental Impacts
Comments on USTR's Environmental Review of
U.S.-Chile Free Trade Agreement**

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Executive Summary

Researchers at the Global Development and Environment Institute (GDAE) at Tufts University, and at the Center for Planning and Research on the Environment (CIPMA), an independent research institute in Chile, have submitted formal comments to the Office of the U.S. Trade Representative (USTR) on the Draft Environmental Review (ER) of the Proposed U.S.-Chile Free Trade Agreement. The authors point out that the draft ER is the most comprehensive ER that has been conducted or proposed to date. However, the authors also establish that the draft ER suffers from a few significant limitations.

In their official comments, which were submitted on November 20, 2001, the authors offered two major criticisms followed by a list of four recommendations for an environmental cooperation component of a US-Chile Free Trade Agreement should it come into force.

1. The draft ER does not estimate the proposed agreement's marginal environmental costs. The central limitation of the quantitative component of the draft ER is that it ignores the potential marginal environmental costs of the proposed agreement. What drives the US interest in smaller, bilateral trade agreements such as this one are the potential marginal benefits of increased trade that will accrue to the US economy. Since in aggregate terms, the benefits of the proposed agreement are predicted to be small, more often than not the draft ER dismisses the associated environmental impacts. The comments that follow establish that at the margins, US exports in many environmentally sensitive areas are increasing at rates far outpacing either the US or Chilean economies. The final draft of the ER should investigate the potential marginal environmental impacts of those projected economic changes.

2. The draft ER does not pay adequate attention to assessing the potential environmental impacts of the "non-trade" aspects of the proposed agreement. The proposed US-Chile Free Trade Agreement includes much more than provisions on tariff rates. Indeed, there are proposed measures for investment, intellectual property, sanitary and phytosanitary measures, and others. Since text has not yet been made public on many of these most controversial subjects of the proposed free trade agreement, the draft ER also ignores the potential regulatory effects associated with these subjects. Of critical concern is the provision that allows compensation for policies that are "tantamount to expropriation" in the investment section of the proposed agreement. These proposed provisions are strikingly similar to the investment chapter of the North American Free

Trade Agreement that has drawn widespread criticism for triggering rollbacks of environmental regulations in North America.

Recommendations:

Based on their comments, the authors propose that an environmental cooperation component of the agreement should create an institutional structure to manage the following processes:

1. Monitoring the marginal environmental impacts of growing US-Chile trade.
2. Monitoring and enhancing environmental regulation and enforcement capabilities of the two nations.
3. Providing incentives and financial support to help firms (especially small and medium sized enterprises) and communities develop sustainable production patterns. A high priority would be to institutionalize and fund efforts for clean production in the Chilean mining sector.
4. Involving the participation of civil society in the identification of actual and potential environmental problems that arise from the agreement, as well as in the implementation of environmental provisions.

Comments on USTR's Environmental Review of U.S.-Chile Free Trade Agreement

The following discussion is in response to the request by the United States Trade Representative (USTR) for comments on its draft environmental review (ER) of the proposed US-Chile Free Trade Agreement (FTA).

The draft ER for the proposed US-Chile FTA, particularly its quantitative component, is the most comprehensive assessment that has been issued or proposed by the US to date. This draft ER builds on the previous environmental review of the US-Jordan FTA, with increased sophistication. In addition, it avoids a number of pitfalls in the "Report of the Quantitative Analysis Working Group to the FTAA Interagency Environment Group" that may jeopardize the quality of the ER of the proposed Free Trade Area of the Americas (FTAA).

Most importantly, the quantitative portions of the ER for the US-Chile FTA avoid the employment of complex and problematical modeling techniques that plague the ER for the FTAA. The FTAA ER has been criticized for relying on controversial computable general equilibrium (CGE) models to form the core of the economic and subsequent environmental analyses. The predictive capability of CGE models is a subject of increasing controversy. If the majority of subsequent environmental analyses are hinged to the results of CGE results, the anticipated effects are only as good as the economic predictions¹.

The draft ER for the US-Chile FTA utilizes a simpler and more transparent methodology for analyzing the economic benefits of the proposed agreement. As a result, the estimated environmental effects are much more straightforward and easier to interpret. The USTR and other participating agencies should be applauded for these efforts. Indeed, we urge them to utilize similar approaches for the upcoming ER of the FTAA.

Although the draft ER for the US-Chile FTA is a significant advance over previous work by the US in this area, there is still room for improvement. The USTR's draft environmental review may be overlooking significant environmental effects of the US-Chile FTA. The shortcomings identified in this commentary point toward key elements that should be addressed in the environmental component to any trade deal between the U.S. and Chile. Our comments primarily focus on the two most important portions of the draft ER, the chapters on "Sectoral Effects" and "Regulatory Review."

Sectoral Effects

The central limitation of the draft ER is that it ignores the potential *marginal* environmental costs of the proposed agreement. A number of statements in the draft ER emphasize that the FTA with Chile will cause only a small change in the US economy. For example, "the United States does not expect changes in the level of economic activity (scale effect), or significant shifts in the composition of the national trade portfolio that would potentially change competitive dynamics

¹ For a discussion of the shortcomings in the "Report of the Quantitative Analysis Working Group to the FTAA Interagency Environment Group" see "The Limits of Economic Modelling in the FTAA Environmental Review," Frank Ackerman, Kevin Gallagher and Alejandro Nadal.
<http://as.e.tufts.edu/gdae/downloads/USTRComments&Summary.pdf>

among national industries that may alter environmental risks" (USTR Draft Review, page 13). Such statements imply that any resulting changes in environmental quality will also be small, and easily contained by the stringent environmental standards that the US enjoys. It is indeed true that the aggregate (or "economy-wide") effects of the proposed agreement will be small. The US economy is more than 100 times as large as Chile's, when measured by GDP. This implies that trade flows that look large relative to Chile will look much smaller relative to the US – both in economic and environmental terms. However, this obvious conclusion does not lead the US to ignore the economics of the trade agreement; likewise, it should not lead to dismissal of the associated environmental impacts.

What drives the US interest in negotiating trade agreements with smaller countries are the *marginal* benefits of increased trade that will accrue to the US economy. Therefore, the appropriate role of an environmental review is to estimate the proposed agreement's *marginal* environmental costs, to be evaluated in connection with those economic benefits. The draft ER fails in the essential task of conducting a marginal analysis of potential changes in US-Chile trade.

Take for instance, the draft ER's discussion of the potential environmental impacts of agricultural trade with Chile. The draft ER identifies five US agricultural exports that are among the most important imports into the Chilean economy. Data on three of these crops are provided in the table below. All three grew extremely rapidly, with increases during the 1990s ranging from 180% to almost 900%. In the same years, Chile's GDP grew by 119%; thus for all three (and for the two other crops as well), US exports to Chile grew much faster than the Chilean economy. Chile buys \$33 per capita of US corn, compared to \$5 per capita in Mexico, a large, much-discussed market for US corn exports.

Moreover, US production of the crops exported to Chile grew slowly if at all; in the case of wheat, US output actually declined. Exports to Chile also grew far faster than US exports as a whole. By any measure, US agricultural exports to Chile are small – half a percent or less of total US production, for example – but growing rapidly.

In the United States, corn, cotton, and wheat are huge crops, together covering more than 100 million acres of farmland; their agro-chemical impacts are of great importance to the North American environment. The US-Chile FTA ER should consider such topics as potential increased rates of fertilizer runoff, herbicide and pesticide use, and groundwater contamination in the US resulting from corn, wheat, and cotton production. Rates of change in land use and soil erosion in the US farm belt, in addition to increasing uses of irrigation and genetically modified organisms in US corn and cotton production should also be investigated. Trade with Chile is not responsible for most of these problems, just as it is not responsible for most of the markets for US agriculture. However, it does matter at the margin as a market, and should be taken equally seriously at the margin as a contributor to environmental impacts.

Selected United States Agricultural Exports to Chile, 1990-1999			
	1990	1999	Growth
Corn			
Exports to Chile (US\$)	\$15,351,690	\$50,714,903	230%
Exports to Chile (1,000 MT)	128	562	339%
Total US production (1,000 MT)	201,532	239,549	19%
<i>Exports to Chile as % of US production</i>	<i>0.06%</i>	<i>0.23%</i>	
Cotton			
Exports to Chile (US \$)	\$577,729	\$5,599,753	869%
Exports to Chile (1,000 MT)	0.23	6.5	2726%
Total US production (1,000 MT)	3,376	3,742	11%
<i>Exports to Chile as % of US production</i>	<i>0.01%</i>	<i>0.17%</i>	
Wheat			
Exports to Chile (US \$)	\$11,785,142	\$33,043,553	180%
Exports to Chile (1,000 MT)	86	302	251%
Total US production (1,000 MT)	74,292	60,758	-18%
<i>Exports to Chile as % of US production</i>	<i>0.12%</i>	<i>0.50%</i>	
<i>Source: Economic Research Service, United States Department of Agriculture</i>			

A more comprehensive ER should look at the marginal environmental impacts of expansion of not only these three agricultural products, but also other key exports projected to increase in US-Chile trade. US trade with Chile in other agricultural sectors, fisheries, and forestry products amounts to hundreds of millions of dollars each year. The potential environmental impacts at the margin in these sectors should also be subjects for review in a US-Chile ER. For example, net US exports of paper to Chile amounted to \$44 million in 2000, and a FTA-sparked reduction beyond the 6 percent tariff that the US paper industry already faces may trigger significant expansion at the margin. The World Bank ranks the US pulp and paper industry as one of the top five most air and water pollution intensive industries in the world². A more comprehensive ER should look at the potential increases in such pollution in the pulp and paper sector as a result of the FTA.

The ER should not be restricted solely to the potential environmental effects of trade expansion. Environmental harm can also occur when industries contract as a result of trade. In the case of US-Chile trade, attention should be paid to the environmental effects of the decline in US metal mining. As US mining has been declining, imports from Chile have been increasing at a steady rate. An FTA with Chile could further exacerbate these trends. It would be important to ask:

² See World Bank rankings in: Muthukumara Mani and David Wheeler. "In Search of Pollution Havens? Dirty Industry in the World Economy, 1960-1995." in *Trade, Global Policy, and the Environment*. World Bank Discussion Paper No. 402.

what are the marginal environmental impacts of Chilean imports on the US mining sector? The impacts could be positive, if the industry response to imports is to cut back the most environmentally damaging US mining activities. On the other hand, the impacts could be negative: when firms contract, they may cut corners on their environmental commitments, and exert pressure to relax environmental rules. Recently, the administration rolled back a proposal to regulate mining on public lands. As a result, it is estimated that US taxpayers could be liable for an additional \$1 billion in environmental clean-up costs in US mines. Is there a link to trade?

The greatest environmental effects of trade on the mining industry will occur in Chile. Since 1974, the Chilean mining sector has received over \$1 billion per year in foreign direct investment (FDI). As Chile continues to gain a comparative advantage in mining as a result of an FTA, more US FDI will go to the Chilean mining sector. The draft ER does not consider whether increased US FDI will transfer "clean" or "dirty" mining technology to Chile. The history of US mining has been highly pollution intensive. Indeed, the EPA estimates that 40 percent of the headwaters of all western watersheds were polluted by mining³. Will this legacy be transferred to Chile? The draft ER fails to consider any of these factors.

Regulatory Review

Since text has not yet been made public on many of the most controversial subjects of the proposed FTA, the ER also ignores the potential regulatory effects associated with those subjects. Of prime concern to the US and Chile alike are provisions regarding investment, intellectual property, and anti-dumping.

The ER process in general should include a review of trade language that is potentially in conflict with US environmental law. Such a review could help ensure that negotiators propose text that is consistent with environmental regulation. The provision that allows compensation for policies that are "tantamount to expropriation" in the investor-state mechanisms, comparable to NAFTA's controversial Chapter 11, is of great concern to many experts and the public. Based on experiences where similar provisions have been used to undermine environmental regulations under NAFTA, three problems are of particular concern: 1) the lack of balance between investors' rights and responsibilities; 2) the potentially negative impact of the investor-state dispute settlement mechanism on the regulatory autonomy of the host government; 3) the lack of transparency of the dispute settlement mechanism.

The draft ER also falls short of adequately addressing the link between the FTA's intellectual property rights discussions and the environment, especially in Chile. There is concern for those cases in which property rights are applied to an active component of a specific plant that has been traditionally used by local or indigenous communities. Patents held by outsiders might restrict the freedom of communities to base economic development on the use of indigenous plants, even if the plant will be used for different purposes than those envisioned in the patents. Recent community claims in Chile have argued that the patent system is a mechanism of appropriation of traditional knowledge and genetic resources without a fair distribution of the benefits. The case of traditional knowledge is most delicate, since it cannot be protected; some communities have even lost access to their own indigenous products. This has occurred with

³ See web page of Mining Policy Center: <http://www.stoptherollbacks.org/moreinfo.htm>

such products as neem, curcuma, quinoa, Mexican bean, and ayahuasca. In addition, intellectual property rights provisions may affect the production and use of genetically modified organisms (GMOs). Chile has few regulations regarding GMOs and there is considerable concern regarding the potential effects of their production on human health and the environment in Chile.

Environmental Cooperation and the US-Chile FTA

The shortcomings of the draft ER point to an agenda that should form the core of environmental cooperation between the two countries. Organizational changes are needed to monitor and improve the environmental impacts of trade, both in the US and in Chile. We propose that an environmental cooperation component of the agreement should create an institutional structure to manage the following processes:

1. Monitoring the marginal environmental impacts of growing US-Chile trade.
2. Monitoring and enhancing environmental regulation and enforcement capabilities of the two nations.
3. Providing incentives and financial support to help firms (especially small and medium sized enterprises) and communities develop sustainable production patterns. A high priority would be to institutionalize and fund efforts for clean production in the Chilean mining sector.
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