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SUMMARY OF THE AGREEMENT ON ENVIRONMENTAL COOPERATION

INTRODUCTION

On August 13, 1993, Canadian Minister for International Trade Thomas Hockin, Mexican Secretary of Trade and Industrial Development Jaime Serra and United States Trade Representative Mickey Kantor completed negotiations on a proposed North American Agreement on Environmental Cooperation. Officials of the three governments have been directed to complete the legal drafting of the Agreement as soon as possible. The final text will be made public when completed.

By strengthening environmental cooperation and the effective enforcement of domestic environmental laws and regulations, the environmental agreement will support the achievement of the economic, trade and environmental goals and objectives of the NAFTA. The two agreements will work in a complementary manner to promote sustainable development, to create jobs, and to make the region more competitive.

The following description does not itself constitute an agreement between the three countries and is not intended as an interpretation of the text.

PREAMBLE AND OBJECTIVES

The Preamble sets out the goals, principles and aspirations on which the Agreement is based. It recognizes a tradition of cooperation on the environment, and expresses a commitment to support and build on international environmental agreements and on existing institutions. The Objectives of the Agreement include the promotion of sustainable development, cooperation on the conservation, protection and enhancement of the environment and the effective enforcement of and compliance with domestic environmental laws. The Agreement promotes transparency and public participation in the development and improvement of environmental laws and policies.

OBLIGATIONS

While affirming the right of each Party to establish its own levels of protection, policies, and priorities, the Agreement requires that each Party ensure that its laws provide for high levels of environmental protection and strive to continue to improve those laws. This agreement also protects the rights of states and provinces to set high levels of protection, consistent with the NAFTA.

To achieve high levels of environmental protection and compliance, each Party agrees to effectively enforce its environmental law through appropriate government actions such as: appointment and training of inspectors; monitoring compliance and examining suspected violations of law; seeking voluntary compliance agreements; and, using legal proceedings to sanction, or to seek appropriate remedies for, violations of its environmental law. The Agreement does not empower one Party's authorities to undertake environmental law enforcement activities within the territory of another Party.

Each Party undertakes, with respect to its territory, to:

- report on the state of the environment;
- develop environmental emergency preparedness measures;
- promote environmental education, scientific research and technological development;
- assess, as appropriate, environmental impacts; and
- promote the use of economic instruments for the efficient achievement of environmental goals.

Each Party will notify the other Parties of a decision to ban or severely restrict a pesticide or chemical and will consider banning the export to another Party of toxic substances, the use of which is banned within its own territory.

Parties agree to ensure that their procedures for the enforcement of environmental law are fair, open and equitable. Each Party undertakes to ensure appropriate public access to procedures for the enforcement of their environmental law. Such access includes the right to:

- request action for the enforcement of domestic environmental law; and
- sue another person under that Party's jurisdiction for damages.

COMMISSION FOR ENVIRONMENTAL COOPERATION

The Agreement establishes a Commission for Environmental Cooperation, comprising a governing Council, a central Secretariat, and a Joint Public Advisory Committee.

The Council

The Council, the governing institution of the Commission, will be composed of cabinet-level officers or equivalent representatives of the Parties. It will oversee the implementation of the Agreement, serve as a forum for discussion of environmental matters, promote and facilitate cooperation, oversee the Secretariat and address questions and disputes that may arise regarding the interpretation or application of the Agreement. The Council has key responsibilities related to the agreement's dispute settlement provisions concerning persistent patterns of failure by any Party to enforce its environmental laws.

The Council will strengthen cooperation on the development and continuing improvement of environmental laws and regulations, by:

- promoting the exchange of information on criteria and methodologies used in establishing domestic environmental standards; and
- without reducing the level of environmental protection, developing recommendations on greater compatibility of environmental standards.

The Council will cooperate with the Free Trade Commission to achieve the environmental goals and objectives of the NAFTA, by:

- contributing to the prevention or resolution of environment-related trade disputes; and
- maintaining a list of experts who could provide information or technical advice to NAFTA institutions.

The Council will consider and develop recommendations with respect to assessing the environmental impact of proposed projects likely to cause significant adverse transboundary effects. It will also consider and may develop recommendations on:

- public access to information, including information on hazardous materials and activities;
- appropriate limits for specific pollutants, taking into account differences in ecosystems; and
- reciprocal access to rights and remedies for damage or injury resulting from transboundary pollution.

The Council may develop recommendations on a wide variety of environmental issues, including:

- pollution prevention techniques and strategies;
- the environmental implications of goods throughout their life-cycles;
- transboundary and border environmental issues;
- protection of endangered and threatened species; and
- approaches to compliance and enforcement.

The Council will meet at least once a year. There will be public meetings at all regular sessions.

The Secretariat

The Agreement establishes a central Secretariat responsible for providing technical, administrative and operational support to the Council and to committees and groups established by the Council. The Secretariat will prepare an annual budget and program, including proposed cooperative activities. The Secretariat will also prepare reports on matters within the scope of the annual program.

The Secretariat will consider submissions from any person or non-governmental organization or association alleging a Party's failure to effectively enforce its environmental law. Provided the submission meets criteria set out in the Agreement, the Secretariat may propose that a factual record be developed. In developing this record the Secretariat can seek information from a variety of sources, including submissions from interested persons and information developed by independent experts.

The size and location of the Secretariat will be determined by the Parties.

The Joint Public Advisory Committee

The Joint Public Advisory Committee will include five members of the public from each country. It will meet at least once a year, concurrent with the regular session of the Council. The Joint Committee will advise the Council and provide technical, scientific or other information to the Secretariat. It will also provide input to the annual program and budget of the Council as well as the annual and other reports.

CONSULTATIONS

A Party may request consultations regarding any matter that affects the operation of the Agreement. Should the consultations fail to resolve the matter, any Party may call a meeting of the Council. In seeking a resolution, the Council may consult technical advisors or create working groups or expert groups and make recommendations.

RESOLUTION OF DISPUTES

If the Council cannot resolve a dispute involving a Party's alleged persistent pattern of failure to effectively enforce an environmental law relating to a situation involving the production of goods or services traded between the Parties, any Party may request an arbitral panel. A panel will be established on a two-thirds vote of the Council.

Panelists will normally be chosen from a previously agreed roster of experts, including experts on environmental matters. With the approval of the disputing Parties a panel may seek information and technical advice from any person or body that it deems appropriate. The report of the panel will be made publicly available five days after it is transmitted to the Parties.

If a panel makes a finding that a Party has engaged in a persistent pattern of failure to effectively enforce its environmental law, the Parties may, within 60 days, agree on a mutually satisfactory action plan to remedy the non-enforcement.

If there is no agreed action plan, then between 60 and 120 days after the final panel report, the panel may be reconvened to evaluate an action plan proposed by the Party complained against or to set out an action plan in its stead. The panel would also make a determination on the imposition of monetary enforcement assessments on the Party complained against.

The panel may be reconvened at any time to determine if an action plan is being fully implemented. If it is not being fully implemented, the panel is to impose a monetary enforcement assessment on the Party complained against.

In the event that a Party complained against fails to pay a monetary enforcement assessment or continues in its failure to enforce its environmental law, the Party is liable to ongoing enforcement actions. In the case of Canada, the Commission, on the request of a complaining Party, collects the monetary enforcement assessment and enforces an action plan in summary proceedings before a Canadian court of competent jurisdiction. In the case of Mexico and the United States, the complaining Party or Parties may suspend NAFTA benefits based on the amount of the assessment.

THE FUNDING OF ENVIRONMENTAL INFRASTRUCTURE PROJECTS IN THE U.S.-MEXICO BORDER REGION

Mexican Secretary of Trade and Industrial Development Jaime Serra and United States Trade Representative Mickey Kantor met to discuss the funding of border environmental infrastructure projects in their border region as an important component of the ongoing discussions regarding the Agreement on Environmental Cooperation. They agreed that there is a serious need to achieve effective coordination and fund environmental infrastructure projects designed to address wastewater treatment, water pollution, municipal solid waste and related matters in the U.S.-Mexico border region. They recognized that many environmental problems in the border region are not confined to either jurisdiction but must be addressed jointly by the United States and Mexico. They emphasized the importance of collaborating with the affected state, local communities and governments, and non-governmental organizations in developing solutions to environmental problems in the border region. Finally, they noted that substantial financial resources must be marshalled over the next decade from all sources, both public and private, to solve the environmental problems of the border region.

Secretary Serra and Ambassador Kantor suggested that negotiations on an agreement to establish coordinating and financing mechanisms for environmental infrastructure projects in the border region be governed by the following principles:

o The functions of a border environment institution would be, for environmental infrastructure projects for which it provides technical and/or financial assistance:

  -- to coordinate environmental infrastructure projects in the region;
  -- to review and approve environmental infrastructure projects;
  -- to assess the technical and financial feasibility of environmental infrastructure projects;
  -- to oversee the financing, construction and operation of environmental infrastructure projects; and
  -- to ensure a transparent process which incorporates the views of affected states, local communities, and non-government organizations.

- o This institution could mobilize sources of financing for environmental infrastructure projects:

    - -- a border environment financing facility;
    - -- direct government support, such as grants, loans, and guarantees from federal, state and local governments;
    - -- the private sector; and
    - -- subject to future agreement by the United States and Mexico, capital raised directly by the institution.

- o The principles governing the provision of financial support mobilized by this institution should be to:

    - -- provide secure sources of financing for environmental infrastructure projects;
    - -- leverage government financing;
    - -- encourage maximum participation of private capital; and
    - -- encourage maximum reliance on fees paid by those causing pollution and those benefitting from the improved environment in order to ensure payment of debt service.

- o A border environmental financing facility would be established, capitalized, and governed by the United States and Mexico. The possibility of a link with the Inter-American Development Bank should be explored. The financing facility would serve the border environment institution as one source of direct loans and partial guarantees for environmental infrastructure projects approved by the institution. The agreement establishing the facility could contain provisions for amendment that would enable the role of the facility to be expanded in the future, if the two governments agreed.

Secretary Serra and Ambassador Kantor agreed that officials would pursue further discussions on these issues in coming weeks.

FACT SHEET:

NAFTA SUPPLEMENTAL AGREEMENT ON ENVIRONMENTAL COOPERATION

Historic Undertaking This is the first environmental agreement negotiated specifically to accompany and build on a trade agreement. NAFTA will create the largest market in the world, grow jobs in America, and enhance the region's competitivenes. The Agreement on Environmental Cooperation will ensure that economic growth takes place in a manner consistent with goals of sustainable development.

New Independent Organization The Agreement creates a new Commission on Environmental Cooperation. The three countries' top environmental officials (the EPA Adminstrator for the United States) will comprise the Commission's *Council.*

- A *Joint Advisory Committee* made up of nongovernmental organizations from all three countries will advise the Council in its deliberations.

- The heart of the Commission is its *Secretariat*, housed in a single location and operating under the direction of an Executive Director. He will take broad direction from the Council, but maintain a high degree of independence.

Environmental Obligations

The NAFTA partners commit themselves to undertake important environmental policies regarding the development, implementation, and enforcement of their environmental laws.

- In the first instance, countries guarantee to grant their citizens *access to national courts* to petition governments to undertake enforcement actions and to seek redress of harm.

- Countries will ensure the openness of judicial and administrative proceedings and *transparent procedures* for the creation of environmental laws and regulations.

- Canada, Mexico and the United States pledged to ensure that their laws and standards continue to *provide high levels of environmental protection* and to work cooperatively in enhancing protections.

- They have committed *to effectively enforce those laws*, a commitment backed up by a dispute settlement process.

- The agreement does not affect the *rights of states and provinces* under the NAFTA to maintain standards at levels higher than the federal governments.

- Countries are obligated to *report on the state of their environments*, and to promote environmental education, scientific research, and technological development.

- They will work toward *limiting trade in toxic substances* that they have banned domestically.

<u>The Commission's Agenda</u> A major goal of the Commission is to broaden cooperative activities among the NAFTA partners. The Commission will have an aggressive and important workplan.

- It will consider the environmental implications of process and production methods, or, in the agreement's language, "environmental implications of products throughout their lifecycles."

- It will promote greater public access to information about hazardous substances (what we call "community right-to-know").

- It will consider ways to promote the assessment and mitigation of transboundary environmental problems.

- The Commission will serve as a point of enquiry for public concerns about NAFTA's effect on the environment, and be an avenue for NAFTA dispute settlement panels to obtain environmental expertise when faced with environmental issues.

<u>Public Participation and Dispute Settlement</u> Transparency is the hallmark of the agreement, and citizens of all three countries will be free to make submissions to the commission on their concerns related to the full range of environmental issues.

- The Commission's secretariat will act on submissions appropriately to develop fact-finding reports. The reports will be made public if two of three Parties concur (i.e., the complained against party cannot bar publication).

- The agreement creates a consultative process for the Council to discuss issues, including those brought to light through the public submission process and the Secretariat's fact-finding activities.

- Special attention is given to matters involving non-enforcement of a nation's environmental law when consultations fail to reolve the matter.

- In the event that one Party considers that another Party has persistently failed to effectively enforce its environmental laws (affecting a sector involving traded goods or services), the matter may be referred to a dispute settlement panel.

- The dispute settlement process provides, in the end, for sanctions if countries have failed to correct problems of nonenforcement.

<u>Scope</u> The Agreement has a broad, inclusive scope.

- Any environmental or natural resource issue may be addressed through the work program, and any environmental concern or obligation of the agreement may be the subject of consultations between parties.

- Understandably, the realm of issues subject to dispute settlement panels and possible sanctions is more circumscribed, focused on whether the Parties are effectively enforcing their environmental laws, and whether that nonenforcement is related to trade or competition among the Parties.

QUESTIONS AND ANSWERS ON THE SUPPLEMENTAL AGREEMENTS

I. ENVIRONMENTAL AGREEMENT

Q: Is border funding part of the environmental side agreement?

A. No, it will be developed as a separate bilateral agreement between the U.S. and Mexico.

Q. Will the Secretariat really be independent?

A. Yes. The parties have agreed to create one central, independent Secretariat. Its executive director, appointed by the Parties, will be able to select his or her own staff.

The Secretariat has a large degree of discretion in setting its priorities and organizing its work, subject to appropriate oversight by the Council. For instance, the Secretariat prepares its own annual program and budget, and enjoys broad responsibility for implementing the Commission's workprogram.

The Secretariat receives and considers submissions from the public on any matter, including allegations regarding a Party's failure to effectively enforce its environmental laws. The Secretariat determines which enforcement-related submissions warrant the development of a factual record, based on a combination of mandatory and discretionary criteria, and subject to the Council's approval. That factual record is used by the Parties in deciding whether to take a matter to dispute settlement.

The Parties have not yet finalized the size and location of the Secretariat.

Q. Will the Secretariat have access to facilities when investigating nonenforcement?

A. The Secretariat has broad authority to gather the information it needs to prepare reports and investigation allegations of nonenforcement. This includes information provided by the Parties and by public submissions, gathered from independent experts, or otherwise developed by the Secretariat. (Article 5(8) & (17), Article 31.)

Parties are to promptly provide information in their possession, and to take all reasonable steps to make other information available. "All reasonable steps" could include arranging for the Secretariat to visit facilites as appropriate.

Q. Are Canada's provinces covered by this Agreement?

A. This Agreement binds Canada for all matters subject to its federal control, including the enforcement of national environmental laws throughout the provinces.

Canada's constitutional system limits its ability to accept the Agreement's obligations on behalf of a province for matters under provincial control. To redress this imbalance among the Parties and to encourage provincial participation, the Agreement commits Canada to take all necessary measures to bring the provinces into this Agreement, and limits its ability to take advantage of dispute settlement procedures according to the extent of provincial participation. For instance:

- o Canada may not take an issue to consultations or dispute settlement on behalf of a province who is not participating in the Agreement.

- o Canada may not seek dispute settlement against another Party for an issue that would, in Canada, be subject to provincial control, unless provinces responsible for at least 55% of Canada's GDP have joined the Agreement.

We fully expect Canada's provinces to be brought on board, and will be following closely their progress in this regard.

Q. Does this Agreement ensure that states can have more stringent standards than federal?

A. This Agreement does not alter States ability to have standards more stringent than the federal standards, consistent with the NAFTA. No specific provisions were considered necessary to address this point because the NAFTA itself, similarly, does not prevent states from having more stringent standards.

The NAFTA is drafted as a set of prohibitions. Unless the NAFTA prohibits a certain type of measure or practice, a NAFTA country is free to maintain or impose it.

Since nothing in the NAFTA precludes states from maintaining or adopting standards that are higher than federal rules, they will continue to have the right to do so.

The NAFTA's language is not meant to suggest — and has not been interpreted under the related CFTA to mean — that state or provincial regulation must conform with federal standards.

Q. What role will States play in this new Commission?

A. The U.S. federal government will work closely with the States throughout the implementation and operation of this Agreement.

The Agreement recognizes each Party's right to create a governmental advisory committee for subfederal governmental representatives.

It is the practice of the federal government to notify state governments directly and promptly upon learning that another government intends to challenge a state measure, including an environmental law, under the dispute settlement procedures of our international trade agreements. This practice will continue under both the NAFTA and this Agreement: The U.S. Council Member **[EPA?]** will work closely with state government representatives at all stages of a dispute settlement proceeding in preparing the defense of any state enforcement action or inaction challenged under this Agreement.

Q. Does the Agreement require the Parties to address Process and Production Methods (PPMs)?

A. The Agreement calls on the Council to consider, as part of its cooperative workprogram, the issue of "the environmental implications of goods throughout their lifecycles". We believe that this concept, which is actually broader than PPMs, also covers them. We thus anticipate that the Council will be able to address environmental questions relating to process and production methods.

We are also continuing to work with Mexico, in other fora, to address the related tuna/dolphin question.

II. DISPUTE SETTLEMENT

Question: How does the trade-related test fit into dispute settlement?

Response: Under the environment agreement, the Parties, in deciding whether to establish an arbitral panel, will look to see if the alleged persistent pattern of failure to effectively enforce the law is trade-related. Under the labor agreement, an Evaluation Committee of Experts is to be established only if the matter is trade-related.

"Trade-related" merely means that the good or industry sector involved is traded within the NAFTA Parties or competes with a traded good or service.

Question: Will the panel proceedings be open to the public?

Response: There is nothing in either agreement that requires the panel proceedings to be confidential. These and other questions regarding the precise operations of the panels will be decided in the Model Rules of Procedure called for under the agreements.

Question: How big is the fine under the agreements?

Response: A panel can impose a monetary enforcement assessment against the government of up to $20 million in the first year. The maximum monetary enforcement assessment is up to .07% of total trade among the Parties in the following years.

Question: Who determines the amount of the fine?

Response: The panel will determine the amount of the monetary enforcement assessment, taking into account such factors as the pervasiveness and duration of the Party's failure to enforce or the reasons for non-implementation of an action plan.

Question: Who pays the fine?

Response: The government of the country that has failed to enforce its law pays the monetary enforcement assessment.

Question: Where does the fine go?

Response: Any monetary enforcement assessments go into a fund established by the Council and are to be spent to improve law enforcement.

Question: Is a country off the hook once it pays its fine?

Response: No. If a Party is not fully implementing the action plan, it remains liable to ongoing enforcement actions.

Question: Why is there a different rule for Canada than there is for the United States and Mexico on enforcing the payment of fines and implementation of action plans?

Response: Canada, which has a tradition of domestic court enforcement of orders of other tribunals, preferred to make available its domestic courts in this instance rather than be subject to potential suspension of NAFTA benefits. We, however, were unwilling to cede our sovereignty and take the unprecedented step of granting standing under domestic law to the decisions of an international tribunal.

Question: How do you decide what sector is involved for purposes of applying trade sanctions?

Response: If the failure to enforce involved enforcement in a particular sector, then a Party would first look to that sector in deciding what benefits to suspend. However, if it is not practicable or effective to suspend benefits in the sector involved in the non-enforcement (for example, because there is no identifiable sector involved), then a Party could look to suspend benefits in any sector.

FACT SHEET: NOT FINAL

FUNDING ENVIRONMENTAL INFRASTRUCTURE PROJECTS IN THE U.S.-MEXICO BORDER REGION

New Institutional Arrangements Although negotiators have not yet begun work on the language of a text, basic agreement was reached on a new institutional structure to promote effective coordination of infrastructure projects.

- o A hallmark of the institution will be a transparent process which incorporates the views of local residents and non-government organizations.
- o Initially, the institution will focus on projects addressing serious wastewater treatment and water pollution problems.
- o The institution will provide assistance on both the technical and financial aspects of the projects.

Financing Options Though the institution will not itself offer bonds initially, it will work to mobilize multiple sources of financing, depending on the nature of the individual project.

- o As appropriate, it will turn to the private sector, direct government support (loans, grants or guarantees at the federal, state and local level), and a *border environmental financing facility*.
- o Subject to future agreement, the institution could raise capital directly.

Border Environmental Financing Facility The United States and Mexico are exploring capitalization of a new financing mechanism to serve the border institution as one source of direct loans and partial guarantees.

U.S. and Mexican officials will hold further discussion in coming weeks, including discussions on the important question of the required levels of funding.

STANDARDS-RELATED MEASURES AND SANITARY AND PHYTOSANITARY MEASURES

The North American Free Trade Agreement (NAFTA) includes an agreement on standards-related measures and on sanitary and phytosanitary measures.

Standards-related measures ("SRMs") deal with voluntary and mandatory product standards and the procedures used to determine whether a particular product meets the standard. Sanitary and phytosanitary measures ("S&P") generally deal with protecting human, animal and plant life and health from risks of plant- and animal-borne pests and diseases, and additives and contaminants in foods and feedstuffs.

The NAFTA explicitly recognizes that countries have a legitimate need for product standards and for regulations to protect human, animal and plant life and health. The NAFTA provisions are designed to preserve the ability of governments to act in this area while guarding against the unjustified use of these types of measures as a way to protect domestic industry. In each case, the NAFTA sets up requirements and procedures that will help to distinguish legitimate measures from protectionist measures.

Question:

Will the NAFTA "harmonization" provisions weaken U.S. food safety by creating strong pressure for the United States to use less stringent Codex Alimentarius standards or Mexican standards?

Answer:

No. The NAFTA SPS provisions were specifically negotiated to be clear that there would be no "downward harmonization" of SPS measures.

While Parties **are** required to use international standards as "a basis" (but by no means the only basis) for their SPS measures, the NAFTA text explicitly states that this is to be done "without reducing the level of protection of human, animal or plant life or health."

It also explicitly provides that **nothing** in this requirement "shall be construed to prevent a Party from adopting, maintaining or applying...a sanitary or phytosanitary measure that is more stringent than the relevant international standard, guideline or recommendation."

Question:

Will the NAFTA severely restrict a country's ability to establish the level of protection it considers appropriate for human, animal and plant life and health? In particular, does it only allow a country to establish **one** level of protection for all its food safety standards?

Answer:

No. The NAFTA explicitly recognizes the right of each country to establish whatever levels of protection from risk that country deems appropriate.

Question:

Will NAFTA lead to challenges to food safety standards that are not based on risk assessment, but rather on policy determinations, such as the Delaney clause zero risk of cancer standards for food additives and pesticide residues which are based on policy not science?

Answer:

No. This concern is unfounded because it confuses two basic concepts.

The level of protection of human health that a society deems appropriate, such as that there should be a zero risk of cancer from food additives and pesticide residues, is not a scientific question and there is no requirement in the NAFTA that it be based on science.

As noted above, NAFTA specifically allows a country to determine the levels of risk it is willing to tolerate, including zero risk. So the Delaney clause, in establishing a zero **level of risk**, is consistent with the NAFTA.

However, in general NAFTA does require that before we ban a particular food additive or pesticide residue under the Delaney clause, we should have at least some scientific basis for concluding there is a cancer threat.

Question:

Does the NAFTA require that S&P measures be the least trade restrictive?

Answer:

No. This concern arises because of the inclusion of the word "necessary" in the S&P text.

Some GATT panels have construed the GATT Article XX general exceptions, which refer to "necessary" measures, to mean that in order for a measure to be determined to be "necessary" measures for purposes of qualifying for the exception, no GATT consistent measure is reasonably available and of the GATT-inconsistent measures available, the country chose the measure that is the least inconsistent with the GATT.

Some groups mistakenly read this as meaning we must adopt the "least trade restrictive" possible health, safety and conservation measures. In the NAFTA, the United States successfully resisted the inclusion of any "least trade restrictive" test in the NAFTA.

Furthermore, although the term "necessary" appears in the NAFTA S&P text, the way in which the term is used makes clear that there it does not create any "least trade restrictive" test.

Question:

Does the NAFTA prohibit S&P measures based on the manner in which food or other agricultural products are produced?

Answer:

No. There is no such prohibition in the NAFTA. In fact, the definition of an S&P measure specifically includes "a product-related processing or production method."

Question:

Will the NAFTA undermine state S&P measures because of its least trade restrictive obligation and because countries can only have one level of protection?

Answer:

No. The NAFTA safeguards the rights of states to have S&P measures, but these measures are subject to the same requirements as federal measures (e.g., are based on scientific principles, are not disguised restrictions on trade, do not arbitrarily discriminate).

As noted above, there is no least trade restrictive obligation in the NAFTA nor are countries limited to only one level of protection.

Question:

Does the NAFTA standards text give precedence to the existing GATT Standards Code over the NAFTA standards text where the two conflict?

Answer:

No. The Parties merely agreed that they would not disturb their rights and obligations under the GATT standards code. NAFTA uses very different language when it gives precedence to other international agreements.

Question:

Would the NAFTA's procedural harmonization provisions eliminate public notice and comment on standards?

Answer:

No. Nothing in the NAFTA would eliminate existing U.S. public notice and comment requirements. In fact, the standards text in general **requires** public notice and comment for standards and is modeled after U.S. practice.

Question:

Will the NAFTA limit environmental standards to the lowest common denominator and inhibit the development of more stringent regulations if they are needed to protect human health or the environment?

Answer:

No. The NAFTA is specifically drafted to ensure the ability of each country, including its state and local governments, to maintain stringent environmental standards.

In particular, the NAFTA recognizes the right of each country to enact and enforce laws and regulations that protect human health and the environment.

Furthermore, the agreement specifically provides that each country may establish those levels of safety and protection of human, animal and plant life and health, of the environment and of consumers that it considers appropriate.

Where the NAFTA calls on the three countries to collaborate on health and environmental standards it deliberately refers to joint efforts to "**enhance**" protection, not lower it.

In addition, the agreement states clearly that any efforts to make environmental or health standards compatible among the three countries should be undertaken "**without** reducing the level of safety or of protection of human, animal or plant life and health, the environment and consumers.

Furthermore, the NAFTA also specifically preserves each country's right to apply more stringent environmental or health measures than those provided under internationally-agreed standards.

Question:

Does the NAFTA's language that requires the federal government to take "all necessary measures" to give effect to NAFTA's provisions "including their observance by state and provincial governments" mean that if, for example, California's Proposition 65 toxic labeling requirement was challenged as a non-tariff trade barrier, the "all necessary measures" provision would require the federal government to pre-empt California's more stringent regulation?

Answer:

No. Nothing in the NAFTA would cause or require federal environmental or health standards to preempt California's standards.

The NAFTA requires each country to take "all necessary measures" to ensure that state and provincial governments observe those provisions of the agreement that apply to them. This language is drawn directly from the U.S.-Canada Free-Trade Agreement, which has been in effect since 1989 and has never been construed to preempt state measures.

The language simply reflects an understanding among the three countries that they intend to apply the agreement equally at the federal and state level, with exceptions to that general rule in certain areas. Thus, for example, the S&P text applies fully to federal, state, and provincial government measures.

One area in which there is somewhat less stringent application at the non-federal level is that of standards. In the SRMs text, the federal government is simply obligated to "seek, through appropriate measures" to ensure that states observe the relevant NAFTA rules.

This lesser degree of obligation, set out in Article 902, reflects an understanding among the three countries that the NAFTA should not intrude unduly on the ability of states to regulate in this important sphere.

Neither Article 105 nor Article 902 — nor any other provision of the NAFTA — creates an obligation that states adopt the same measures as the federal government. Accordingly, there is no basis under the NAFTA for challenging a state measure simply because it is more stringent than a relevant federal measure.

Furthermore, nothing in the NAFTA requires the federal government to take legal action against state measures that NAFTA dispute settlement panels may determine to be inconsistent with trade obligations.

Under the NAFTA, panel opinions are advisory only. If the defending country loses, it is not required to remove or change the offending measure.

It may offer trade compensation instead or simply permit the other country to take retaliatory action of equivalent effect.

As has been the case under the GATT, in those rare instances where state rules may be successfully challenged under the NAFTA, the federal government will work cooperatively with the states to seek a satisfactory resolution of the matter. Under the NAFTA, each country will retain full discretion, under our own political and legal system, to determine how to satisfy our trade obligations.

Question:

Is it true that the harmonization process does not require that we come to final agreement on particular standards? That is, if Canada and Mexico refuse to change their standard, can we insist on retaining ours as well?

Answer:

Yes. The NAFTA does not require that the United States change any particular standard.

Instead, the NAFTA creates a process by which the three countries can try to reach greater compatibility of standards among the three countries, but that does not require us to agree to any particular change in our standards.

Further, if the Administration believed that changes were desirable, whether because of discussions under the NAFTA or for any other reason, we would consult fully with Congress and domestic interests. Congress alone votes to change U.S. laws.

No "harmonization" process can ever force us to agree to standards we find unacceptable, nor could Congress be bound by any result it found unacceptable. Congress would need to pass specific legislation to effect a change.

Question:

Does the NAFTA preserve state standards that are more stringent than federal standards?

Answer:

Yes. From the beginning of the NAFTA negotiations, a fundamental objective of U.S. policy was to ensure that the NAFTA did not result in lowering U.S. health and environmental protection standards, including state and local standards. The Agreement secured that objective.

The agreement does apply to state laws and regulations in most respects. But it does so not by mandating compliance with federal law but by requiring that state measures comply with the rules set out in the agreement. Just as the federal government will be free to maintain or change its laws, subject to NAFTA rules, so will state and local governments.

The NAFTA is drafted as a set of prohibitions. Unless the NAFTA prohibits a certain type of measure or practice, a NAFTA country is free to maintain or impose it.

Since nothing in the NAFTA precludes states from maintaining or adopting standards that are higher than federal rules, they will continue to have the right to do so.

The NAFTA negotiators specifically used the plural "levels" (in Article 904(2) and in the equivalent provision of Chapter Seven (Article 712(2)), which talk in terms of each Party's right to set the **levels** of health, safety, or environmental protection that it sees fit), in part in order to account for the fact that each country may have a multiplicity of levels due to differences among the states and between the states and federal government.

Article 105 requires each country to take "all necessary measures" to ensure that state and provincial governments observe those provisions of the agreement that apply to them. This language is drawn directly from the U.S.-Canada Free-Trade Agreement ("CFTA"), which has been in effect since 1989.

It simply reflects an understanding among the three countries that they intend to apply the agreement equally at the federal and state level, with exceptions to that general rule in certain areas.

This language is not meant to suggest — and has not been interpreted under the CFTA to mean — that state or provincial regulation must conform with federal standards.

Question:

How, when, and by whom will a state be notified if one of its environmental laws is challenged under NAFTA? What forum and procedures will be utilized in hearing such challenges? In what way will a state be allowed to defend its laws under NAFTA?

Answer:

It is the practice of the federal government to notify state governments directly and promptly upon learning that another government intends to challenge a state measure, including an environmental law, under the dispute settlement procedures of our international trade agreements. This practice will continue under the NAFTA.

The NAFTA dispute settlement procedures are the avenue for formal government challenges against a state measure. Those procedures are detailed in Chapter 20 of the NAFTA.

These include consultations between the countries involved, recourse to the good offices of the NAFTA Trade Commission and, if no settlement can be reached, referral of the matter to non-binding arbitration.

In addition, there are a number of other procedures available to try to resolve disputes over either state or federal measures. For example, the NAFTA establishes trilateral committees to facilitate consultations and avoid or settle disputes regarding standards.

In the case of agricultural and food safety standards, the countries concerned may also have recourse to the good offices of relevant international organizations for purposes of resolving their differences.

As is the case under existing international trade agreements, USTR will work closely with state government representatives at all stages of a dispute settlement proceeding in preparing the defense of any state measure challenged under the NAFTA.

Border fact sheets
Publicly avail docs
See changes

OK N w/ Dan. Pa

DRAFT DRAFT DRAFT

August 12, 1993

Dear Governor Richards:

Thank you for contacting me regarding your thoughts about the establishment of an International Air Quality Management District in El Paso/Juarez. It was good to hear from you.

As you know, I share your commitment to the preservation of our global environment, and specifically in border regions, in a way that leads to strong and sustainable economic growth. The environmental challenges we currently face along our 2000 mile border with Mexico will provide an excellent opportunity to address transboundary environmental concerns on a binational, cooperative basis. The environmental supplemental agreement negotiated to support the NAFTA recognizes the importance of cooperation in achieving common environmental goals and envisions new and innovative mechanisms that will effectively achieve those goals in a trilateral arena.

I share your enthusiasm for the NAFTA and the sidebar agreements pertaining to transborder environmental challenges. I believe that the NAFTA will solidify the relationship between our two countries and provide a more effective context for resolving these border pollution issues. As you indicated, we must look into the use of new and innovative, cooperative institutions in order to determine the most efficient way to focus these new resources on environmental concerns. I support the concept behind your proposal, and I look forward to working with you in the future in implementing border clean-up initiatives.

Again, thank you for sharing your thoughts with me.

Sincerely,

BC

Change - since Friday get to Sandy + Silvia Correa

Dan - This is Aimee's draft reworked a bit. I never heard whether sign off was given or even who she was dealing with. Thx T

Points from Sandy Gaines

Concern on para 2; sounded preachy since she's been one of the most ardent supporters; been almost the other way around.

Also P. 2: Through econ growth... Sounds like Bush-speak for what's wonderful about NAFTa and misses the point about the emissions trading concept which Aimee was writing about and has little to do with econ growth, but rather need for innovative ccoperative mechanisms.

** Impt point could be instered: along with the NAFTA will solidify the relationship between our two countries and provide a more eff context for resolving these birder pollution questions.

Trey —

here is a draft of the letter to go to Ann Richards from BC. EPA & USTR still need to sign off on it — I will deal with that and call you from Idaho.

— Aimée.

Letter to Governor Ann Richards

Dear Ann,

I have read with great interest your letter of July 26, 1993 in which you propose the creation of an International Air Quality Management District to deal with problems of air quality in the U.S-Mexico border region. As you well know, I share your concern over the environment in the border area. The transboundary nature of environmental problems is nowhere more apparent than along our 2,000 mile border, and it is important to confront those problems on a binational, cooperative basis. The environmental supplemental agreement negotiated to support the NAFTA recognizes the importance of cooperation in achieving common environmental goals and envisions new and innovative mechanisms that will effectively achieve those goals in a trilateral arena. As you point out, however, the 1983 La Paz Agreement does present a viable opportunity to use an existing mechanism to pursue the improvement of shared environmental resources, such as the shared El Paso-Juarez airshed.

The first step to a better environment in the border region is the passage of NAFTA. Through economic growth the region can generate the resources to solve its environmental problems. But to efficiently direct those new resources to improvement of the environment we will need innovative, cooperative institutions such as you have proposed. I strongly support the concept behind your proposal and hope you will continue to work with me in obtaining passage of NAFTA and in implementing our border clean-up plan. With this foundation, we can move quickly to address other environmental concerns, including that of transboundary air pollution.

5601

cc NSC
NEC
K McGinty
Nia
John Podesta
7/28

State of Texas
Office of the Governor
Austin, Texas 78711

ANN W. RICHARDS
GOVERNOR

Dear Bill,

This formal letter proposes the creation of an International Air Quality Management District. El Paso/Juarez is the perfect location. I am sending Carol Browner and Mickey Kantor a copy. This idea will really be great for the border — good business and good for our communities.

Best,

Ann

Post Office Box 12428 Austin, Texas 78711 (512) 463-2000

STATE OF TEXAS
OFFICE OF THE GOVERNOR
AUSTIN, TEXAS 78711

ANN W. RICHARDS
GOVERNOR

July 26, 1993

The Honorable William Jefferson Clinton
President of the United States
The White House
Washington, D.C. 20500

Dear Mr. President:

Many cities along the border between the United States and Mexico are experiencing environmental problems caused by rapid population growth and expanded economic activity. One of the most severe problems we face is in the border cities of El Paso, Texas and Ciudad Juarez, Chihuahua, where air pollution is the worst of any United States-Mexican border community and seriously threatens public health. I see an opportunity to address this problem by using an innovative approach that would involve binational management of a shared international airshed. I urge you to provide your support and leadership to a proposal to create an International Air Quality Management District encompassing the border cities and surrounding region.

An International Air Quality Management District could promote efficient solutions to this complicated problem by establishing common air quality targets, setting emission limits that reduce pollutants to health levels, and adopting an incentive-based approach to work toward those goals in a timely and efficient manner. The District could also coordinate air pollution monitoring work, inventory sources of pollution, and develop cost-effective and equitable programs to improve air quality. In particular, the District would oversee the establishment of an international emission trading program that would encourage transboundary investment in pollution control and use economic growth to reduce pollution. Individual businesses operating in the airshed would have the flexibility to decide where and how to make the required reductions in pollution and receive valuable emission reduction credits that can be traded or banked for future use.

The ongoing negotiations regarding the environmental accord to supplement the North American Free Trade Agreement provide an excellent opportunity to create an International Air Quality Management District. Alternatively, a Memorandum of Understanding could be negotiated with Mexico, under Annex V of the 1983 La Paz Agreement. In either event, the District would be composed of representatives appointed by the respective federal, state and local governments. The purposes, duties, and powers of the District would, at a minimum, include the following:

POST OFFICE BOX 12428 AUSTIN, TEXAS 78711 (512) 463-2000 (VOICE)/(512) 475-3165 (TDD)

1. Development of air quality goals of the airshed that promote expeditious attainment of U. S. national ambient air quality standards and la Norma Mexicana de Calidad del Aire;

2. Development of guidelines for air pollution control programs that will be effective in meeting air quality goals for the airshed, including specific guidelines governing the creation and use of emission reduction credits and an international trading program;

3. Coordination of monitoring programs (ambient air quality, meteorological and emissions), including establishment of a joint data base, modeling protocols, and appropriate training programs;

4. Preparation of regular reports to inform the public about air quality conditions and trends in the airshed;

5. Establishment of mechanisms to ensure that the necessary pollution reduction and prevention programs are developed, implemented, and enforced on a binational basis; and

6. Adoption of administrative procedures to ensure adequate public participation in the District's activities, including providing a forum for citizen complaints regarding air quality related problems.

Establishing an appropriate framework for regional management will expand our options for achieving pollution reductions and lower the cost of cleaning up air pollution. It will also provide a new source of revenue for investments in environmental protection and infrastructure improvements. For these reasons, the proposal to create an International Air Quality Management District has my full support. In addition, I can assure you that it has been favorably reviewed by federal, state, and local officials in Mexico.

With your leadership, U. S. and Mexican citizens along the border can make this innovative approach work.

Sincerely,

Ann Richards

ANN W. RICHARDS
Governor

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

July 15, 1993

MEMORANDUM FOR ALICE RIVLIN (OMB)
KARIN KIZER (OMB)
MICHAEL PUNKE (NEC)
JOHN KNOX (STATE)
JIM DERHAM (STATE)
DOUG TURNER (EPA)
CHUCK FOX (EPA)
JEFFREY SHAFER (TREASURY)
KAREN MATHISEN (TREASURY)
BRYAN SAMUEL (USTR)
DAN BLANK (OEP)

FROM: SHERMAN ROBINSON (CEA) SR

SUBJECT: The IBWC border authority option for funding NAFTA-related environmental projects

I have some concerns about the options paper on financing NAFTA-related environmental investment projects ("NAFTA-Related U.S.-Mexico Border Environmental Activities: Needs Assessment and Alternative Financing Mechanisms," July 13, 1993). The paper states that "the interagency group generally supported the concept of a border authority," and was in favor of expanding the role of the International Boundary and Water Commission (IBWC) to make it the lead institution for financing NAFTA-related environmental investments along the border. I do not agree.

The IBWC was established by a treaty between Mexico and the U.S. in 1944. The U.S. and Mexican "sections" of the Commission are each headed by an engineer. The U.S. Commissioner is appointed by the President, with no Senate confirmation. I understand that many of the U.S. staff are from the Corps of Engineers. The IBWC gets all its U.S. funds through appropriations to the State Department and EPA, and has no authority to issue bonds.

Like the Corps of Engineers, The IBWC appears to be an agency that does a good job, given its technical mandate. It also has a reputation for not being reponsive to community and environmental groups and has been seriously criticized in various studies by academics and researchers in institutions such as the Udall Center for Public Policy (University of Arizona), the Texas Center for Policy Studies, and the Natural Resources Defense Council. Whether or not these criticisms are justified, the IBWC appears not to be popular with environmental groups whose support is being sought through the establishment of a funding mechanism for environmental projects. As the proposed lead financing institution for a "green" NAFTA, the IBWC starts with one strike against it politically.

While it might be possible to transform the IBWC into a more accountable and responsive institution with bonding authority, as suggested in the options paper, the changes would require a fundamental redesign of the institution, including a new treaty with Mexico. My fear is that the attempt to change the IBWC might yield a new institution that does not satisfy the concerns of environmentalists and their supporters in Congress, but yet dilutes or loses the technical strengths of the IBWC as currently structured.

The IBWC proposal takes an existing institution with a very narrowly defined mandate and attempts to extend it as little as possible, in a manner designed to cost the U.S. government as little as possible. The proposal represents a minimal institutional response to the need for a funding source to implement NAFTA plus the side agreements. The development bank option (NADBank), either as a separate institution or as a subsidiary within the Inter-American Development Bank (IDB), is more ambitious, seeking to establish a tri-national institution capable of handling a wider range of infrastructure investment needs. The NADBank and IDB/NADBank proposals better fit into the Administration approach to NAFTA-PLUS, reflecting the view that the Administration is committed to managing the problems of North American integration in a way that is quite different from the approach of the Bush Administration.

I favor the IDB/NADBank proposal. Establishing a NADBank in the IDB is potentially the cheapest option, and could be implemented the most quickly. The IBWC option envisions raising money by issuing investment grade (Ba or BB) bonds. The IDB currently issues AAA bonds, and it should be feasible to structure the IDB/NADBank so that it can share the IDB's credit standing. Even if there is some reason to separate the IDB/NADBank financially from the IDB, it should be able to do better than BB. Also, the IDB/NADBank option provides the greatest leveraging of U.S. funds, requiring a much smaller amount of paid-in capital (and a larger share of "callable" capital, which is currently scored at zero by CBO and OMB) than would be required to start up a separate NADBank. Administrative costs would be also be lower, since the IDB would provide the necessary facilities and support.

There have been discussions with the President of the IDB (E. Iglesias) concerning the feasibility of creating a NADBank within the IDB. It is evidently feasible to do so, and the institution could easily be structured so that it could lend for projects on both sides of the border. I understand that Iglesias and IDB staff are very interested in the idea.

The IDB/NADBank is politically attractive because it best meets the needs articulated by the environmental community for an institutional response to the need to finance environmental infrastructure investments. While environmental groups have been suspicious of the multilateral development banks in the past, there are indications that they would support this proposal, and might well see it as a good way to make the IDB more responsive to their concerns.

I also see the IDB/NADBank as complementary to the IBWC. The IBWC apparently does a good job designing and implementing water projects. It is certainly feasible for the IDB/NADBank to work with the IBWC, providing an additional source of funding for their projects. The IDB/ NADBank, however, would not be restricted to working only with the IBWC, but could do other things as well.

several groups — both w/ the USG and w/o — have developed proposals aimed at env. protection on the US/Mex border — connected w/ the NAFTA.

MEMO

TO: Katie McGinty
FROM: Dan Blank

NAFTA BORDER ENVIRONMENTAL CONSIDERATIONS

I. **Issue:** The North American Free Trade Agreement must be joined by an environmental protection proposal in order to garner the support it needs from congress. Can environmental protection be provided for without being prohibitively expensive? Will it demand selective tariffs or additional financial commitments? Can additional sanctions be a part of this agreement? What form(s) should the proposal take?

Tariffs perhaps are the most controversial as they go against the very nature of free trade. In addition, sanctions (besides those already mandated by existing international agreements) raise sovereignty concerns for all involved and Mexico and Canada have strongly resisted the idea.

The key is to create a proposal strong enough to protect the border region, while avoiding reopening NAFTA, undercutting U.S. business support, or causing Canada or Mexico to back off on sovereignty grounds.

project? institution?

II. **Primary issues to be dealt with by ~~the~~ a border agreement:**
- monitoring corporations by gathering information ~~from~~ corporations and NGOs within the border region
- promoting clean technology development and deployment
- clean-up of solid and hazardous waste
- funding of environmental projects/ environmentally benign infrastructure

III. **Probable funding demands of Mex/U.S. border protection:** Between $4 billion and $6.5 billion over the next decade, or $400-650 million/year.

Some of the costs may be covered by existing funding sources:

a) The EPA has $150 million annually in the FY 94-98 budget request for projects on both sides of the border.

b) The Mexican Government has targeted about $400-500 million over a 3-4 year period for environmental projects in the border region.

c) The World Bank is to provide loans of $250-400 million in FY 94-96 for environmental projects by mexican municipalities alon ghte border. Portions of a $300 million water project loan and $150 million solid waste loan may be focused on the border.

The Inter-American Development Bank (IDB) is also providing funding for water projects in Tijuana from a credit line of $108 million.

IV. To provide the additional funding that will be needed, three ~~possible fina~~ncial mechanisms have been proposed by an interagency group. which?

a) A NAFTA Environmental Trust Fund (NEFT) in the IDB, ~~or~~ ?
b) A Border Authority as an expansion and restructuring of the International Boundary and Water Commission (IBWC), or
c) A "Dedicated Fund" for environmental or general border infrastructure.

when.

The interagency group agreed that further analysis should concentrated on the ~~first~~ two options. Neither would have to be fully negotiated by the time NAFTA is submitted to Congress, but the governments would need to reach agreement on the broad objectives and general funding requirements of the institution. The interagency group opposes "Dedicated" funding (i.e., increasing or earmarking tariffs) since it could be politically difficult and cotradict the basic premise of NAFTA.

- The **NEFT** would be a separate fund in the Inter-American Development Bank(IDB) under the control of the NAFTA participants. It would provide up to $10 billion in loans to finance enviromental investments in Mexico only to ensure compliance with NAFTA. The IDB would administer the NEFT, with loans to regional and municipal authorities in Mexico, on IDB hard loan terms (about 8%). Because the IDB is chartered to operate only in regional developing countries, it is assumed that the U.S. and Canada would not be elligible to borrow.

? The ~~U.S.~~ would provide 75%, Canada 15%, and Mexico 10%. Under the 2.5% paid-in formula of the IDB, the U.S. share would only be $187.5 million or $37 million in budget authority annually; however, the limited diversity of the NEFT portfolio suggests that a higher paid-in contribution might be required. In addition, it is unclear whether Mexico and its municipalities have the need to borrow and capacity to service $10 billion over the next 5-10 years. And finally, the NEFT may ~~also~~ duplicate existing facilities in which Mexico is one of the largest borrowers. ?

The NEFT would require international negotiations ~~to be established~~ and ~~would require~~ Congressional authorization through at least the House and Senate banking committees. ? Both the paid-in capital and contingent liability would be subject to annual discretionary appropriations. It would probably take 12-18 months to begin operations.

- The **Border Authority** would be an expanded and restructured International Boundary and Water Commission (IBWC). The underlying premise is that the environmental infrastructure problems in the border ~~area are~~ on both sides of the boundary and are interrelated. (**unlike NEFT) The Border Authority would

what is?

Spellcheck

approve the design and siting decisions for projects in the border zone. It would also determine priorities and standards working with the state and local authorities, providing rationalization and avoiding duplication of existing institutions.

Of the institutional proposals, this has the most potential to be structured in a way that does not constitute direct foreign aid. The Authority could own and operate public utility projects and charge user fees, or oversee the ownership and operations by local entities. The IBWC already owns and operates many public utility projects and has 225 engineering professionals. These assets would be transferred to the Border Aurthority and their cashflow used to pay for the operations of the Authority.

It could raise funds for environmental projects in two ways: by guaranteeing bonds (issued directly through finance entities or guarantee the bonds of other entities); or, issue bonds directly by operating as a central funding mechanism. The proposal would require budget authority in the U.S. and Mexico for administrative expenses and an annual appropriation to cover the subsidy cost of the guarantee. For initial capitalization the IBWC's existing assets may cover such requirements at $400 million. For every $1 billion in financing for projects, the budget cost to the U.S. could range from $50 million to $100 million. 2

It would require international negotiations between the U.S. and Mexico and need to be authorized through numerous Congressional Committees before becoming operational. It would also require annual discretionary appropriations and perhaps some initial capitalization. It could become operational in 12-18 months.

2.

• The **Dedicated Fund** would be established through (a) an increase in the current tariffs applied to Mexican and ~~U.S.~~ goods and services at the border, or (b) redirection of revenues from existing tariff revenue. This pool would fund projects on a current financial basis (such as grants), through either annual appropriations action or provision for off-setting collections.

Projects would be selected in one of three ways: (a) using existing structures (IBWC, U.S./Mexico binational commission) for ~~developing an inter-agency Administration position for the U.S. and~~ negotiations with Mexico for a second stage of the current border plan; (b) creating a new institution such as a commission to coordinate federal, state and local activities and select projects that meet regional needs; or (c) creating a new institution separate from the existing federal and state agencies that could either contract out to existing agencies or would have its own staff.

This proposal hinges on either imposing additional tariffs on trade or redirecting existing tariff revenue, both of which would have serious budget and political ramifications. For every $1 billion in environmental financing, this proposal would require at least $500 million and perhaps as much as $1 billion in either additional tariffs or direct appropriated budget authority for the U.S. side. The additional tariffs and use of

According to ?

such to finance fiscal programs violates GATT under Article XXIV and VIII.

It would also require international negotiations with Mexico and authorization from Congressional Committees and annual discretionary appropriations for the financing (grants).

V. Besides the above financial proposals, both governmental and non-governmental sources have proposed several institutions and programs to provide for border environmental protection. These vary from a "Border Environmental Commerce Zone" to an overarching governmental "International Boundary Environmental Commission."

Non-Governmental Proposals:

• **"International Boundary Environmental Commission"** is proposed jointly by the Udall Center for Studies in Public Policy at the University of Arizona, and the International Transboundary Resources Center at the University of New Mexico School of Law.

The IBEC would be a binational border environmental management institution building on the advances of the La Paz Agreement and the achievements of the IBWC. Specifically it would be an expansion and alteration of the IBWC to deal with not only water, but also air, hazardous material, and toxic waste management. This would be done through codification of the annexes under the La Paz Agreement in treaty form with designation of the IBEC as the lead agency with responsibility for border environmental protection. It would not duplicate or supplant existing institutions, but would serve a needed coordinating and service role in the border region.

The IBEC would be structured as a binational commission with strong local involvement and supported by advisory boards, and co-chaired by appointees of the Presidents of Mexico and the United States. It would hold public meetings, technical meetings, workshops and briefings.

It's first task would be to collect, maintain and update an inventory of border environmental resources and threats to air and water quality, hazardous materials and toxic waste problems. In addition, IBEC would act as a clearinghouse for information about environmental problems and provide technical assistance services to agencies, officials, NGOs and private individuals. The goal would be to empower local officials, not to supplant them. Designated Critical Environmental Management Areas (CEMAs) may be organized in border areas identified as having significant environemntal problems.

A Border Environmental Trust Fund (BETF) would be established to finance the IBEC. It would receive appropriations from the two national governments. It would also have a stable source of funding in a "customs processing fee" which would be a percentage of the value of transboundary trade at a rate low enough to avoid distortion of trade of investment activities. In addition to financing IBEC and CEMAs, money would be made available to border communities through grants and low interest loans for needed infrastructure projects identified during the planning process.

The groups involved have already formed a task force to identify the problems on this side of the border before working on the creation of the IBEC. However, they are encountering problems through the Integrated Border Environment Plan (IBEP) created by the Bush Administration to deflect concern, but was severly criticized for failing to consult local groups. The IBEP continues to operate, however, and is a difficult beaureaucracy to work around.

Some members of the Task Force currently include Gary Mauro and Tyrus Fain (of the Texas General Land Office); William Tilney, Mayor of El Paso; and Alicial Chacon, El Paso County Judge. They will, and have been, pushing this initiative on the Hill.

• **A "Border Environmental Commerce Zone"** is proposed by the Sierra Club of San Diego.

The BECZ will be designed to "create an environment in which innovative, minimal-impact processes and/or end-use products can be developed and utilized to help clean our air, water and land by providing incentives for companies that manufacture products or provide services that are environmentally beneficial, in a manner that is environmentally-friendly."

These qualifying businesses must utilize the highest level of pollution prevention technology and processes with a zero discharge goal or minimum depletion of natural resources. They must receive a threshold score on an Environmental Audit (outlined in the paper) and promote environmental education while maintaining its high level of environmental standards.

The BECZ is a block that extends 15 miles north from the Mexican border, and is bound by the major transit systems on all three sides. It would offer business assistance and state and federal incentives to qualifying businesses.

An Environmental Technology Resource Center/Incubator is proposed to provide assistance as an "incubator" to businesses within the zone that wish to incorporate the criteria of the BECZ. This assistance includes space and shared services, business development services, marketing development services, and advanced growth services. The BECZ proposes that it get its funding from the President's Economic Development stimulus package and other federal agencies.

• The Arizona Toxics Information Border Ecology Project demanded that **NACE** strengthen Mexico's Environmental Management ~~if sanctions~~ are to applied. They support NACE's role to investigate, arbitrate and recommend sanctions to be applied when a persistent and unjustifiable pattern of non-enforcement of domestic environmental law exists.

The structure of NACE should reflect the many governmental and non-governmental groups in all three countries. It should act not only as an instrument of investigation and arbitration but also a means of facilitating and promoting continuous exchange of information among both groups or, as in the Mexican

How do NACE sanctions relate to the border?

case, as a link to proposed national commissions created with plural representation and executive capacity.

NACE should cooperate with Mexico to increase its capacity for protecting the environment by helping obtain financial and technical resources through the "polluter pays" and "user pays" principles. Rejecting environmentally-based sanctions on the basis of protecting national sovereignty is inconsistent with compliance strategies (including sanctions) accepted by the three trading partners within the strictly commercial aspects of the NAFTA.

These sanctions should not be used as a penalty against Mexico, but as a means within the NACE to complement Mexico's domestic enforcement of environmental norms. Trade sanctions should include a direct linkage betweent he use of revenues collected and the remediation and prevention of Mexico's environemntal and health problems.

Governmental Proposals: The following "Port Authority" and "Binational Border Authority" proposals are very similar and appear to have been built upon each other (if not from the same source).

• **The "Port Authority"** proposal by the State Department OES, is a broad-based program to provide resources for border environmental needs. It builds upon the promise of NAFTA to help enable Mexico to enhace per capita income and devote more resources to environmental protection. Mexico has responded to the NAFTA challenge by devoting increasing resources to environmental needs (1% of GDP), and a completed NAFTA will encourage Mexico to continue to expand its environemntal programs along the border and throughout Mexico.

The proposal incorporates the existing governmental agencies of the IBWC and the National Labs, as well as our environmental goods and services industry. Many of the IBWC assets could be privatized to provide revenue to finance border infrastructure and environmental investments. These revenues would be used to guarantee or provide other financial concessions for loans from private financial markets. Since the IBWC assets are owned jointly by Mexico and the U.S., use of them for this purpose would have the benefit of **not requiring the identification of new resources on the U.S. or Mexican side.**

In addition, states on both sides of the border would need to be encouraged to establish minimum land use and development standards for the new residential and industrial construction (to ensure that future development will not recreate problems that exist today. The U.S. would also want to mobilize our environmental industry to help meet the demand for technologies and services, and to develop new technologies for use in Mexico. The National Labs could help assist and guide efforts with private industry.

• **The "Binational Border Authority"** would be created jointly by the U.S. and Mexico to implement the financing, completion and supervision of the proposed border infrastructure projects. It

how is this different from 1-2?

would contain elements of a number of existing entities that deal with cross-boundary infrastructure projects (the IBWC,

Two basic powers of the Authority would be to approve design and siting decisions for projects in the border zone and the authorization to guarantee locally issued bonds that would be used to finance the projects. It would also develop equipment standards for the project, and provide oversight for the construction and operation of the projects so as to assure independent accountability.

In addition, the Authority would have regulatory powers, similar to those already exercised by the U.S. and Mexico, but would complement and supplement them, though also supersede them in cases of conflict.

The Authority should not be viewed as a significant direct source of funding for environmental infrastructure projects, but as a facilitator of access to the private capital markets. It will, however, be structured to have the ability to own and operate projects on its own and could serve as a conduit for use of funds contributed directly by the two governments or from international institutions.

The primary sources of funding for the operations would be three fold: (a) the infrastructure assets of the IBWC that are not already income-producing should be made so, and then all transferred to the Authority; (b) the cost of the engineered services of the Authority would be reimbursed by allocation to the projects; and (c) as with the IBWC, each country would pay for the operation of its section of the Authority, which should be relatively small.

The primary financial power of the Authority relating to the financing of the projects would be the ability to guarantee locally issued revenue bonds. The underlying credit for such bonds would rest upon the cashflow generated from projects through user fees.

As a "government sponsored enterprise," the Authority could play a role in five functional areas:

- facilitation of cross-jurisdictional actions
- standardization of design, siting and construction of environmental infrastructure projects
- provision of liquidity for financing such infrastructure projects
- subsidization-to some extent-of such projects and
- encouragement of the development and export of environmental equipment and technology.

All caps

MEMO TO KATIE FROM DAN

RE:

~~**TO: Katie McGinty**~~

~~**FROM: Dan Blank**~~

7/16/93

NAFTA BORDER ENVIRONMENTAL CONSIDERATIONS

I. Issue: Several groups, both governmental and non-governmental, have developed proposals for models of environmental protection for the U.S./Mexico border. ~~The final~~ proposals by the OMB-led interagency task-force ~~is expected to be the one upon which the final policy will be built.~~ will be discussed at the NEC Deputies meeting 7/19.

II. Probable funding demands of Mex/U.S. border protection: Between $4 billion and $6.5 billion over the next decade, or $400-650 million/year. OMB estimates?

Some of the costs may be covered by existing funding sources:

a) The EPA has $150 million annually in the FY 94-98 budget request for projects on both sides of the border.

b) The Mexican Government has targeted about $400-500 million over a 3-4 year period for environmental projects in the border region.

expected? planning?

~~c) The World Bank is~~ to provide loans of $250-400 million in FY 94-96 for environmental projects by mexican municipalities along the border. Portions of a $300 million water project loan and $150 million solid waste loan may be focused on the border. The Inter-American Development Bank (IDB) is also providing funding for water projects in Tijuana from a national credit line of $108 million.

III. Non-Governmental Proposals for the border region:

• **"International Boundary Environmental Commission"** is proposed jointly by the Udall Center for Studies in Public Policy at the University of Arizona, and the International Transboundary Resources Center at the University of New Mexico School of Law.

The IBEC would be a binational border environmental management institution building on the advances of the La Paz Agreement and the achievements of the IBWC. Spell out first time

Specifically it would be an expansion and alteration of the IBWC to deal with not only water, but also air, hazardous material, and toxic waste management. This would be done through codification of the annexes under the La Paz Agreement in treaty form with designation of the IBEC as the lead agency with responsibility for border environmental protection. It would not duplicate or supplant existing institutions, but would serve a needed coordinating and service role in the border region.

The IBEC would be structured as a binational commission with strong local involvement and supported by advisory boards, and co-chaired by appointees of the Presidents of Mexico and the United States. It would hold public meetings, technical

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meetings, workshops and briefings.

It's first task would be to collect, maintain and update an inventory of border environmental resources and threats to air and water quality, hazardous materials and toxic waste problems. In addition, IBEC would act as a clearinghouse for information about environmental problems and provide technical assistance services to agencies, officials, NGOs and private individuals. The goal would be to empower local officials, not to supplant them. Designated Critical Environmental Management Areas (CEMAs) may be organized in border areas identified as having significant environmental problems.

A Border Environmental Trust Fund (BETF) would be established to finance the IBEC. It would receive appropriations from the two national governments. It would also have a stable source of funding in a "customs processing fee" which would be a percentage of the value of transboundary trade at a rate low enough to avoid distortion of trade and investment activities. In addition to financing IBEC and CEMAs, money would be made available to border communities through grants and low interest loans for needed infrastructure projects identified during the planning process.

The groups involved have already formed a task force to identify the problems on this side of the border before working on the creation of the IBEC. They mentioned that they are encountering problems through the Integrated Border Environment Plan (IBEP) created by the Bush Administration to deflect concern. When it was initiated, the IBEP was severely criticized for failing to consult local groups. The IBEP continues to operate, however, and is a difficult bureaucracy to work with.

Some members of the Task Force currently include Gary Mauro and Tyrus Fain (of the Texas General Land Office); William Tilney, Mayor of El Paso; and Alicia Chacon, El Paso County Judge. They will ~~and have been, pushing~~ continue to push this initiative on the Hill with the following staffers and Congressional members: Coleman, De La Garza, Richardson, Pastor, Bingaman, Krueger, Feinstein, Boxer and Deconcini.

• **A "Border Environmental Commerce Zone"** is proposed by the Sierra Club of San Diego.

The BECZ will be designed to "create an environment in which innovative, minimal-impact processes and/or end-use products can be developed and utilized to help clean our air, water and land by providing incentives for companies that manufacture products or provide services that are environmentally beneficial, in a manner that is environmentally-friendly."

These qualifying businesses must utilize the highest level of pollution prevention technology and processes with a zero discharge goal or minimum depletion of natural resources. They must receive a threshold score on an Environmental Audit (outlined in the paper) and promote environmental education while maintaining its high level of environmental standards.

The BECZ is a block that extends 15 miles north from the Mexican border, and is bound by the major transit systems on all three sides. It would offer business assistance and state and federal incentives to qualifying businesses.

An Environmental Technology Resource Center/Incubator is proposed to provide assistance as an "incubator" to businesses within the zone that wish to incorporate the criteria of the BECZ. This assistance includes space and shared services, business development services, marketing development services, and advanced growth services. The BECZ proposes that it get its funding from the

President's Economic Development stimulus package and other federal agencies.

• The **Arizona Toxics Information Border Ecology Project** outlined their ideas of **NACE**'s role in border issues and specifically stated that we cannot isolate our strategies for the border region from those being developed for the interior of Mexico and the North American continent in general. They support NACE's role to investigate, arbitrate and recommend sanctions to be applied when a persistent and unjustifiable pattern of non-enforcement of domestic environmental law exists.

The structure of NACE should reflect the many governmental and non-governmental groups in all three countries. It should act not only as an instrument of investigation and arbitration but also a means of facilitating and promoting continuous exchange of information among both groups or, as in the Mexican case, as a link to proposed national commissions created with plural representation and executive capacity.

Regarding the border region, NACE should cooperate with Mexico to increase its capacity for protecting the environment by helping obtain financial and technical resources through the "polluter pays" and "user pays" principles. Rejecting environmentally-based sanctions on the basis of protecting national sovereignty is inconsistent with compliance strategies (including sanctions) accepted by the three trading partners within the strictly commercial aspects of the NAFTA. They suggested that NACE must strengthen Mexico's environmental management if sanctions are to applied.

These sanctions should not be ~~used as~~ a penalty against ~~Mexico~~, but as a means within the NACE to complement Mexico's domestic enforcement of environmental norms. Trade sanctions should include a direct linkage between the use of revenues collected and the remediation and prevention of Mexico's environmental and health problems.

Leading up to ~~staff~~ process

Governmental Proposals: ~~As part of~~ the OMB-led interagency ~~task force,~~ ~~the~~ State ~~Department~~ OES outlined their version of a "Binational Border Authority."

• **The "Binational Border Authority"** would be created jointly by the U.S. and Mexico to implement the financing, completion and supervision of the proposed border infrastructure projects. It would contain elements of a number of existing entities that deal with cross-boundary infrastructure projects.

Two basic powers of the Authority would be to approve design and siting decisions for projects in the border zone and the authorization to guarantee locally issued bonds that would be used to finance the projects. It would also develop equipment standards for the project, and provide oversight for the construction and operation of the projects so as to assure independent accountability. (Currently the IBWC deals with these areas on a negotiated basis.)

In addition, the Authority would have regulatory powers, similar to those already exercised by the U.S. and Mexico, but would complement and supplement them, though also supersede them in cases of conflict.

The Authority should not be viewed as a significant direct source of funding for environmental infrastructure projects, but as a facilitator of access to the private capital markets. It will, however, be structured to have the ability to own and operate projects on its own and could serve as a conduit for use of funds contributed directly by the two governments or from international institutions.

The primary sources of funding for the operations would be three fold: (a) the infrastructure assets of the IBWC that are not already income-producing should be made so, all privatized, and then all transferred to the Authority; (b) the cost of the engineered services of the Authority would be reimbursed by allocation to the projects; and (c) as with the IBWC, each country would pay for the operation of its section of the Authority, which should be relatively small.

The primary financial power of the Authority relating to the financing of the projects would be the ability to guarantee locally issued revenue bonds. The underlying credit for such bonds would rest upon the cash-flow generated from projects through user fees.

As a "government sponsored enterprise," the Authority could play a role in five functional areas:

- facilitation of cross-jurisdictional actions
- standardization of design, siting and construction of environmental infrastructure projects
- provision of liquidity for financing such infrastructure projects
- subsidization-to some extent-of such projects and
- encouragement of the development and export of environmental equipment and technology.

The paper drafted ~~The final proposal is~~ by the ~~the~~ **OMB-led interagency group** outlines three possible options for general financing mechanisms:

a) a Border Authority as an expansion and restructuring of the International Boundary and Water Commission (IBWC);
b) a multilateral development bank; or
c) a "Dedicated Fund" for environmental or general border infrastructure.

The interagency group generally supported the concept of a border authority. The IBWC could be altered to avoid creating an entirely new institution. The interagency group opposes "Dedicated" funding (i.e., increasing or earmarking tariffs) since it could be politically difficult and contradict the basic premise of NAFTA.

There are two **"Border Authority"** options that build on the existing (IBWC ~~International Boundary and Water Commission~~). The underlying premise is that the environmental infrastructure problems in the border area are on both sides of the boundary and are interrelated. The Border Authority would approve the design and siting decisions for projects in the border zone. It would also determine priorities and standards working with the state and local authorities, providing rationalization and avoiding duplication of existing institutions.

(a) The current IBWC's mandate would be expanded to include:
- a broader scope of water quality issues and
- authority to guarantee publicly placed private bonds.

The new organization would review and select projects to improve water quality in the border region, have its own staff to conduct its financial operations, and partially guarantee bond issued by private finance corporations created to construct specific water treatment facilities. Bonds or loans would be repaid by charging user fees on affected communities, wither at market-rates or with subsidies.

Such alterations of the IBWC would require negotiations with the Mexicans, (12-24 months), and a new treaty, subject to two-thirds Senate approval. The U.S. share of all future project costs would be negotiated as part of the restructuring. The proposed U.S. share is 50 percent of the amount of any partial guarantee placed on projects. To finance its share the U.S. would provide a subsidy to back the guarantee on the project bonds.

b) The IBWC's responsibilities would be expanded to include additional water quality issues in the border region as well as review and select projects related to water quality, and coordinate with EPA on technical and financial feasibility of the project.

The expanded IBWC would not provide financing itself, but would coordinated financial support from the U.S. and Mexico. Each would fund its share (to be negotiated) of the private finance corporations created to construct specific water treatment facilities in the border region. Bonds or loans would be repaid by charging user fees on affected communities, either at market-rates or with subsidies.

The U.S. Treasury Department or EPA could provide U.S. financial support either by guaranteeing a portion of private bond issues and/or by lending directly to the finance corporation.

Although Mexico will be expected to commit to financing, it will decide what form of financing it wants to provide, (e.g., relying on the MDBs from which Mexico is a principle borrower).

Expanding the IBWC's scope without financial authority would require negotiations with the Mexicans but could become effective through executive agreement rather than a new treaty.

The U.S. share of all future project costs would be negotiated as part of the restructuring, but would be at least 50 percent. The proposal assumes that $150 million per year, currently in EPA's budget, would be committed over a five-year period. This amount could be divided between credit subsidies and grants, the latter for financing communities where user fees cannot be supported. Implementing legislation for NAFTA could serve as the vehicle for authorizing Treasury or EPA to provide loans or guarantees.

• The **Development bank** model would be an international organization directed by representatives of the U.S., Mexico and possibly Canada, with its own staff. It would provide grants, loans or guarantees to local communities or the private sector along the border regions for basic infrastructure projects or for more specific environmental infrastructure, such as waste water facilities.

The Bank would work in cooperation with the participating governments and be funded through a combination of paid-in and callable capital (a contingent liability) from the participating governments. It would presumably ensure that U.S. environmental standards were enforced in the projects it financed within the border region, where its activities would be concentrated.

National Council de la Raza, a public interest group, has promoted the concept of a North American Development Band (NADBank) to members of Congress, and Representative Torres (D-CA) plans to introduce legislation to create a NADBank.

A variation of this proposal would create a NAFTA environmental trust fund

(NEFT) in the IDB, rather than create a new institution. The **NEFT** would be a separate fund in the Inter-American Development Bank (IDB) under the control of the NAFTA participants. It would provide up to $10 billion in loans to finance environmental investments in Mexico only to ensure compliance with NAFTA. The IDB would administer the NEFT, with loans to regional and municipal authorities in Mexico, on IDB hard loan terms (about 8%). Because the IDB is chartered to operate only in regional developing countries, it is assumed that the U.S. and Canada would not be eligible to borrow.

The NEFT would require international negotiations and require Congressional authorization through at least the House and Senate banking committees. Both the paid-in capital and contingent liability would be subject to annual discretionary appropriations. It would probably take 12-18 months to begin operations. It is also possible that a NEFT would duplicate current IDB and World Bank lending to Mexico.

- The **Dedicated Fund** would be established through (a) an increase in the current tariffs applied to Mexican and U.S. goods and services at the border, (as proposed by House Majority Leader Gephardt), or (b) redirection of revenues from existing tariff revenue. This pool would fund projects on a current financial basis (such as grants), through either annual appropriations action or provision for off-setting collections.

Projects would be selected in one of three ways: (a) using existing structures (IBWC, U.S./Mexico binational commission) for negotiations with Mexico for a second stage of the current border plan; (b) creating a new institution such as a commission to coordinate federal, state and local activities and select projects that meet regional needs; or (c) creating a new institution separate from the existing federal and state agencies that could either contract out to existing agencies or would have its own staff.

According to OMB, This proposal hinges on either imposing additional tariffs on trade or redirecting existing tariff revenue, both of which would have serious budget and political ramifications. For every $1 billion in environmental financing, this proposal would require at least $500 million and perhaps as much as $1 billion in either additional tariffs or direct appropriated budget authority for the U.S. side. OMB suggests that additional tariffs and use of such to finance fiscal programs violates GATT under Article XXIV and VIII.

It would also require international negotiations with Mexico and authorization from Congressional Committees and annual discretionary appropriations for the financing (grants).

The interagency group generally supported the Border Authority Option (b) because it met most of the criteria considered likely to generate additional support for NAFTA. However, David Harwood ~~of the State Department~~ mentioned that he felt that the OMB proposal focused too much of the IBWC and that border NGOs, environmental groups and the business sector had problems with the IBWC. He felt that the Border Authority should have some similarities to the IBWC, but that it should be new and distinct for both political and substantive reasons.

The OMB paper asked that the Deputies consider:
- whether to support the concept of a border authority; • should the

Border Authority act as a financing authority with support from both governments (unitary mode) or whether the U.S. and Mexico should provide financing separately (parallel mode);

- to what extent can the projects along the border realistically be supported through user fees;
- whether the U.S. and Mexico can make sufficient progress in negotiations for inclusion in the implementing legislation;
- what level of commitment the U.S. and Mexico intend to make for future border environmental infrastructure, beginning in FY 1995, and;
- what type of leveraging mechanism (direct loans, partial guarantees, or both) the U.S. should use.

[prepared by Aimée]

I. CURRENT DOI BORDER ENVIRONMENT PROGRAMS

The U.S. Department of the Interior has a long history of cooperative projects with Mexico. Our common border has led to shared species and habitat protection, water management, mapping and shared recreational planning. Our common heritage has led to shared programs of cultural and historic exchanges. Our increasing trade has led to shared information about and techniques for minerals extraction and methods to decrease the environmental impacts of our projects. The Department currently has eight active Memoranda of Understanding with its Mexican counterparts.

MEXICO - U.S. JOINT COMMITTEE FOR WILDLIFE CONSERVATION The Joint Committee serves as a mechanism through which wildlife conservation projects are solicited, reviewed, approved, and implemented in Mexico by the U.S. Fish and Wildlife Service, its Mexican government counterpart, and non-governmental organizations. In FY 1992, approximately 50 projects were approved in the fields of protected area management, endangered species, migratory birds, plant conservation, and training.

The Joint Committee is an ongoing process and has met annually since 1975 to review project proposals, pursuant to a bilateral agreement between the two agencies, as well as the Migratory Bird Treaty with Mexico (1936), the Western Hemisphere Convention (1940), and the Endangered Species Act. Three examples of the types of on-going projects are described below:

1. Recovery Plan for the Sonoran Pronghorn Antelope. FWS personnel from Cabeza Prieta National Wildlife Refuge have worked cooperatively with the Arizona Game and Fish Department, The Nature Conservancy, and the Centro Ecologico de Sonora in Mexico to study and manage this endangered species, which ranges south from the refuge into the Pinacate Desert, a protected area on the Mexican side of the border. Population surveys were begun in 1988, and in 1990 and 1991, pronghorn were captured from a helicopter and fitted with radio collars to study movement patterns. Joint management plans are now being written for the species. FWS provided $5,000 for the project in FY'93.

2. Status of the Desert Tortoise in the Sonoran Desert. FWS has worked cooperatively with the Arizona Game and Fish Department, the University of Arizona, The Nature Conservancy, and the Centro Ecologico de Sonora in Mexico to ascertain the status of this endangered species and its habitat in Mexico, and to develop management plans for its conservation. A permanent monitoring plot has been established in Sonora to pursue long-term studies. An environmental education program targets local people in areas of tortoise habitat, stressing the importance of conservation. FWS provided $5,000 for the project in FY'93.

3. Status and Distribution of the Gould Turkey in Northern Mexico and the U.S. FWS has worked cooperatively with the Arizona Game and Fish Department, the U.S Forest Service, The Nature Conservancy, The Wild Turkey Federation, the Centro Ecologico de Sonora, and the Universidad Autonoma de Chihuahua to study this endangered species and its habitat on both sides of the border. The eventual aim is to establish new populations in suitable habitat in the U.S. and Mexico through the trapping and transfer of live birds. FWS provided $5,000 for the project in FY'93.

TRIPARTITE AGREEMENT FOR CONSERVATION OF WETLANDS AND MIGRATORY BIRDS Trilateral agreement, including Canada, which serves as a vehicle for Mexican participation in the North American Waterfowl Management Plan and the North American Wetlands Conservation Fund. To date, five projects have been implemented near the Mexican border under this authority:

1. Laguna Madre (State of Tamaulipas; Sponsor-DUMAC);
2. La Encrugijada Coastal Reserve (State of Chiapas; Sponsor-Chiapas Institute of Natural History);
3. Delta Colorado River (State of Sonora; Sponsor-Sonora Ecology Center);
4. Development of Conservation Plan for the Sinaloa Wetlands;

Funding has been supported by the North American Wetlands Conservation Fund, U.S. Non-Government Organizations, the Mexican Government and Mexican NGO's. Program initiated in 1990 and ongoing.

REGIONAL CONFERENCE OF U.S./MEXICO BORDER STATES ON PARKS AND WILDLIFE Meeting of federal agencies with border area programs, border states, local government, and NGOs to discuss on-going programs/projects and to exchange information. Funding Source(s) include the NPS, FWS, the Parks and Wildlife Departments of Texas, New Mexico, Arizona and California; the States of Baja California Norte, Sonora, Chihuahua, Coahuila, Nuevo Leon, and Tamaulipas in Mexico; and various NGOs. The regional conference is conducted every 18 months and the venue alternates between U.S. and Mexico and at different sites in each country.

ECOLOGICAL STUDIES AND RESEARCH Binational academic team will conduct a natural/cultural resources survey along the Chihuahuan-Big Bend corridor. A written analysis of the survey will be made available to agencies and offices managing lands in the subject area. Funding source(s) include the National Park Service and the World Wildlife Fund. New Mexico State University and the University of Chihuahua are jointly conducting the research.

BIG BEND NP/SIERRA DEL CARMEN SISTER PARKS Resource management and inventory surveys in the Sierra Del Carmen, Coahuila. Since the 1930's, the U.S. and Mexican governments have been discussing a sister park relationship between Big Bend NP and a proposed protected area in the adjacent Sierra del Carmen. Initial base line research began in 1992 (although independent research on bears and falcons has been on-going for several years). Future intent to develop cooperative general management and protection plans for these contiguous sites.

CORONADO TRAIL STUDY Study of the Coronado Trail corridor for possible inclusion in the National Trails System. In 1988, the Congress enacted the Coronado Trail Study Act authorizing a study of the Coronado Trail for possible addition to the National Trails System. At least eight NPS managed areas lie along the route. The study results were submitted to Congress in 1991. U.S. sites include Arizona, New Mexico, Texas, and Kansas and Mexico sites include Nayarit, Durango, and Chihuahua.

THE LOWER RIO GRANDE COMMUNITY HERITAGE PROJECT Establish an historic corridor from Laredo to Brownsville encompassing sites of historic significance on both sides of the border. This is a U.S./Mexico cooperative project with an objective of developing cultural tourism along the Texas - Tamaulipas, Mexico border.

SIERRA MADERAN VEGETATION STUDIES Literature search on all aspects of non-agricultural vegetation in the Sierra Madre. Additional subjects to be included are influences upon vegetation such as, fire, meteorology, grazing, and introduction of non-native plants. Following the literature search, material will be analyzed to identify informational gaps. The Cooperative Park Studies Unit at the University of Arizona in Tucson will carry out the research in cooperation with the Instituto de Ecologia in Sonora.

PALO ALTO BATTLEFIELD NHS This National Historical Site was established by an Act of Congress in 1978 to "preserve and commemorate...an area of unique historical significance as one of only two important battles of the Mexican War fought on American soil..." Palo Alto is the only unit of the National Park System directed to the preservation and interpretation of resources related to the Mexican - American War. Various agencies and organizations in Tamaulipas, as well as INAH, will be involved.

U.S.S. SOMERS Cooperative program with Mexican Government to preserve the hull of the U.S.S. Somers, an American ship sunk in 1846 off the coast of Mexico in the State of Vera Cruz near the city of Vera Cruz. While participating in a naval blockade off the coast of Mexico near Vera Cruz, the Somers, a U.S. Navy warship, was hit by a sudden squall and sunk. Since discovery of the hull several years ago, the U.S. and Mexican governments have been debating ownership of the wreck. A government to government agreement is in the process of being prepared by the Dept. of State to resolve proprietary issues. The NPS assisted U.S. Navy and Mexican divers in initial underwater archeological documentation in 1989. Further underwater investigation by the NPS, the Department of the Navy, INAH and the GOM Navy is tentatively scheduled for June 1993.

INTERNSHIPS Support participation of Mexico students in internship positions at various National Park Service sites and offices.

MEXICO AFFAIRS BRANCH OFFICE Serves as the principal NPS liaison in implementing and coordinating binational projects and activities including training, park planning, research, interpretation, and environmental education.

SAN PEDRO RIVER WATERSHED PROJECT The San Pedro River originates in the State of Sonora, Mexico, flows northward into southern Arizona, supporting one of the Southwest's premier riparian ecosystems. Cooperative discussions between the U.S. and Mexico are essential in promoting sound resource management of the watershed's biologically diverse ecosystem. Principal areas of cooperation could include management and protection of riparian ecosystems, migratory wildlife habitats, global climate change studies, biodiversity research, habitat rehabilitation techniques, fire management, public education, and the interpretation of natural resources.

PINACATE COOPERATION The Bureau of Land Management coordinates with other major landholders on both sides of the border to explore cooperatively-developed plans. The Mexican Government recently designated their portion as a Biosphere Reserve.

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II. PROPOSED FY'94 DOI BORDER ENVIRONMENT PROGRAMS

The Department of the Interior-projects that are included in the proposed 1994 budget are similar to those currently being conducted.

The Fish and Wildlife Service would conduct the following:

Border Law Enforcement Inspections/special agents; implement the Wild Bird Trade Act	$330,000
Endangered species consultation	$100,000
Cooperative programs with Mexico RESERVA training program, habitat conservation, and wetlands conservation.	$700,000

The National Park Service

Las Cruces Mexico Office	$75,000
Cooperative Border Projects at Parks	

Bureau of Land Management	$50,000

DRAFT

III. Proposed Border Initiatives for FY'95 or as Supplement for FY'94

NAFTA funding requirements for the Department of the Interior
($ in thousands)

	NAFTA funding
ESSENTIAL FUNDING	
Fish and Wildlife Service	
Law Enforcement: Would fund increased border presence for additional points of entry, funding for special agents and for specific activities under the Wild Bird Trade Act.	1,870
Ecological Services: NAFTA-related activities will give greater urgency to the tasks of listing, consultation, and recovery actions for at least 460 species within 25 miles of the border in Texas, New Mexico, Arizona, and California.	4,493
Refuges and Wildlife: Eight National Wildlife Refuges are within the Mexican border area. Urban and agricultural expansion will place greater resource burdens on these areas. Additional funds needed for increased resources protection.	3,300
subtotal, Essential funding	**9,663**
DISCRETIONARY	
Fish and Wildlife Service	
Cooperation with Mexico/Technical Assistance	2,500
National Park Service: Transboundary ecosystem management and additional support for Mexico in areas related to natural resource management, technical assistance and training.	4,900
Bureau of Land Management: Would fund enhanced resource management projects on the border.	795
Territorial and International Affairs: Would fund a U.S./Mexico fellows program and develop two conceptual plans for sister parks/reserves.	1,000
subtotal, Discretionary funding	**9,195**
TOTAL DOI FUNDING	**18,858**

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ATTACHED IS THE PAPER FOR TOMORROW'S

1:30 NAFTA MEETING

IF YOU NEED MORE INFORMATION

PLEASE CALL KARIN KIZER ON 395-3947

Katy McGinty

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NAFTA-RELATED U.S.-MEXICO BORDER ENVIRONMENTAL ACTIVITIES: NEEDS ASSESSMENT AND ALTERNATIVE FINANCING MECHANISMS

Executive Summary

This paper examines the NAFTA-related current and future environmental improvement needs along the U.S.-Mexican border. It also addresses the U.S. government's current funding for environmental activities along the border and considers priorities over the next several years. The U.S. government agencies are involved in a wide variety of activities to promote environmental preservation on the border. Most needs can be met through reallocating existing federal support. One area, environmental infrastructure, has not received adequate funding to date. Funding for this activity could be provided in the future through the adoption of an alternative financing mechanism.

Three general financing mechanisms were considered by an OMB-chaired inter-agency group:

- a "border authority";
- a multilateral development bank, and;
- a "dedicated" fund.

The interagency group generally supported the concept of a border authority. An existing authority, the International Boundary and Water Commission (IBWC) could be altered to avoid creating an entirely new institution. Several issues are still to be resolved:

- whether the expanded IBWC should act as a financing authority with support from both governments (unitary mode) or whether the U.S. and Mexico should provide financing separately (parallel mode);
- to what extent the projects along the border can realistically be supported through user fees;
- whether the U.S. and Mexico can make sufficient progress in negotiations for inclusion in the implementing legislation;
- what level of commitment the U.S. and Mexico intend to make for future border environmental infrastructure, beginning in FY 1995, and;
- what type of leveraging mechanism (direct loans, partial guarantees or both) the U.S. should use.

The Deputies are asked to consider:

- whether to support the concept of a border authority;
- within this concept, whether U.S.-Mexican projects should be financed through a unitary or parallel mode.

agree

Background

The border between Mexico and the United States separates two countries with distinct cultures and histories. Yet despite their countries' diversities, the people who live in the border area (as defined within 100 kilometers on either side of the border) share many socioeconomic and environmental concerns.

From an environmental perspective, the border area is undivided. Several rivers, including the Santa Cruz, Rio Grande, San Pedro, Colorado, Tijuana, and New Rivers, flow along and across the border. Several ecosystems, such as deserts and groundwater aquifers, lie on both sides of the border. The sister cities on both sides of the border share airsheds and drainage basins. See Figure 1.

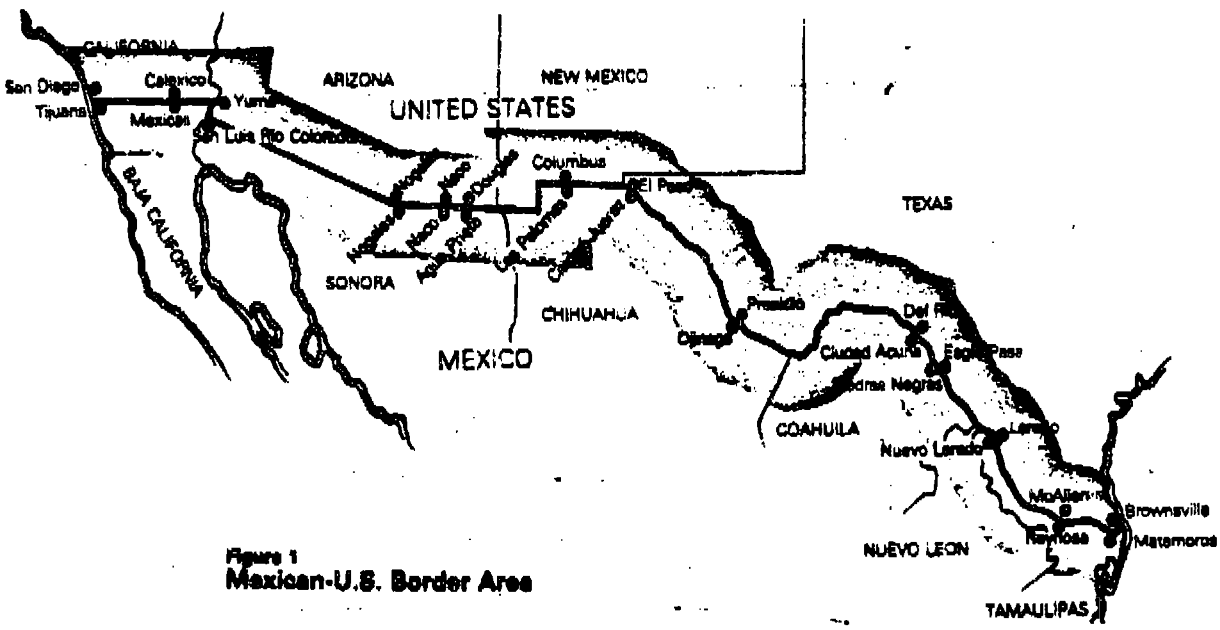

Figure 1
Mexican-U.S. Border Area

Approximately 9.5 million people live in border communities. Most of the population is in seven pairs of border cities. In these cities, population is growing between 3-4% per year and is projected to rise from 7 million in 1993 to 10.3 million by 2003. Many households in these cities are currently under served, or not served at all, by adequate drinking water facilities, wastewater treatment plants, and facilities for disposing of solid and hazardous wastes. Basic plumbing and distribution systems to connect households and businesses to drinking water distribution and wastewater collection systems are in many cases lacking. At many places on the U.S. side of the border, unincorporated communities, called colonias, have sprung up adjacent to towns and cities. These colonias, which are the homes to over 250,000 people in Texas and New Mexico are characterized by substandard housing, inadequate roads and drainage, and barely adequate water and sewer systems, if such systems exist at all.

In addition, since 1965, the Mexican government has promoted the development of the border region through the "maquiladora" program. The maquiladoras are export-oriented processing and assembly plants located primarily in Mexico's border area. Most of the plants are part of production-sharing arrangements with U.S. and other foreign firms that use lower-wage Mexican workers for the more labor intensive portions of the production process, such as assembly of foreign-made components and inputs. The maquiladoras also benefit from the proximity to U.S. suppliers and consumers. Mexican environmental regulations provide that the hazardous waste generated in Mexico by the maquiladoras must be returned to the country of origin of the raw materials. With increased pressure on the Mexican government to enforce the repatriation of hazardous waste generated from the maquiladoras to the U.S., locating private sector facilities to handle these wastes has become a concern.

The environmental problems along the border have accumulated over many years and obviously were not caused by NAFTA. While increased economic activity, as well as general population growth, could further strain existing environmental infrastructure, NAFTA will likely increase the standard of living for the border population and generate economic growth that could support financing some of the existing and future needs for improved environmental services. The current negotiations on the side agreements are aimed at improving enforcement of existing environmental standards on both sides of the border. Hence, NAFTA presents an opportunity to solve the existing and future problems of environmental degradation on the border.

Needs Assessment

A number of federal, state and private consultant studies have been undertaken to assess the current and future environmental needs of the border region. These studies illustrate the magnitude of costs associated, at various levels of government, with improving environmental conditions along the U.S.-Mexican border. They do not, however, represent specific funding plans nor do are they necessarily the U.S. Federal government's responsibility for funding all of these projects. Traditionally, the focus has been the funding of wastewater treatment needs in order to prevent contamination of U.S. waters. The U.S. Army Corps of Engineers prepared a study for the IBWC in 11 Mexican cities along the U.S./Mexico border. The study estimated a cost of $2.5 billion to construct wastewater treatment facilities in the identified cities that would meet U.S. secondary treatment standards and anticipated capacity requirements through the year 2010. This estimate does not include the $200 million required for the wastewater treatment plant in Tijuana. Although all projects with the exception of Nogales would be built in Mexico, the U.S. would enjoy many of the environmental benefits because these projects are designed to prevent pollution of U.S. and binational waters. Operation and maintenance costs for all projects would total approximately $70 million per year.

A soon-to-be-published study by the U.S. Council of the Mexico-U.S. Business Committee estimates that approximately $6.5 billion is required for water, sewage, solid and hazardous waste services and facilities on both sides of the border over the next 10 years. Of this total, $2.1 billion is required in the U.S. and $4.4 billion in Mexico. By type, wastewater treatment plants will require $4.3 billion, water treatment and supply $997 million, solid waste disposal facilities (landfills) $442 million and hazardous waste disposal facilities $750 million. Requirements for land sites for hazardous waste facilities, water, and wastewater treatment facilities for the border population without access to these services could add another $1.5 billion to this total. See Table 1.

Table 1

U.S./Mexico Border Infrastructure Needs
(1993-2003)[1]
($ in millions)

Capital Cost	Mexico	U.S.	Total
Water Supply	$496	$501	$997
Wastewater	2,804	1,475	4,279
Solid Waste	322	120	442
Hazardous Waste	750	--	750
Total	**$4,372**	**$2,096**	**$6,468**

Another study conducted by the State of Texas concluded that the cost of providing adequate environmental infrastructure along the Texas/Mexico border to solve existing problems and meet the growth demands through the year 2010 is $4.2 billion. Of this total, $2.0 billion is required in Texas and $2.2 billion in Mexico. The largest component by far is wastewater treatment which totals $2.5 billion. Water supply and treatment will require $1.3 billion, solid waste and hazardous waste $296 million and air pollution $79 million. The State of California estimates that the environmental infrastructure needs along its common border with Mexico exceeds $1 billion.

Resources Devoted to the Border Area

Most of the existing funding for environmental infrastructure activities or those under construction has been provided by either grants from the federal governments of Mexico and the U.S. either directly to communities or through the International Boundary Water Commission (IBWC). Funding for the colonias is matched dollar-for-dollar by the U.S. states. Funding for the facilities constructed by the IBWC comes mainly from both the U.S. and Mexican governments and is supplemented at times by local contributions. There are also U.S. resources devoted to technical assistance, training, and education. In addition, in the U.S., additional capital has been raised through the sale of municipal sewer bonds. Other U.S. border cities are able to obtain loans with below market interest rates from EPA's State Revolving Fund program.

In anticipation of NAFTA, the U.S. and Mexico planned and agreed to an Integrated Border Environment Plan in 1992 to provide the long-term protection of human health and natural ecosystems along the border between Mexico and the U.S. In its first stage (1992-1994), the Border Plan was intended to address the most serious environmental problems, both existing and emerging in the border area. Key objectives of the Border Plan included: reduction of pollution through new initiatives; strengthened enforcement of existing laws; and increased community participation,

[1]Source: The U.S. Council of the Mexico-U.S. Business Committee of the Council of the Americas.

cooperative planning, training, research, and education.

In order to implement the Border Plan, Mexico has committed to provide $460 million through 1994 for environmental projects in Mexican border cities, which includes funds for transportation, along with $220 million for wastewater treatment and $25 million for solid waste disposal. The previous Administration committed $379 million over the period FY 1992-93 for the implementation of the Border Plan. A survey of U.S. Federal resources devoted to the border area for environmental activities indicates that $360 million have already been appropriated over the period FY 1992-93.

The President's Budget for FY 1994 includes $231 million for border environmental activities. See Table 2.

Table 2
U.S. Budgetary Resources for Environmental Activities Along the U.S.-Mexico Border
($ in Millions)

Agency	FY 1991 Actual	FY 1992 Actual	FY 1993 Enacted	FY 1994 Pres Bud	FY 1994 Cong Act
Environmental Protection Agency	$17	$98	$154	$164	$49
Department of Agriculture	0	0	26	29	29
Department of Interior	0	0	1	1	1
Department of Health and Human Services	1	2	2	2	2
Department of State (IBWC, Exim Bank, AID)	24	42	36	35	34
Total	**42**	**142**	**218**	**231**	**115**

However, the U.S. House of Representatives, which recently completed action on EPA's FY 1994 appropriations bill, has not funded the President's request. The proposed funding level of $90 million for international wastewater treatment was reduced to $35 million (for Tijuana) and funds earmarked for the U.S. colonias in Texas and New Mexico were not appropriated. Instead, the House created a Hardship Communities reserve fund of $500 million. The colonias would, therefore, compete with other U.S. jurisdictions for funding from this reserve pool if an authorization for such funding can be enacted by March 31, 1994. Because they are perceived as assisting a foreign country rather than U.S. citizens, funding for the construction of wastewater treatment facilities in Mexico has always been difficult within the HUD-VA Appropriations Subcommittee, under whose jurisdiction EPA lies. The Administration will have to make a major effort to seek restoration of the funds in the

Senate if the commitment to border environmental funding proposed in the President's FY 1994 Budget is to be maintained.

In FY 1995, the U.S. is proposing to build upon its 1994 Mexican Border programs by expanding its efforts through investing an additional $10 million in EPA's operating programs to strengthen enforcement, reduce pollution in all major environmental media, provide increased tracking and oversight of hazardous waste flow, increase monitoring in air and water quality. The U.S. Department of the Interior will expand their existing conservation programs to include funding for increased activities under the Wild Bird Trade Act, listing, consultation, and recovery actions for at least 460 species within 25 miles of the border in Texas, New Mexico, Arizona, and California, and to further protect national wildlife refuges that are within the Mexican Border area. The Department is proposing to invest an additional $17.4 million in FY 1995.

The Department of Transportation (DOT) provides grants to States along the border for congestion management and air quality improvements for metropolitan areas. In FY 1995, DOT is proposing to allocate $262 million to the border States for this effort. How the States apportion the funds to the Border Area is left up to the States. DOT also is proposing to allocate a portion of the $110 million to the border states for transit funding in major urban centers (e.g., El Paso, TX). This funding may provide positive environmental benefits if the funding is used to move current riders (e.g., single-occupant vehicle drivers) to more efficient forms of transportation, such as buses.

Protecting water quality requires major infrastructure construction. Most of the contemplated wastewater treatment construction projects along the border are aimed at maintaining U.S. standards (secondary treatment) rather than Mexican standards (primary treatment). These projects, mostly in Mexico, are designed to protect U.S. and common waters from pollution generated in Mexico, where facilities are inadequate. Other water quality projects, such as those designed to bring a safe drinking water supply to the colonias will be funded by the U.S. Department of Agriculture through their Rural Development Administration.

<u>Need to Consider Alternative Financing Mechanisms</u>

The President has requested over $230 million in FY 1994 for border environmental activities, of which the majority, $150 million, is for border environmental infrastructure. It is uncertain whether Congress will actually appropriate the resources for infrastructure. Even if the FY 1994 level were fully granted by Congress, one year's appropriation is only the first step toward meeting the environmental infrastructure needs in the border area. Given the estimated costs for construction of environmental infrastructure and the difficulty the Administration's appropriations requests for grants for these projects faces in Congress, a new approach to financing border environmental infrastructure is needed. The challenge is to find ways to leverage available resources and seek new revenue sources from future users of these environmental services, in order to ensure that the debt incurred in such leverage can be repaid.

Any new financing mechanism and institutional arrangement should meet the following political criterion:

- gain votes for NAFTA (e.g., can be linked to NAFTA implementing legislation).

It should also meet the following programmatic criteria:

- improves decision-making, cooperation and coordination along the border (local and federal levels) for selecting and funding projects to improve the border environment over time;
- enhances U.S. and Mexican commitment to fund agreed priorities along the border over time;
- ensures U.S. communities sharing resources with Mexico that U.S. environmental quality standards will be maintained;
- where possible, allocates costs to the users, both residential and commercial;
- acknowledges Mexican constitutional provisions preventing municipal governments from issuing bonds, and;
- preserves U.S. and Mexican sovereignty.

Financing Mechanism Options

The inter-agency group considered three general types of new financing arrangements. These are summarized below.

1. "Border authority": There are two options that build on the existing International Boundary and Water Commission (IBWC). (See Appendix A.)

   Option A: The current IBWC's mandate would be expanded to include:

   - a broader scope of water quality issues, and;
   - authority to guarantee publicly-placed private bonds.

   An advisory group (e.g., representatives from local communities and environmental groups) to the new organization would participate in the review process. The new organization would:

   - review and select projects to improve water quality in the border region;
   - have its own staff to conduct its financial operations, and;
   - partially guarantee bonds issued by private finance corporations[2] created to construct specific water treatment facilities. Bonds or loans would be repaid by charging user fees on affected communities, either at market-rates or with subsidies.

   The new organization represents a transformation of the existing IBWC, although it still perform the basic functions of the current IBWC. Such a transformation of the IBWC would require negotiations (e.g., 12-24 months) with the Mexicans and a new treaty, subject to two-thirds Senate approval.

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[2]Because Mexican states and municipalities are constitutionally prevented from issuing bonds, private finance corporations can act as the entity to raise capital.

The U.S. share of the all future project costs would be negotiated as part of the restructuring. The proposed U.S. share is 50 percent of the amount of any partial guarantee placed on projects. To finance its share, the U.S. would provide a subsidy to back the guarantees on the project bonds.

Option B:

The existing IBWC's responsibilities would be expanded to include additional water quality issues in the border region. An advisory group (e.g., representatives from local communities and environmental groups) to the new organization would participate in the review process. The expanded IBWC would:

- review and select projects related to water quality, and;
- coordinate with EPA on technical and financial feasibility of the project.

The expanded IBWC would not provide financing itself, but would coordinate financial support from the U.S. and Mexico. Mexico and the U.S. each would fund its share (to be negotiated) of the support to the private finance corporations created to construct specific water treatment facilities in the border region. Bonds or loans would be repaid by charging user fees on affected communities, either at market-rates or with subsidies.

The U.S. Treasury Department (or EPA) could provide U.S. financial support either by:

- guaranteeing a portion of private bond issues, and/or;
- by lending directly to the finance corporation.

Although Mexico will be expected to commit to financing, it will decide what form of financing it wants to provide (e.g., relying on the multilateral development banks, from which Mexico is one of the principal borrowers).

Expanding the IBWC's scope without financial authority would require negotiations with the Mexicans, but could become effective through executive agreement rather than a new treaty.

The U.S. share of the all future project costs would be negotiated as part of the restructuring. The U.S. intended share would be at least 50 percent. The proposal assumes that $150 million per year, currently in EPA's budget, would be committed over a five year period. This amount could be divided between credit subsidies and grants, the latter for financing in communities where user fees cannot be supported. Implementing legislation for NAFTA could serve as the vehicle for authorizing Treasury (or EPA) to provide loans or guarantees.

2. Development bank model: An international organization (directed by representatives of the U.S., Mexico and possibly Canada) with its own staff, would provide grants, loans or guarantees to local communities or the private sector along the border regions for basic infrastructure projects or for more specific environmental infrastructure, such as wastewater facilities. The Bank would work in cooperation with the participating governments. It would be funded through a combination of paid-in and callable capital (a contingent liability) from the participating governments. It would presumably ensure that U.S. environmental standards were enforced in the projects it financed within the border region, where its activities would

be concentrated. A variation of this proposal would create a NAFTA environmental trust fund (NEFT) in the Inter-American Development Bank (IDB), rather than create a new institution.

Negotiations among the participants would be required before the Bank could begin operating (e.g., 12-24 months). National Council of La Raza, an public interest group, has promoted the concept of a North American Development Bank (NADBank) to members of Congress. Rep. Torres (D-CA) plans to introduce legislation to create a NADBank. These proposals suggest capitalizing NADBank at $5 billion over a ten-year period. The U.S. would be expected to assume 60 percent of the costs, in both paid-in and callable capital. This amounts to at least $60 million per year in paid-in and perhaps some subsidy associated with the remaining contingent liability of $2.4 billion. (See Appendix B.)

3. "Dedicated" fund: Existing agencies, federal or local, or a new entity could provide grants, loans or guarantees for infrastructure projects. This fund would be derived from a nominal tax on all trade crossing the border, as proposed by House Majority Leader Gephardt. Criteria for project selection would need to be developed jointly by Mexico and the U.S. Resources provided on a guarantee or loan basis would require a subsidy to back the contingent liability. A variation on this proposal could be to redirect the interim U.S./Mexico tariff revenue toward border activities. The U.S. portion of the redirected tariff revenue, a loss to the U.S. federal government, would require an equal increase in taxes or reduction in direct spending (entitlement programs) under current budget law. Taxing trade, however, is inconsistent with the intent of NAFTA: to eliminate barriers to trade among the NAFTA partners. It could also put U.S. exporters at a competitive disadvantage with other exporters to Mexico. (See Appendix C.)

Discussion

The inter-agency group supported the concept described in Border Authority: Option B because it met most of the criteria considered likely to generate additional support for NAFTA. Because Option B relies closely on the existing authority of the IBWC and provides for more flexibility in determining appropriate financing mechanisms, it represents a simpler solution to the conditions along the border. As a simpler solution, it can be established more quickly since it requires an executive agreement rather than a new treaty.

Option B results in a new forum for reviewing and coordinating selection of environmental infrastructure projects, by broadening the IBWC's programmatic scope and encouraging local participation in the selection process. It will represent a formal commitment from the U.S. and Mexico to fund environmental infrastructure in the border region. It offers potential involvement with the private sector as a source of funding. It draws on the region as a source of financing rather than all trade, since the communities in the region are the primary source of pollution along the border and will benefit from the services provided.

Outstanding Issues

The outstanding issues which remain are:

- whether the expanded IBWC should act as a financing authority with support from both governments (unitary mode) or whether the U.S. and Mexico should provide financing separately (parallel mode);

- to what extent can the projects along the border realistically be supported solely through user fees;

- whether the U.S. and Mexico can make sufficient progress in negotiations for inclusion in the implementing legislation;

- what level of commitment the U.S. and Mexico intend to make for future border environmental infrastructure, beginning in FY 1995, and;

- what type of leveraging mechanism (direct loans or partial guarantees) should be used.

The first issue, whether financing is provided through a unitary or parallel mode, needs to be decided before the concept of the border authority can be further refined. The other items are considerations which will shape the border authority as it is refined.

Mode of Financing

Both the U.S. and Mexico will need to provide financing for the environmental infrastructure projects discussed above. Even though the majority of the projects will probably be constructed on the Mexican side of the border,[3] the U.S. has an interest in ensuring that quality in areas where Mexico and the U.S. share water resources meets U.S. standards, and should contribute to the cost of the projects. Under either the unitary mode or the parallel mode, U.S. appropriations will be required.

Creation of a border authority would demonstrate a firmer commitment to recognizing that the border region is a joint responsibility of the U.S. and Mexico. As stated above, a single financial authority would also require negotiation of a treaty to provide the IBWC with financial powers. Such a negotiation would not be completed within the Administration's current timetable for submitting implementing legislation for NAFTA to Congress. U.S. and Mexican resources, although dedicated to a single institution, would still need to be contributed by each country separately. A single financing authority, as proposed, results in a complicated financial transaction. It could also increase the risk to the U.S. government by implying the U.S. government was ultimately liable for the full amount, rather than only a portion, of any loans or guarantees the authority provides.

Because the U.S. and Mexico now fund projects on a parallel basis, a continuation of a parallel structure could be criticized as preserving the status quo. Parallel financing, however, is simpler and more flexible than providing the IBWC with financial authority. The U.S. and Mexico

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[3]Army Corps of Engineers, September 1992.

could commit to fund, on an agreed-to ratio, future project costs through parallel measures in the context of an executive agreement to expand the scope of the IBWC.

Feasibility of Collecting User Fees

User fees would be the primary base for repayment for either direct loans or guaranteed bonds. User fees or local taxes would be paid by the communities which the facility served. Based on available census data in both U.S. and Mexico, median household income for the region is low. On the Mexican side, official data suggests that median household income is approximately $6,000, but this figure does not include federal subsidies such as housing allowances. On the U.S. side, average median household income for border communities is $16,039 for a family of three. Assuming average U.S. percentages of income for water utilities of between 0.5 and 1.0 percent, Mexican user fees would amount to $30-$60 dollars annually and U.S. user fees of between $80-$160, depending on the location in the region. It is likely that, at least in the near term, user fees, at this level, would not provide for full cost recovery, unless they were substantially higher. Thus, a program that relied solely on user fees could generate insufficient revenue to service debt.

Economic growth on both sides of the border as a result of NAFTA and other factors could cause median household incomes to rise over time. This would make the collection of user fees or local taxes for repayment of either direct loans or guaranteed bonds more feasible in the future. Maquiladoras and other industrial and commercial consumers of environmental services will also pay user fees.

Given the uncertain capacity to finance these projects, particularly on the Mexican side, subsidies from the Mexican federal government may be needed to ensure the project's repayment prospects. It could also require additional grant support from the U.S. This could make the proposal less attractive, from the perspective of the U.S. side of the border, since, in some instances, U.S. beneficiaries may be expected to pay user fees when the Mexicans are not, but the project were located on the Mexican side of the border.

Timing of Negotiations

Any arrangement to cooperate with Mexico on border environmental activities will require negotiations with Mexico. To persuade those concerned about the border environment, it would need to be specific and indicate a firmer commitment than would be associated with the Mexican and U.S. commitments in the next stage of the Border Plan. The more comprehensive or controversial the negotiating objective, the longer the negotiations will take. Creating a new institution will require negotiations of at least a year, if not longer. Some argue, however, that a commitment to negotiate a transformation of the IBWC, outlining the general parameters of the future negotiations, could be completed in time to include in the NAFTA implementing legislation. A limited expansion of the IBWC's role, however, would require only an executive agreement. Parallel financing authority could also be provided more quickly, since it does not require treaty negotiations.

Source of U.S. and Mexican Commitment

The U.S. contribution could be financed by reallocating EPA's current construction grants for projects along the border, or reallocating resources from other programs. Reallocating the current EPA commitment will be politically difficult since some of the Administration's FY 1994 request for these types of projects have been combined into a single "hardship fund" that places border projects in competition with other communities with environmental clean-up needs (e.g., Boston Harbor). The "hardship fund" will apply to FY 1994 funding, but may not apply in FY 1995 and beyond. If the U.S. is perceived as providing resources primarily to Mexico, there could be pressure to finance these projects from existing international activities.

On the Mexican side, the multilateral development banks could be a principal source of lending to Mexico for environmental infrastructure because of pressure from all MDB donors for the banks to increase their share of lending to improve social and environmental conditions in developing countries. It may, however, be difficult to persuade the MDBs to finance projects meeting U.S. standards which will exceed Mexican standards and exceed the traditional project criteria for MDB lending. Mexico may continue to be reluctant to pay for higher cost projects to meet U.S. standards rather than the lower Mexican standards.

Type of U.S. Leveraging Mechanism

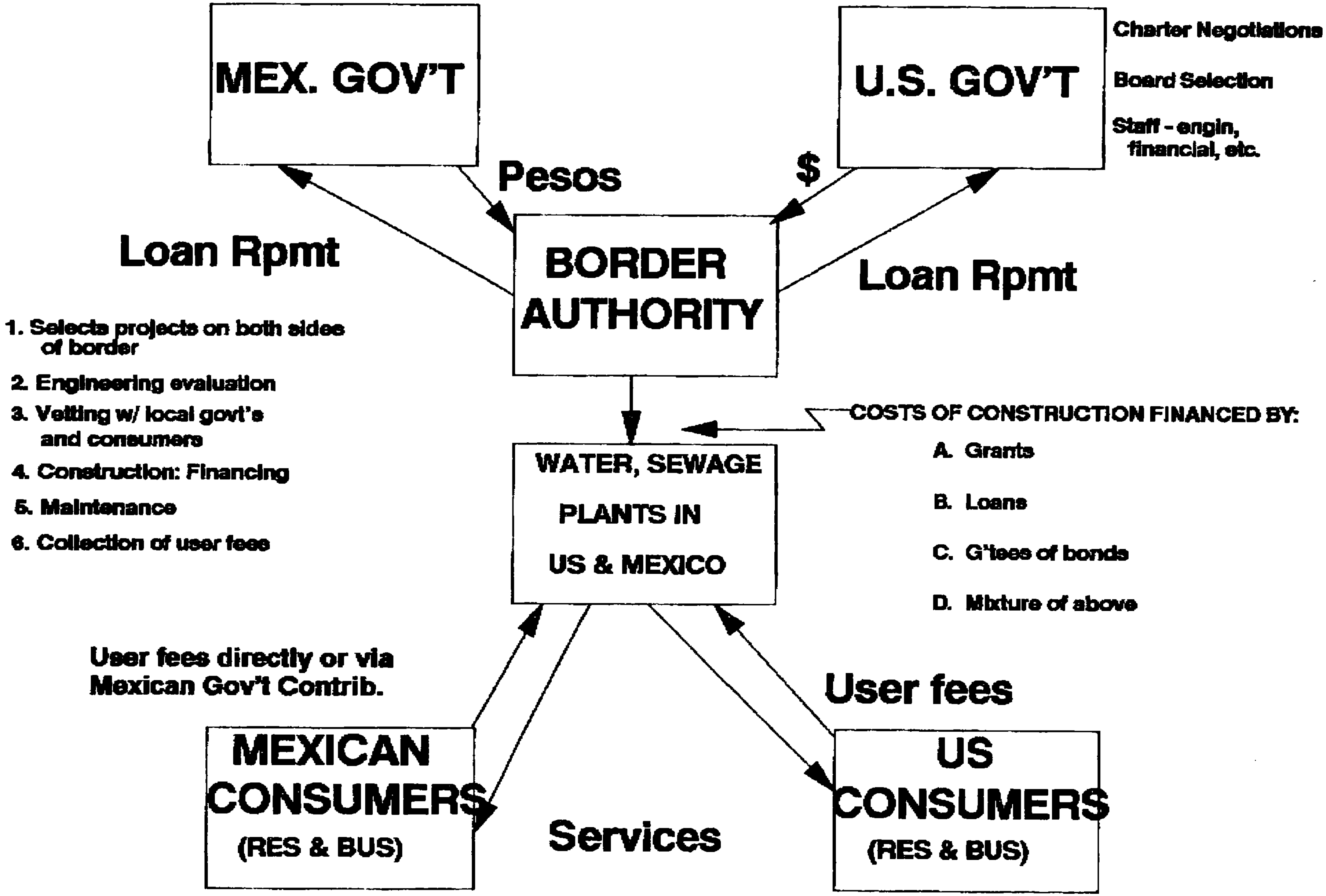
The two leveraging mechanisms discussed by the interagency group were partial guarantees and direct loans. Although it is not necessary to decide between the two types of leveraging, each does have certain strengths and weaknesses. These are discussed below.

A direct loan program could be established through implementing legislation and could become operational soon. It would not need to involve private financial intermediaries. The cost of capital could be lower because the government could provide a direct loan at a lower interest rate than a bond for similar financing would need to charge. The government, not the market, would determine the viability of the project. A direct loan program would not necessarily mobilize private sector resources.

A partial guarantee to privately-issued bonds could result in more leverage than a direct loan if it backed less than the full U.S. share of project costs. Additional research is required, however, to determine whether a partial guarantee would provide adequate assurance to the market. With a partial guarantee, the federal role, unlike the direct lending program, would facilitate rather than provide project financing. The partial guarantee would shift some of the financing risk from the federal government to the private sector. The primary financing decision would rest with the private sector, rather than the government. The project would be subject to market discipline not only at its inception but throughout its economic life. The bond would carry some residual project risk and would not be tax exempt; therefore, the cost of financing would be higher than with the direct loan.

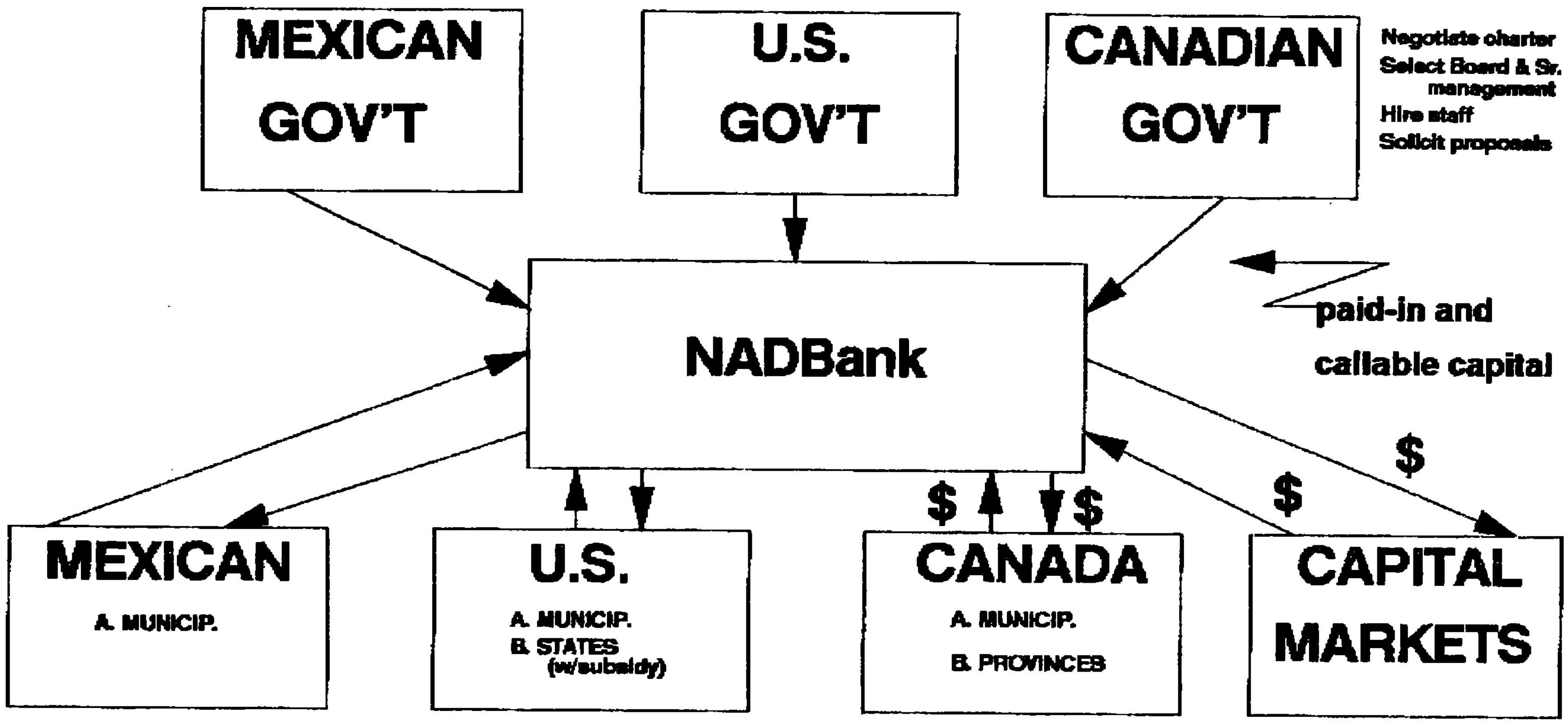
APPENDIX A

BORDER AUTHORITY



APPENDIX B

NORTH AMERICAN DEVELOPMENT BANK (OR IDB TRUST FUND)



NADBank

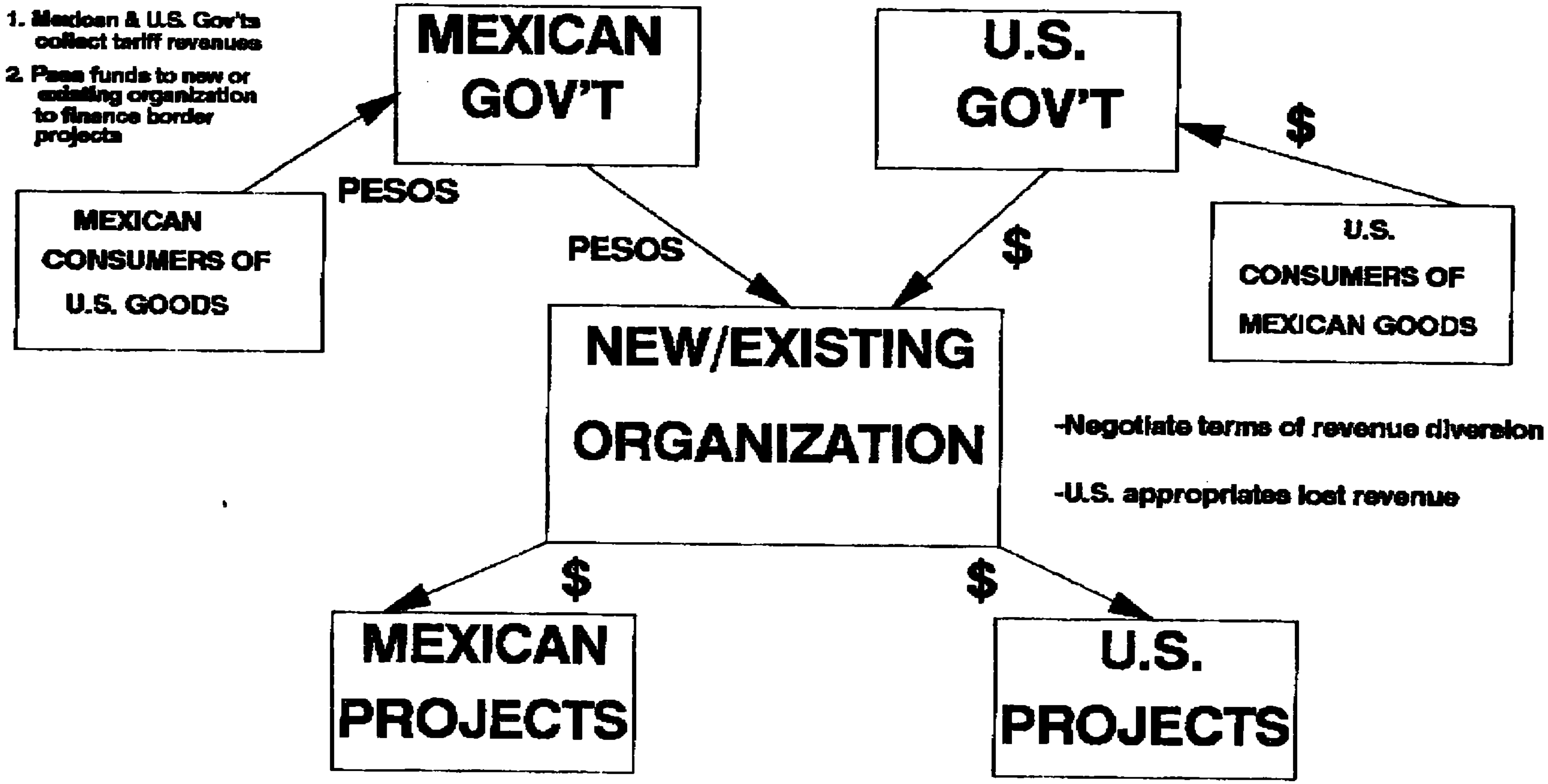
1. Receives proposals for infrastructure from all of North America
2. Staff prepare direct loans and tech. assistance programs
3. Vet with member gov'ts
4. Borrow from world capital markets, lend to municipalities and gov'ts

ISSUES

1. Who are borrowers?
2. Types of eligible projects
3. Terms & conditions of lending
4. Gov't shares of paid in & callable capital
5. Start up time & costs
6. Narrow only to border region
7. Duplication of existing institutions

APPENDIX C

DEDICATED BORDER FUNDS
(SIMPLE VARIANT)



ISSUES

1. Degree of revenue collection
2. Creation of new organization
3. Vetting of projects: engineering & financial
4. User fees to pay operating costs
5. Scope of projects: water, sewer, air?

MEMO

TO: Katie McGinty
FROM: Dan Blank

NAFTA BORDER ENVIRONMENTAL CONSIDERATIONS

I. **Issue:** Several groups, both governmental and non-governmental, have developed proposals for models of environmental protection for the U.S./Mexico border. The final proposal by the OMB-led interagency task-force is expected to be the one upon which the final policy will be built.

II. **Probable funding demands of Mex/U.S. border protection:** Between $4 billion and $6.5 billion over the next decade, or $400-650 million/year.

Some of the costs may be covered by existing funding sources:
a) The EPA has $150 million annually in the FY 94-98 budget request for projects on both sides of the border.
b) The Mexican Government has targeted about $400-500 million over a 3-4 year period for environmental projects in the border region.
c) The World Bank is to provide loans of $250-400 million in FY 94-96 for environmental projects by mexican municipalities along the border. Portions of a $300 million water project loan and $150 million solid waste loan may be focused on the border. The Inter-American Development Bank (IDB) is also providing funding for water projects in Tijuana from a national credit line of $108 million.

III. **Non-Governmental Proposals** for the border region:

• **"International Boundary Environmental Commission"** is proposed jointly by the Udall Center for Studies in Public Policy at the University of Arizona, and the International Transboundary Resources Center at the University of New Mexico School of Law.

The IBEC would be a binational border environmental management institution building on the advances of the La Paz Agreement and the achievements of the IBWC. Specifically it would be an expansion and alteration of the IBWC to deal with not only water, but also air, hazardous material, and toxic waste management. This would be done through codification of the annexes under the La Paz Agreement in treaty form with designation of the IBEC as the lead agency with responsibility for border environmental protection. It would not duplicate or supplant existing institutions, but would serve a needed coordinating and service role in the border region.

The IBEC would be structured as a binational commission with strong local involvement and supported by advisory boards, and co-chaired by appointees of the Presidents of Mexico and the United States. It would hold public meetings, technical meetings, workshops and briefings.

It's first task would be to collect, maintain and update an inventory of border environmental resources and threats to air and water quality, hazardous materials and toxic waste problems. In addition, IBEC would act as a clearinghouse for information about environmental problems and provide technical assistance services to agencies, officials, NGOs and private individuals. The goal would be to empower local officials, not to supplant them. Designated Critical Environmental Management Areas (CEMAs) may be organized in border areas identified as having significant environmental problems.

A Border Environmental Trust Fund (BETF) would be established to finance the IBEC. It would receive appropriations from the two national governments. It would also have a stable source of funding in a "customs processing fee" which would be a percentage of the value of transboundary trade at a rate low enough to avoid distortion of trade and investment activities. In addition to financing IBEC and CEMAs, money would be made available to border communities through grants and low interest loans for needed infrastructure projects identified during the planning process.

The groups involved have already formed a task force to identify the problems on this side of the border before working on the creation of the IBEC. They mentioned that they are encountering problems through the Integrated Border Environment Plan (IBEP) created by the Bush Administration to deflect concern. When it was initiated, the IBEP was severely criticized for failing to consult local groups. The IBEP continues to operate, however, and is a difficult bureaucracy to work with.

Some members of the Task Force currently include Gary Mauro and Tyrus Fain (of the Texas General Land Office); William Tilney, Mayor of El Paso; and Alicia Chacon, El Paso County Judge. They will, and have been, pushing this initiative on the Hill with the following staffers and Congressional members: Coleman, De La Garza, Richardson, Pastor, Bingaman, Krueger, Feinstein, Boxer and Deconcini.

• **A "Border Environmental Commerce Zone"** is proposed by the Sierra Club of San Diego.

The BECZ will be designed to "create an environment in which innovative, minimal-impact processes and/or end-use products can be developed and utilized to help clean our air, water and land by providing incentives for companies that manufacture products or provide services that are environmentally beneficial, in a manner that is environmentally-friendly."

These qualifying businesses must utilize the highest level of pollution prevention technology and processes with a zero discharge goal or minimum depletion of natural resources. They must receive a threshold score on an Environmental Audit (outlined in the paper) and promote environmental education while maintaining its high level of environmental standards.

The BECZ is a block that extends 15 miles north from the Mexican border, and is bound by the major transit systems on all three sides. It would offer business assistance and state and federal incentives to qualifying businesses.

An Environmental Technology Resource Center/Incubator is proposed to provide assistance as an "incubator" to businesses within the zone that wish to incorporate the criteria of the BECZ. This assistance includes space and shared services, business development services, marketing development services, and advanced growth services. The BECZ proposes that it get its funding from the President's Economic Development stimulus package and other federal agencies.

• The **Arizona Toxics Information Border Ecology Project** outlined their ideas of **NACE**'s role in border issues and specifically stated that we cannot isolate our strategies for the border region from those being developed for the interior of Mexico and the North American continent in general. They support NACE's role to investigate, arbitrate and recommend sanctions to be applied when a persistent and unjustifiable pattern of non-enforcement of domestic environmental law exists.

The structure of NACE should reflect the many governmental and non-governmental groups in all three countries. It should act not only as an instrument of investigation and arbitration but also a means of facilitating and promoting continuous exchange of information among both groups or, as in the Mexican case, as a link to proposed national commissions created with plural representation and executive capacity.

Regarding the border region, NACE should cooperate with Mexico to increase its capacity for protecting the environment by helping obtain financial and technical resources through the "polluter pays" and "user pays" principles. Rejecting environmentally-based sanctions on the basis of protecting national sovereignty is inconsistent with compliance strategies (including sanctions) accepted by the three trading partners within the strictly commercial aspects of the NAFTA. They suggested that NACE must strengthen Mexico's environmental management if sanctions are to applied.

These sanctions should not be used as a penalty against Mexico, but as a means within the NACE to complement Mexico's domestic enforcement of environmental norms. Trade sanctions should include a direct linkage between the use of revenues collected and the remediation and prevention of Mexico's environmental and health problems.

Governmental Proposals: As part of the OMB-led interagency task force, the State Department OES outlined their version of a "Binational Border Authority."

• **The "Binational Border Authority"** would be created jointly by the U.S. and Mexico to implement the financing, completion and supervision of the proposed border infrastructure projects. It would contain elements of a number of existing entities that deal with cross-boundary infrastructure projects.

Two basic powers of the Authority would be to approve design and siting decisions for projects in the border zone and the authorization to guarantee locally issued bonds that would be used to finance the projects. It would also develop equipment standards for the project, and provide oversight for the construction and operation of the projects so as to assure independent accountability. (Currently the IBWC deals with these areas on a negotiated basis.)

In addition, the Authority would have regulatory powers, similar to those already exercised by the U.S. and Mexico, but would complement and supplement them, though also supersede them in cases of conflict.

The Authority should not be viewed as a significant direct source of funding for environmental infrastructure projects, but as a facilitator of access to the private capital markets. It will, however, be structured to have the ability to own and operate projects on its own and could serve as a conduit for use of funds contributed directly by the two governments or from international institutions.

The primary sources of funding for the operations would be three fold: (a) the infrastructure assets of the IBWC that are not already income-producing should be made so, all privatized, and then all transferred to the Authority; (b) the cost of the engineered services of the Authority would be reimbursed by allocation to the projects; and (c) as with the IBWC, each country would pay for the operation of its section of the Authority, which should be relatively small.

The primary financial power of the Authority relating to the financing of the projects would be the ability to guarantee locally issued revenue bonds. The underlying credit for such bonds would rest upon the cash-flow generated from projects through user fees.

As a "government sponsored enterprise," the Authority could play a role in five functional areas:

- facilitation of cross-jurisdictional actions
- standardization of design, siting and construction of environmental infrastructure projects
- provision of liquidity for financing such infrastructure projects
- subsidization-to some extent-of such projects and
- encouragement of the development and export of environmental equipment and technology.

The final proposal is by the **OMB-led interagency group** outlines three possible options for general financing mechanisms:

a) a Border Authority as an expansion and restructuring of the International Boundary and Water Commission (IBWC);
b) a multilateral development bank; or
c) a "Dedicated Fund" for environmental or general border

infrastructure.

The interagency group generally supported the concept of a border authority. The IBWC could be altered to avoid creating an entirely new institution. The interagency group opposes "Dedicated" funding (i.e., increasing or earmarking tariffs) since it could be politically difficult and contradict the basic premise of NAFTA.

There are two **"Border Authority"** options that build on the existing International Boundary and Water Commission. The underlying premise is that the environmental infrastructure problems in the border area are on both sides of the boundary and are interrelated. The Border Authority would approve the design and siting decisions for projects in the border zone. It would also determine priorities and standards working with the state and local authorities, providing rationalization and avoiding duplication of existing institutions.

(a) The current IBWC's mandate would be expanded to include:
- a broader scope of water quality issues and
- authority to guarantee publicly placed private bonds.

The new organization would review and select projects to improve water quality in the border region, have its own staff to conduct its financial operations, and partially guarantee bond issued by private finance corporations created to construct specific water treatment facilities. Bonds or loans would be repaid by charging user fees on affected communities, wither at market-rates or with subsidies.

Such alterations of the IBWC would require negotiations with the Mexicans, (12-24 months), and a new treaty, subject to two-thirds Senate approval. The U.S. share of all future project costs would be negotiated as part of the restructuring. The proposed U.S. share is 50 percent of the amount of any partial guarantee placed on projects. To finance its share the U.S. would provide a subsidy to back the guarantee on the project bonds.

b) The IBWC's responsibilities would be expanded to include additional water quality issues in the border region as well as review and select projects related to water quality, and coordinate with EPA on technical and financial feasibility of the project.

The expanded IBWC would not provide financing itself, but would coordinated financial support from the U.S. and Mexico. Each would fund its share (to be negotiated) of the private finance corporations created to construct specific water treatment facilities in the border region. Bonds or loans would be repaid by charging user fees on affected communities, either at market-rates or with subsidies.

The U.S. Treasury Department or EPA could provide U.S. financial support either by guaranteeing a portion of private bond issues and/or by lending directly to the finance corporation.

Although Mexico will be expected to commit to financing, it will decide what form of financing it wants to provide, (e.g., relying on the MDBs from which Mexico is a principle borrower).

Expanding the IBWC's scope without financial authority would require negotiations with the Mexicans but could become effective through executive agreement rather than a new treaty.

The U.S. share of all future project costs would be negotiated as part of the restructuring, but would be at least 50 percent. The proposal assumes that $150 million per year, currently in EPA's budget, would be committed over a five-year period. This amount could be divided between credit subsidies and grants, the latter for financing communities where user fees cannot be supported. Implementing legislation for NAFTA could serve as the vehicle for authorizing Treasury or EPA to provide loans or guarantees.

• The **Development bank** model would be an international organization directed by representatives of the U.S., Mexico and possibly Canada, with its own staff. It would provide grants, loans or guarantees to local communities or the private sector along the border regions for basic infrastructure projects or for more specific environmental infrastructure, such as waste water facilities.

The Bank would work in cooperation with the participating governments and be funded through a combination of paid-in and callable capital (a contingent liability) from the participating governments. It would presumably ensure that U.S. environmental standards were enforced in the projects it financed within the border region, where its activities would be concentrated.

National Council de la Raza, a public interest group, has promoted the concept of a North American Development Band (NADBank) to members of Congress, and Representative Torres (D-CA) plans to introduce legislation to create a NADBank.

A variation of this proposal would create a NAFTA environmental trust fund (NEFT) in the IDB, rather than create a new institution. The **NEFT** would be a separate fund in the Inter-American Development Bank (IDB) under the control of the NAFTA participants. It would provide up to $10 billion in loans to finance environmental investments in Mexico only to ensure compliance with NAFTA. The IDB would administer the NEFT, with loans to regional and municipal authorities in Mexico, on IDB hard loan terms (about 8%). Because the IDB is chartered to operate only in regional developing countries, it is assumed that the U.S. and Canada would not be eligible to borrow.

The NEFT would require international negotiations and require Congressional authorization through at least the House and Senate banking committees. Both the paid-in capital and contingent liability would be subject to annual discretionary appropriations. It would probably take 12-18 months to begin operations. It is also possible that a NEFT would duplicate current IDB and World Bank lending to Mexico.

• The **Dedicated Fund** would be established through (a) an increase in the current tariffs applied to Mexican and U.S. goods and services at the border, (as proposed by House Majority Leader Gephardt), or (b) redirection of revenues from existing tariff revenue. This pool would fund projects on a current financial basis (such as grants), through either annual appropriations action or provision for off-setting collections.

Projects would be selected in one of three ways: (a) using existing structures (IBWC, U.S./Mexico binational commission) for negotiations with Mexico for a second stage of the current border plan; (b) creating a new institution such as a commission to coordinate federal, state and local activities and select projects that meet regional needs; or (c) creating a new institution separate from the existing federal and state agencies that could either contract out to existing agencies or would have its own staff.

According to OMB, This proposal hinges on either imposing additional tariffs on trade or redirecting existing tariff revenue, both of which would have serious budget and political ramifications. For every $1 billion in environmental financing, this proposal would require at least $500 million and perhaps as much as $1 billion in either additional tariffs or direct appropriated budget authority for the U.S. side. OMB suggests that additional tariffs and use of such to finance fiscal programs violates GATT under Article XXIV and VIII.

It would also require international negotiations with Mexico and authorization from Congressional Committees and annual discretionary appropriations for the financing (grants).

The interagency group generally supported the Border Authority Option (b) because it met most of the criteria considered likely to generate additional support for NAFTA. However, David Harwood of the State Department mentioned that he felt that the OMB proposal focused too much of the IBWC and that border NGOs, environmental groups and the business sector had problems with the IBWC. He felt that the Border Authority should have some similarities to the IBWC, but that it should be new and distinct for both political and substantive reasons.

The OMB paper asked that the Deputies consider:

- whether to support the concept of a border authority;
- should the Border Authority act as a financing authority with support from both governments (unitary mode) or whether the U.S. and Mexico should provide financing separately (parallel mode);
- to what extent can the projects along the border realistically be supported through user fees;
- whether the U.S. and Mexico can make sufficient progress in negotiations for inclusion in the implementing legislation;
- what level of commitment the U.S. and Mexico intend to make for future border environmental infrastructure, beginning in FY 1995, and;
- what type of leveraging mechanism (direct loans, partial guarantees, or both) the U.S. should use.

United States Department of State

Bureau of Oceans and International Environmental and Scientific Affairs

Washington, D.C. 20520

OMB paper

RAPIDFAX

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MESSAGE

DRAFT

ALTERNATIVE FINANCING PROPOSALS FOR NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) ENVIRONMENTAL ACTIVITIES

Issue **Is a new approach to financing border environmental infrastructure necessary?**

Introduction

The Administration is negotiating a supplementary environmental agreement with Mexico as a key add-on to the NAFTA to help win support for NAFTA implementing legislation in Congress. U.S. environmental groups are also looking for a long-term commitment of funds for environmental projects on both sides of the border. The Administration needs to consider:

(a) potential funding needs for environmental projects along the border,

(b) whether these needs can be met through existing programs within (or with small increases to) the current Administration budget, or

(c) whether the creation of new institutions or funding mechanisms is desirable and necessary as a concrete pledge of substantial future funding in order to secure passage of NAFTA.

This paper discusses some of the new institutions and funding mechanisms currently under consideration.

Funding Requirements: We do not yet have a clear indication of the funding needs or the precise scope of environmental projects that are not already covered by existing funding and programs. Realistic estimates from private studies suggest that there are between $4.0 billion to $6.5 billion,[1] in "unfunded" environmental projects or activities in the border region over the next decade or roughly $400-650 million per year. Key projects involve wastewater, solid waste, and hazardous waste cleanup, with the major construction expenses particularly on the Mexican side.

Some of these requirements could be met from existing funding:

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[1]These studies include the Army Corps of Engineers ($3.3 billion including construction, operations and maintenance; the Institute for International Economics ($5 billion for environmental needs in Mexico and along the border, and $2 billion for transportation), Border Trade Alliance (Top Ten Priority Projects equal $1 billion), and the State of Texas (draft estimate of $6-8 billion). The NGO community is compiling an assessment of "needs." Majority Leader Gephardt has asked the states to compile a list of their needs and report to him.

- o The Environmental Protection Agency (EPA) has a current baseline of $150 million annually in the President's FY 94-98 budget request for projects on both sides of the border.

- o There are indications that the Mexican Government has targeted about $400-500 million over a 3-4 year period for environmental projects in the border region.

- o The World Bank pipeline includes loans of $250-$400 million in FY94-96 for environmental projects by Mexican municipalities along the border. In addition, portions of a $300 million water project loan and $150 million solid waste loan may be focused on the border. The IDB is also providing funding for water projects in Tijuana from a nationwide credit line of $108 million.

- o Private, state and local funding may also be available or currently planned.

Because this data is imprecise, we can not yet fully assess the additional budget requirement, if any. We do know, however, that the FY 1995 spending caps will be extremely tight. Any requests for additional spending for environmental infrastructure on the border will require strong justifications and tough choices regarding offsets from other programs.

Funding Mechanisms: If the Administration decides that a new, primary funding mechanism is needed, we have identified three basic options:

(1) Creation of a new NAFTA Environmental Trust Fund in the Inter-American Development Bank;

(2) Establishment of a United States-Mexican Border Authority, as an expansion of the current functions of the International Boundary and Water Commission; and

(3) Creation of a "Dedicated Fund" for general border infrastructure.

The interagency group agrees that further analysis should concentrate on the first two options. Neither of these new institutions would be expected to be fully negotiated by the time NAFTA is submitted to Congress. If either is determined to be desirable, the governments of the United States and Mexico would need to reach agreement on the broad objectives and general funding requirements of the institution prior to transmitting NAFTA implementing legislation. The interagency group opposes "Dedicated" funding (i.e., increasing or earmarking tariffs) since it could be politically difficult and contradict the basic premise of NAFTA: to reduce barriers to trade between NAFTA partners.

In addition, the interagency group has identified supplementary funding for projects in Mexico which could be grafted onto existing programs or any new funding mechanism.

Funding Mechanism Proposals

(1) Establish a NAFTA Environmental Trust Fund (NEFT) in the Inter-American Development Bank (IDB)

Proposal: The NEFT would be established as a separate fund in the Inter-American Development Bank (IDB) under the control of the NAFTA participants. It would provide up to $10 billion in loans to finance environmental investments in Mexico only to ensure compliance with NAFTA environmental provisions. Its focus could therefore be broader than just the border area. The NEFT would be administered by the IDB, which would originate loans targeting environmental problems in Mexico that are of concern to the United States and Mexico. The loans, to regional and municipal authorities and utilities in Mexico, would be on IDB hard loan terms (i.e., about 8 percent), and carry a Mexican sovereign guarantee. Because the IDB is chartered to operate only in regional developing countries, it is assumed that the U.S. and Canada would not be eligible to borrow from the NEFT.

As suggested by IDB President Enrique Iglesias, the NEFT would be capitalized by the NAFTA partners over a five year period, with paid-in capital of $250 million (2.5% of lending, the current IDB paid-in requirement) and $9.75 billion in callable capital (contingent liability). The U.S. would provide 75 percent of the paid-in capital, Canada 15 percent, and Mexico 10 percent. The callable capital would be provided only by the U.S. and Canada to ensure the highest investment rating and lowest borrowing costs. Because the NEFT would borrow, like existing MDBs, on the international capital markets, it would need to be a separate legal entity, similar to the IDB's existing private sector lending entity.

Budget Implications: Under the 2.5% paid-in formula, the United States share would only be $187.5 million or $37 million in budget authority annually. Such high leverage (40:1) is attractive, but perhaps unrealistic. The limited diversity of the NEFT portfolio (Mexico only) suggests that (a) a higher paid-in contribution might be required and (b) there may be pressure from Congress for a subsidy appropriation to cover the contingent liability. Canadian contributions to clean-up the Mexican border may also be highly questionable. An alternative formulation -- 10% paid-in capital (85% U.S. and 15% Mexico) and 90% callable capital from the United States (with some subsidy cost for the contingent liability) -- would increase the budget impact of U.S. paid-in and subsidy costs to $1.75 billion or $350 million per year.

For every $1.0 billion in financing for environmental projects on the border, the budget cost to the United States could range from $18.7 million to $175 million under these formulations. Since the lending would be to Mexico, the NEFT would probably be financed from existing international resources (function 150), and offset requirements could crowd out other international initiatives.

Implementation: NEFT would require international negotiations to establish. It would also require Congressional authorization through at least the House and Senate banking committees. Both the paid-in and contingent liability would be subject to annual discretionary appropriations. In light of our experience with the Multilateral Investment Fund, it probably would take at least 12-18 months before it could begin operations. NEFT could start its operations relatively soon, ahw because it could build on the existing IDB organization.

Other Considerations: It is unclear whether Mexico and its municipalities have the need to borrow and capacity to service $10 billion over the next 5-10 years. Furthermore, the proposal addresses capital project costs, but does not address operational costs and maintenance. The NEFT may also duplicate existing facilities (e.g., the World Bank, the International Finance Corporation and the IDB) in which Mexico is one of the largest borrowers.

(2) Create a Border Authority by Expanding and Restructuring Certain Functions of the International Boundary and Water Commission (IBWC)

Proposal: The underlying premise is that the environmental infrastructure problems in the border area are on both sides of the boundary and are interrelated. Therefore, a regional, binational solution is required because of the physical and jurisdictional nature of the problem. A "border authority" could be comprised of elements of the existing IBWC and additional responsibilities for other border environmental infrastructure matters (similar to the Port Authority of New York and New Jersey). The Border Authority would approve the design and siting decisions for projects in the border zone. It would also determine priorities and standards together with and through existing state and local authorities, thus providing rationalization to create environmental infrastructure and avoiding duplication of existing institutions. The Authority would address water, sewage and municipal solid waste issues.

The Authority could own and operate public utility projects such as waste water treatment plants and dams and charge user fees, or oversee the ownership and operations by local entities. The IBWC already owns and operates a wide array of public utility projects and has an engineering department of 225 professionals who are highly experienced in the design, planning and construction of large infrastructure projects. These assets would be transferred to the Border Authority and their cashflows used to pay for the operations of the Authority, including equity investments in specific projects, if needed. The Authority could also be structured to accept or act as a conduit for other funds from other sources (e.g., an initiative could made to encourage private companies in the border region to contribute equity to particular projects).

The Border Authority could raise funds for environmental projects in two ways:

(1) Guaranteeing Bonds: The "border authority" would have authority to issue bonds indirectly through finance entities, or directly guarantee the bonds of other entities used to finance the projects. Financing would be through revenue bonds rather than general obligation bonds to avoid Mexican constitutional provisions that prohibit municipalities from issuing general obligation bonds.

(2) Issuing Bonds directly: The border authority could operate as a central funding mechanism. Rather than guaranteeing project bonds issued by other entities, it would

directly issue all bonds for project funding, with a government guarantee. This might prove to be a relatively efficient funding mechanism since it will become a familiar player in the bond market and has the potential to pool project risk.

In either case, the United States Government would provide only a partial guarantee. The bonds could provide for recourse to the cashflows from the projects, the projects themselves and limited recourse on a 50/50 basis to the U.S. and Mexican governments, in that order. The proposal anticipates that operations and maintenance expenses must be covered by the bond issue and schedule of user fees.

Budget Implications: The proposal would require budget authority in the United States and Mexico for administrative expenses and an annual appropriation to cover the subsidy cost of the guarantee. The proposal may also require initial capitalization, although the IBWC's existing assets may cover such requirements since their historical capital costs of these assets has been estimated to exceed $400 million.

Under credit reform, any U.S.G. guarantee would require appropriations to cover the subsidy cost (risk of default). Determination of the subsidy cost is complicated because of the binational nature of the border authority, the uneven level of risk associated with different municipalities and projects, and the potential recourse to the cash flow and assets associated with the projects. Proponents of this proposal suggest that the primary financing risk of the border authority may be temporary liquidity problems. If this is the case, the credit reform costs might be reduced further if the U.S. guarantee were limited to one year of interest payments, on a rolling basis. [Note: According to OMB staff, this has not been allowed for Eximbank]. The budget scoring issue is currently under review by OMB staff, but a conservative proxy for the subsidy cost would be about 10-20% of the portion guaranteed by the United States Government. For example, the subsidy cost to the United States of a 50% guarantee of $5 billion would be $250-500 million. Spread out over 10 years, this would amount to $25-50 million in appropriations annually.

For every $1.0 billion in financing for environmental projects on the border, the budget cost to the United States could range from $50 million to $100 million. So long as the U.S. guarantee applies to 50 percent or less of the cost of the project, the program could be considered "domestic" and funded through domestic discretionary appropriations. Currently, the U.S. share of the IBWC projects are funded from multiple accounts, with administration expenses drawn against international activities, construction costs from EPA and contributions from state and local governments.

[illegible] contributions

Implementation: The proposal would require international negotiations between the U.S. and Mexico. It would probably need to be authorized through numerous Congressional Committees before becoming operational. It would also require annual discretionary appropriations and perhaps some initial capitalization. Because it would involve a restructuring of an existing organization (IBWC), rather than the time-consuming creation of a new organization, we expect it could become operational in 12-18 months.

Other Considerations: Of the institutional proposals, this has the most potential to be structured in a way that does not constitute direct foreign aid. In addition, it addresses the problems on both sides of the border and avoids the Mexican constitutional obstacle. The proposal is likely to be attractive to municipalities on both sides of the border since they will be involved in issuing bonds and developing projects. The proposal would have to be modified to eliminate the tax exempt feature of the bonds, because direct or indirect guarantees for tax exempt obligations are expressly prohibited under section 149(b) of the Internal Revenue Code. In addition, the partial guarantee should be consistent with long-standing credit and guarantee policies enumerated in OMB Circular A-129.

(3) Establish a "Dedicated Fund" for Environmental or General Border Infrastructure

Proposal: A separate, designated pool of resources would be established through (a) an increase in the current tariffs applied to Mexican and U.S. goods and services at the border, or (b) redirection of revenues from existing tariff revenue. This pool would fund projects on a current financial basis (such as grants), through either annual appropriations action or provision for offsetting collections. Proposals covered by this category have not specified how projects would be selected. Options include:

- Using existing structures (e.g., IBWC, U.S.-Mexico binational commission) for developing an inter-agency Administration position for the U.S. and negotiations with Mexico for a second stage of the current border plan.
- Creating a new institution such as a commission to coordinate federal, state and local activities and select projects that meet regional needs.
- Creating a new institution separate from the existing federal and state agencies that could either contract out to existing agencies or would have its own staff.

Budget Implications: These proposals hinge on either imposing additional tariffs (taxes) on trade or redirecting existing tariff revenue, both of which would have serious budget and political ramifications. **For every $1.0 billion in environmental financing, this proposal would require at least $500 million (and perhaps as much as $1.0 billion) in either additional tariffs/taxes on trade or direct appropriated budget authority for the U.S. side.**

Imposing taxes on trade would contradict the basic principle of the NAFTA: to eliminate barriers to trade among NAFTA partners. Total U.S. collections on Mexican imports now only amount to about $700 million annually. Were Mexico and the U.S. to increase existing tariffs on their trade, it would be a direct violation of the NAFTA, which obligated these trading partners to negotiate from tariffs in place on August 1, 1991. A similar concern would also apply to the 30 percent and 50 percent of U.S. exports to and imports from, respectively, Mexico that are currently not subject to duties. President Clinton has made it clear that he will not reopen the NAFTA text.

If the fund were financed out of existing tariff revenues, then the amount redirected would need to be offset along with the tariff revenues being phased out under NAFTA. Thus, the pay-go offsets could be expanded to include the redirected revenues. This option could be modified to be covered by a redirection in general revenues, although no programmatic rationale has been presented for this type of option. It would have the same implications as redirecting tariff revenues. Identifying an increase in other taxes would still have the same programmatic effects. One tax that has been presented as a possible revenue offset has been an increase in the corporate income tax. If it were used to offset the loss of tariff revenue, then it could be expanded to also cover the "redirection" of tariff revenue.[2]

Implementation: This proposal would require international negotiations with Mexico. It would also require authorization from Congressional Committees, and annual discretionary appropriations for the financing (grants).

Other Considerations: Imposing taxes on trade to finance specific programs could open the U.S. to challenges that we were violating our GATT obligations under (a) Article XXIV, under which the U.S. and Mexico agreed to negotiate the NAFTA to "substantially eliminate all barriers", and, (b) Article VIII, which prohibits countries from using tariffs to finance "fiscal programs." The U.S. was found in violation of its GATT obligations for its initial customs user fee used to finance border monitoring and enforcement. It has since been redrafted to conform to GATT obligations.

Additional Sources of Mexican Financing

These proposals focus on financing environmental infrastructure only in Mexico. None would require additional U.S. budget authority and outlays; the funding requirements are met either by private sector contributions, earmarking/reallocation of existing resources, or commitments from Mexico to provide funding in return for certain USG considerations.

(1) Private Sector Financial Guarantee Fund. A private sector financial guarantee fund could help back financing of environmental projects that generate user fees. The Fund would provide financial guarantees for the repayment of debt instruments issued by public and private financial organizations, the proceeds of which would be used to fund projects to create, replace, or improve the environmental infrastructure in the United States-Mexico border region.

Under the proposal, the EPA Administrator would propose to appropriate authorities in Mexico the creation of an infrastructure finance system which would provide for the issuance of public debt by subsovereign government entities in Mexico. The underlying credit for such bonds would rest primarily on the cashflow generated from projects through user fees from

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[2]The redirection of any kind of revenue is really a "shell game" within the general fund since, under the Budget Enforcement Act (BEA) of 1990, any changes in mandatory spending or revenues must be deficit-neutral.

industrial, commercial and residential users. The Fund would be capitalized solely by private-sector contributions, some of which might come from American companies along the border. The Fund guarantee should confer on underlying debt instruments issued by public and private financial organizations the lowest investment grade ratings (e.g., BBB) from independent and internationally recognized securities rating organizations for the purpose of leveraging the Fund to the maximum extent possible so that the greatest possible ratio exists between the amount of debt guaranteed by the Fund and its capitalization. The proposal assumes that the problem with providing loans to smaller communities is delinquency (liquidity) rather than default on loans (solvency). It expects minimal write-offs on its guarantees and argues that its resources will be used to allow debt payments to lenders to be made on time if a municipality is unable to pay.

The proposal's funding mechanism may be better suited for smaller projects, since it is unlikely that the private-sector seed money for the guarantee fund would be sufficient to back larger infrastructure projects. In addition, the proposal does not address broader issues such as regional coordination of environmental infrastructure projects. Finally, the proposal may have to be revised so that it does not raise Mexican constitutional problems (Mexican municipalities do not have the authority to issue general obligation bonds).

(2) Multilateral Development Banks. Both the Inter-American Development Bank (IDB) and the World Bank are addressing major environmental and social problems in Mexico. For example, the World Bank has made new loans to Mexico for environmental improvement, science and technology infrastructure development and housing market development during its 1992 fiscal year (July-June). The World Bank pipeline includes loans of $250-$400 million in FY94-96 for environmental projects by Mexican municipalities along the border. In addition, portions of a $300 million water project loan and $150 million solid waste loan may be focused on the border. Because the U.S. is a contributor to these institutions, U.S. representatives to both institutions could "encourage" increased lending to the border region in Mexico. In addition, negotiations for a replenishment of the IDB's resources are underway and the new replenishment may concentrate more on Latin American social and environmental needs. The banks could also, however, play a larger role in overall environmental policy reform in Mexico, rather than focusing on the wealthier border region. The World Bank's private sector window, the International Finance Corporation, has also been active in Mexico.

(3) Brady Bond Buyback and Environmental Funding. For a Mexican commitment to provide specific additional funds for environmental clean-up along the U.S.-Mexican border, Treasury could reduce its constraints on Mexico's redemption of the zero-coupon Treasury securities backing the Mexican Brady bonds. Brady bonds are Mexican securities which were issued in 1990 as part of the debt/debt service reduction agreement between Mexico and its commercial banks. Under the current terms of its Memorandum of Understanding (MOU) with Treasury, Mexican redemptions of zero coupon bonds will be limited to $1.5 billion per year beginning in June 1993, a pace well below the $5.2 billion redeemed in the last half of 1992.

The proposal should be considered a supplementary measure because it could be started quickly and without appropriations. The environmental resources generated by the proposal hinge entirely on whether the Government of Mexico wants to buy back Brady bonds and redeem the zero coupon bonds at a faster pace than allowed by the current MOU and if it is willing to commit environmental resources of this magnitude. Depending upon the agreed "environmental contribution" per dollar of debt retired, this approach could provide $150 million or more in Mexican local currency environmental funding for each additional $1 billion in zero-coupon bonds that Mexico retires per year beyond the current $1.5 billion limit. Implementation of this proposal would require an early meeting with the Mexican Ministry of Finance to determine their interest and to estimate resources to be generated. Renegotiation of the MOU could be done quickly.

For the United States, the proposal requires no budget authority. For Mexico, the proposal could be financially attractive. For example, we have suggested that Mexico's total cash requirements for each additional dollar of Brady bonds retired could be 68 cents: a net cost of 53 cents to purchase the debt after redeeming the collateral and 15 cents in pesos for the environment (the latter could come directly out of the retired collateral). Any dramatic increase in secondary market prices or depletion of Mexican reserves could reduce the attractiveness of this option to Mexico in future years and reduce the amount of environmental resources. This problem could be resolved if Mexico made a commitment to provide a specified amount of environmental resources in the renegotiated MOU.

(4) No-cost Sales of Eximbank/CCC Loans: Treasury could use existing legislation for the Enterprise for the Americas Initiative to permit Mexico to buy back at no U.S. budget cost a portion (10-20 percent) of its $1.2 billion in rescheduled Eximbank credits (and perhaps later its $400 million in Commodity Credit Corporation (CCC) credits), provided Mexico commits to provide local currency resources to the environment equivalent to the discount amount. This approach could generate a small amount--from $15-30 million--for "green" resources for the Mexican side of the border.

The necessary authorizing legislation for Eximbank and CCC sales is already enacted; approval of the appropriators has been provided for Eximbank sales in FY 1993, but would be needed for Eximbank and CCC for FY 1994). The actual sales/swap programs would need the concurrence of Eximbank and CCC and must be set up operationally at both institutions. Eximbank was concerned about Hill reaction to debt reduction for Mexico when it is still lending huge amounts of new money. CCC staff opposed any decision until its political team on board.

This proposal could be implemented without budget cost to the U.S. if the debt is sold to Mexico at the same price as the debt is valued in the U.S. budget. It would cost Mexico one dollar for each dollar of Eximbank/CCC debt retired: 88 cents to buy back the debt from the U.S.G. and 12 cents in environmental funds. The World Wildlife Fund and the Nature Conservancy want to activate this program. House Agriculture Committee Chairman de la Garza designed the CCC swap legislation with "green" resources for the border in mind. His staff indicated a "strong interest" in activating the program as a small assist to NAFTA.

Binat'l Border Auth

ISSUE PAPER: STRUCTURE AND POWERS OF A U.S.-MEXICO BORDER AUTHORITY FOR THE IMPLEMENTATION AND FINANCING OF ENVIRONMENTAL INFRASTRUCTURE PROJECTS

ISSUE

What organizational structure and what powers should a regional, U.S-Mexico border authority have to facilitate the financing, construction and operation of environmental infrastructure projects in the U.S.-Mexico border area?

BACKGROUND

I. Context

It has been proposed that, because of the unique nature of the environmental infrastructure problems in the U.S.-Mexico border area, a new binational entity should be established to administer and facilitate financing and construction of border environmental infrastructure projects. (See Appendix I attached hereto for a discussion of the facts and rationales that give rise to said proposal.) Briefly, the basics of the "Border Authority" proposal are as follows:

1. In order to accommodate the transboundary nature of the problems and to allow rational coordination of resource allocation among the many jurisdictions in the region, a new institution would be created, jointly by the U.S. and Mexico, to implement the financing, completion and supervision of the proposed border infrastructure projects.

2. The form of such an institution would be that of a "Border Authority," containing elements of a number of existing entities that deal with cross-boundary infrastructue projects.

3. Two essential powers of the "Border Authority" would be the right to approve design and siting decisions for projects in the border zone and the authorization to guarantee locally issued bonds that would be used to finance the projects. The guarantee would provide for recourse to the cashflows (user fees) from the projects, the projects themselves and limited recourse to the U.S. and Mexican Governments, in that order.

II. Reasons for a Border Authority Structure

A regional, binational authority, similiar to local bonding authorities such as the New York and New Jersey Port Authority, would satisfy all of the criteria identified in Appendix I for the successful implementation of a program of border environmental infrastructure projects:

1. A binational authority would facilitate international, cross-border cooperation in siting, planning and operating large environmental intrastructure projects which are physically located in two countries or deal with pollution that originates in two countries. Other solutions, such as direct Federal budget allocations, border trust funds and development bank models, are based on unilateral action from one or both sides of the border. They address only the issue of the source of funds, not how to spend those funds rationally and efficiently in the context of problems that transcend numerous physical and political boundaries. The Border Authority model addresses binational problems in a binational manner.

2. A binational, regional authority can help ensure that what are basically local issues are addressed at a local level with appropriate participation by local jurisdictions. The environmental problems associated with the border zone are essentially local problems. The complicating factor is that the border area is an identifiable, interrelated ecosystem that has developed its own economic and demographic characteristics. If the border region were located within one jurisdiction these problems could be addressed on a unified and local basis. Overlapping jurisdictions make this impossible without some overarching organization. A Border Authority would provide the unifying factor without depriving the affected localities of the authority to deal with local problems. Direct federal funding from the two governments, or from a development bank, would not afford the same combination of coordination and local participation. This combination is crucial, as local user fees should be the primary source of revenue for funding the projects.

3. A Border Authority would reduce the risk of

duplication of effort and waste that is inherent in allowing multiple jurisdictions to deal individually with problems that affect them all. Even if direct federal funds or development bank funds were available, some mechanism to coordinate distribution thereof and to monitor the projects would be necessary.

4. A binational authority would provide a mechanism for financial oversight and accountability, which is essential to international projects undertaken by countries with significantly different cultures and political systems. Both parties must see the system of implementation as fair and their ability to participate as equal.

5. A Border Authority would provide a focal point for other aid and financing efforts. It would act as a clearinghouse, reducing the overhead of other organizations interested in participating in border environmental infrastructure projects.

6. A Border Authority, as proposed, would obviate the need for large appropriations from the general budget or a "border tax" that could partially defeat the purpose of the NAFTA. The power to guarantee locally issued bonds would provide a mechanism to properly leverage local cashflows through use of the private capital markets.

As important as what the Border Authority would do, is what it would not do. This model does not address other areas of environmental concern in the border region, such as hazardous waste and air pollution. These, and many other areas of concern, should continue to be handled by the EPA. Not only is the EPA well suited to continue to deal with issues it has been handling for some years, but for the Border Authority to focus on too many areas would defeat its purpose.

NOTE: IMPLEMENTATION OF THE FOLLOWING PROPOSALS, OR ALMOST ANY VARIATION THEREOF, WOULD REQUIRE A TREATY, OR EQUIVALENT, BETWEEN THE U.S. AND MEXICO AND U.S. AND MEXICAN FEDERAL LEGISLATION.

STRUCTURE AND POWERS OF BORDER AUTHORITY

I. Organization and Personnel

A good precedent for much of the structural organization of a Border Authority is the structure and procedures established by and pursuant to the 1944 treaty (the "1944 Water Treaty") that gave the U.S.-Mexico International Boundary and Water Commission (the "IBWC") its "water" powers. Some of the following key features come from the 1944 Water Treaty, while others are new:

1. The authority would be comprised of two independent sections, one U.S., one Mexican. This reflects the structure of the IBWC and creates an entity that must operate on consensus. Each country would pay for the operations of its own section, just as is the case now with the IBWC.

2. Unlike the 1944 Water Treaty, certain finite areas of jurisdiction would be delegated to the Authority, thus allowing the Authority to act independently of the two federal governments, just as the IBWC has come to operate in practice. It is important to note that while the Authority would have the power to act in designated matters, its actions would have to be based upon the consensus of both national sections, thus ensuring binational solutions. In general, though, outside the areas of delegated jurisdiction, the two sections would be subject to the direct control of their respective governments.

3. As with the IBWC, the head of each national section would be a presidential appointee and would have to have a technical background, i.e., engineering or a related field of training. This would help keep the Authority focused on the practical instead of the political.

4. The Authority would be advised by a committee of experts appointed by the governors of the border states. Each Mexican state would appoint two members and each U.S. state would appoint three members each, for a total of twenty-four members (twelve Mexican and twelve U.S.). At least one member from each state (Mexican and U.S.) would have to have some relevant expertise, e.g., environmental, engineering, planning, etc. This advisory committee would ensure state and local participation at the planning stages. All projects would be referred to and reported on by the advisory committee at the same time that the Authority was studying them. The committee's reports would be non-binding. The constituent states would fund the advisory committee and membership would be voluntary.

5. The Authority would take over that portion of the IBWC's current engineering staff that works on infrastructure projects. This core staff would be expanded as projects are developed. An independent engineering staff is central to the

Binat'l Border Auth.
6/21/93

success of the Authority, just as it has been to the water projects of the IBWC. The Authority needs to have the capacity to independently review proposed projects, as well as engineer its own projects. An engineering staff is the key to one of the central functions of the authority --- standardization and coordination of siting and design of the infrastructure projects. Initially, some direct funding will be necessary to operate the engineering staff, but it should eventually become self-sustaining, as individual projects contribute to the operational costs and the staff takes on outside work.

6. The Authority would also need the same kind of fiscal controls that a bonding authority has. Specifically, it would need the capacity to conduct the same kind of financial analysis that the market uses in reviewing revenue bonds with no guarantees. This is crucial in assuring that the proposed guarantee does not become a disguised direct subsidy. While all projections are subject to being wrong to a greater or lesser degree, independent analysis of the financial assets of each project is the key to deciding when and to what extent to guarantee a particular project. The Authority could not rely on the financial analysis from the markets, as the market would discount the project's credit and focus on the potential value of the guarantee. (Alternatively, the Authority could be limited to issuing guarantees on projects that can obtain a stated minimum rating from one of the big two rating agencies, which rating would be done without regard to the guarantee.)

<u>Summary of Management</u>

The management model for the Authority is probably the Port Authority of New York and New Jersey or other similar interstate public services entities. Because of the binational character of the Authority, management will have to be based on consensus and working relationships, rather than a command and control structure. While this appears problematic on paper, the experience of the IBWC proves otherwise. Also, the proposed internal dispute settlement process for technical issues is intended to limit the number of areas where the parties can cause inaction through disagreement. The narrow and local focus of the Authority is also intended to limit the number of political issues that could interfere with a collegial management approach.

Finally, while the Authority would be managed by the two section heads, who are engineers, it would also require a separate unit to focus on financial reviews and controls related to the projects. This unit would be under the general direction of the section heads, but would need to have the independence to be the sole judge of the commercial viability of a project. The head of this unit, something like a comptroller for the Authority, would be appointed jointly by the two Governments and could report directly to the two Treasuries, as well as to the section heads.

II. Jurisdiction and Non-Financial Powers

While the 1944 Water Treaty and the IBWC provide the primary model for the structural organization of the Authority, its jurisdiction and operating powers would resemble those of a regional or state public authority that deals with similar infrastructure issues. The following are the basic areas of competence the Authority should have:

1. Geographical Jurisdiction - While the "border zone" is often referred to as being 100 KM on either side of the international boundary, the jurisdiction of the Authority should not be based upon an artificial parameter, but should be set by the topographical realities of the border region's ecosystems. Its physical and jurisdictional limits should be set based on a holistic analysis of the ecosystems that affect and are affected by the border area. Therefore, a precise geographical jurisdiction cannot be delineated at this time.

2. Subject-Matter Jurisdiction - The substantive area of concern for the Authority would be limited to environmental infrastructure. This would include: water facilities, both treatment and distribution; sewage collection and treatment; solid waste collection and disposal in the municipal, non-hazardous setting and associated projects, such as flood control, irrigation and recycling. In addition, the Authority would play a role in regional land use planning and establishment of minimum sanitation and development standards.

3. Technical - At its core, the Authority would be a technical institution. The technical problems relating to construction of environmental infrastructure in the border area give rise to one of the basic rationales for the Authority. It is important that the Authority stay focused upon its narrow mandate. Therefore, power to deal with technical issues should be comprehensive and would include the following:

i) Perhaps the most important operational function of the Authority would be the identification of areas of environmental need throughout the region and the rationalization of resource allocation to deal with such needs. This would be accomplished by an ongoing environmental survey of the region. (Initial work in this regard has been done under the Integrated Border Plan, Phase I, prepared by the EPA and its Mexican counterpart, SEDUE/SEDESOL (the "Integrated Border Plan"). Concrete cost estimates on 11 core projects have been prepared by the U.S. Army Corps of Engineers. See "International Boundary and Water Commission Sanitation Issues, Design and Cost Estimate Report, September 1992".) A cooperative, binational approach toward this subject is crucial. While local authorities will of course identity projects and needs to the Authority, only an organization such as the Authority can establish regional priorities and assure a unified approach to addressing such priorities.

ii) The Authority, through its engineering staff, would review or initiate siting and design studies of all proposed projects. This would encourage uniformity in siting criteria so as to ensure consistency and fairness in the distribution of projects throughout the region.

iii) The engineering staff would also develop equipment standards for the projects, so that future maintenance can be done on a uniform, and hopefully less expensive, basis.

iv) The Authority engineers would also provide oversight of construction and operation of the projects so as to assure independent accountability.

<u>Summary of Non-Financial Powers</u>

The Authority will need to have some concrete regulatory powers. These powers would be limited and similar to powers already exercised in the U.S. by a combination of state, local and Federal authorities and in Mexico by the Federal Government. These powers would not replace existing powers, but would complement and supplement them, though also supersede them in cases of conflict. The Authority's regulatory powers would touch three areas: i) initiation of projects, ii) siting, design and supervision of projects and iii) establishment of uniform sanitation and discharge standards. (It is important to note that the IBWC currently deals with all three of these areas on a negotiated basis.)

It is anticipated that local authorities on both sides of the border will generally seek to take advantage of the Authority's ability to facilitate projects that will improve the living conditions and business climate of the region. If there is a technical consensus, however, as to the need for a project to protect the environment, the Authority would have the power to initiate the project, even over local opposition. Ideally, the project would proceed with some local cooperation. If not, it would be owned and operated by the Authority through a finance vehicle. The Authority would issue only a guarantee on revenue bonds of the finance vehicle (rather than general obligation bonds).

Related to but separate from the power to initiate, the Authority will need the power to control siting and design issues. If the full benefit of its "cross-jurisdictional" function is to be realized, the Authority must be able to override local siting decisions which are inconsistent with the technical and physical realities of the region. However, as stated previously, localities should generally initiate the projects and coordinate with the Authority so that solutions would remain locally based, even if the ultimate authority is in a regional entity.

Finally, whether a project is locally initiated or initiated by the Authority, there is a need to standardize construction and the permitted levels of discharge. These issues are already the subject of negotiations between the U.S. Section and the Mexican Section of the IBWC. These negotiations usually result in the U.S. subsidizing Mexican construction costs so as to assure that the projects meet higher U.S. environmental standards. The Authority's "standardization" power would also include the ability to force new and existing development to participate in projects by hooking up to collection systems. In the U.S., this power is no different from the process that occurred in the 1970's and 1980's whereby small localities were required to provide primary sewage treatment under the Clean Water Act. In that example, however, the Federal Government provided less assistance than the Authority would provide to localities in the border region.

As discussed previously, the Authority would operate upon the consensus of its two national sections. However, disagreements on technical issues (such as whether a project is required, the siting of a project and the basic standards of sanitation) would not be allowed to halt the project. Such technical and scientific disputes would be settled by agreement of a panel of experts appointed by the two sections. The procedure would not be an arbitration and lawyers would be barred from the panel, though the panel could seek the advice of counsel. The Authority charter should make clear that if the Authority, or the panel of experts, agrees as to the technical need and feasibility of a project (and assuming the project meets financial requirements), it is not legitimate (other than on immediate security grounds) for either government to stop a project.

III. Financial Powers

Consistent with its primarily technical nature, the Authority should not be viewed as a significant direct source of funding for environmental infrastructure projects, but as a facilitator of access to the private capital markets. However, it will be structured so as to have the ability to own and operate projects on its own, and it could serve as a conduit for use of funds contributed directly by the two governments or from international institutions.

The primary sources of funding for the operations of the Authority would be threefold: First, the infrastructure assets of the IBWC, to the extent they are not already income producing, should be made so and these assets transferred to the Authority. Second, the cost of the engineering services of the Authority would be reimbursed by allocation to the projects. Finally, as with the IBWC, each country would pay for the operation of its section of the Authority, which should be relatively small.

The primary financial power of the Authority relating to the financing of the projects would be the ability to guarantee locally issued revenue bonds. The underlying credit for such bonds would rest upon the cashflow generated from projects through user fees. To the extent a project's estimated user fees would not allow the sale of public bonds, the Authority could, to the extent of available capital, make a direct equity investment in the project sufficient to make the bonds commercially saleable. The financial principle of the Authority would be that the projects should be funded by accessing the private capital markets. To the extent that is not possible, all deals should be structured so that government funding should be used only to the extent necessary to make the deal privately financeable. With this concept in mind, the following are the minimum bonding powers the Authority should have:

i) The primary, and preferred, power of the Authority would be to issue guarantees of local bonds. This mechanism minimizes the use of government credit and preserves the role of local organizations, thus avoiding creation of new structures and overheads.

ii) The form of guarantee would be a several obligation of the U.S. and Mexico, 50% each, as to the guaranteed amount. Only so much of the principal and interest would be guaranteed as was necessary to sell the bonds at market rates. The guarantee would be payable only after recourse was had to the project's revenues and assets.

iii) To enhance the marketability of the bonds, and to reduce the financing cost of the projects, the guaranteed bonds would be tax-exempt in Canada, the U.S. and Mexico. (The tax exemption in the U.S. would require a change in the Internal Revenue Code and in OMB policy regarding tax-exempt bonds. These changes may not be possible, but the tax-exempt feature is not central to the proposal.) In addition, the bonds could be issued in Canadian dollar, U.S. dollar and Mexico peso tranches. Again this is a marketing feature and would allow projects located in Mexico to avoid some foreign exchange risk.

iv) Finally, as mentioned, as a less preferred alternative, the Authority could create and own separate financing vehicles where the project was not yet marketable. The bonds of this type of vehicle would carry the same guarantee outlined above.

Summary of Financial Powers

It is useful to analyze the proposed Border Authority as a "government sponsored enterprise." This analysis indicates that the Authority could play a role in five functional areas: i) facilitation of cross-jurisdictional actions; ii) standardization of design, siting and construction of environmental infrastructure projects; iii) provision of liquidity for financing such infrastructure projects; iv) subsidization, to some extent, of such projects and v) encouragement of the development and export of environmental equipment and technology. No one of these functions justifies the use of the Border Authority model, but all five in combination do justify this model.

Three of these functions could be accomplished without use of the proposed guarantee. In addition, if all of the proposed projects could be financed commercially with revenue bonds, no guarantee would be necessary. A central reality underlying the proposal for a Border Authority is that the average environmental infrastructure project in the border zone cannot currently be financed without technical and financial assistance. It does not follow, however, that all such projects must be financed through public appropriations. The precise combination of factors required to support commercial financing will vary from project to project.

All of the projects will benefit from the "facilitation" and "standardization" functions of the Authority model. Some percentage of the projects will be made commercially viable solely by being subject to an overarching authority that facilitates resolution of problems implicating multiple jurisdictions. Others will require more. For these projects, the first function of the guarantee will be to provide liquidity. Until a project is constructed, it is not possible to tap the income stream generated by the new services. Therefore, even if the underlying credit of the project is sound, interim construction financing will be difficult without an assured takeout mechanism. The ability of the Authority to issue a U.S.-Mexico backed guarantee will assure access to interim financing, because the guarantee will make it easier to get an underwriting commitment upon which the interim financier will rely.

Obviously, such a guarantee shifts a quantity of risk from the interim financier to the bondholders, through the underwriter, and ultimately to the two Governments through the Authority. This shifting of risk is a form of subsidy. However, assuming that the financial projections for each guaranteed project (of which more later) show that the project is financially viable, the guarantee will cover risk arising from future circumstances that are external to the project. This type of guarantee can be distinguished from a direct subsidy guarantee, which is assumed to be payable, at least in part, on the day it is issued. (The financial market analogy is the difference between a revenue bond with credit enhancement and a letter of credit-backed commercial paper program.)

It is intended that the guarantee not be used as a direct subsidy or a substitute for the underlying commercial viability of any project. Projects that cannot be financed with such a "limited" guarantee would be subsidized directly through government (state, local or Federal) equity contributions, but only to the extent necessary to allow them to meet the outlined criteria. Such contributions would be open and not disguised as a guarantee. The funding for such equity contributions would come from the Authority only to the extent that it generated excess cashflow from its operations or was given specific budget allocations for said purpose. Therefore, it is possible that some projects could not be financed by use of the Border Authority alone.

IV. Project Case Study

Although additional details are necessary to fully outline a hypothetical bond issuance, it will be helpful to apply the foregoing to a proposed project.

Mexicali/Imperial County Waste Water

Under the Integrated Border Plan the following projects are proposed in connection with cleaning up the New River: i) efficient operation of existing wastewater treatment lagoons, ii) construction of new treatment facilities in southeast Mexicali to handle domestic and industrial wastewater and iii) elimination of all discharges of untreated domestic and industrial wastewater through expansion of the sewage collection system.

First, the Authority engineering staff would assess the problem and make sure it is a priority issue and that the proposed solutions fit within the broader framework of the border cleanup. Next the Authority would approach the local officials in Mexicali/Imperial County, or vice versa, and the appropriate local entity would be identified or created. This local entity, under the supervision of the Authority, would begin planning and design of the necessary facilities. This planning would include costing out the project, identifying users and establishing estimated user fees. The local jurisdictions, backed by the Authority, would be responsible for formulating and enforcing rules that assure use of the facilities by individuals and companies that discharge wastewater. The Governor's Advisory Committee would review the project simultaneously. After all federal, state, county and municipal reviews and approvals are obtained, the Authority would be in a position to give its approval. Interim financing would come from commercial banks based upon a take-out through the bond financing. The construction contracts would be let by the local entity under the supervision of the Authority. Construction would be by private companies under direction of the Authority engineering staff. Near completion, private underwriters would be engaged to market long-term bonds to payoff the interim financing and provide permanent financing for the project. The bonds would be guaranteed by the Authority, but would be issued and serviced by the local issuing entity. The local entity would collect all revenues and operate the facilities. The Authority engineering staff would continue to monitor operations until the bonds were paid or refinanced.

V. Capitalization of the Authority

This model would be greatly enhanced by a "transforming idea". While there is an argument that, in the context of implementing and financing a border environmental clean-up, the proposal itself is a "transforming idea", there are other possibilities, relating to innovative sources of initial capital, that arise within the context of the proposal itself.

IBWC Assets - Originally, the border clean-up problem was addressed in a broader paper which dealt more generally with the question of how to finance the NAFTA supplemental environmental package. This paper suggested, among other things, the privatization of the public utility assets of the IBWC, with the proceeds being used to fund infrastructure projects. This proposal has now been modified to call for the privatization and retention of said assets by the Border Authority, with the cashflows therefrom being used to operate the Authority. Obviously, any excess cashflow could be used to make equity contributions to weak projects. Sale of the assets and use of the proceeds as an endowment is also a possibility. The Mexican Section maintains separate ownership of its share of the joint assets and prepares its own financial data. Therefore, in reviewing IBWC assets, it must be remembered that the U.S. data does not reflect the full value of the assets.

"Brady Bonds" - Treasury has discussed an interesting potential source of revenue for border cleanup involving the "Brady Bonds" that were created for the restructuring of the Mexican sovereign debt. These bonds are partially collateralized by U.S. Treasury bonds. Starting this year, the amount of Brady Bonds that Mexico can purchase in the open market and retire (and thus redeem the collateral on the bonds with the U.S. Treasury) is limited by the restructuring agreement with the U.S. Because of the differential between the rate of interest on the Brady Bonds and the rate of interest that Mexico now pays on its new borrowings, it is profitable for Mexico to purchase Brady Bonds and retire them. Last year Mexico retired $5.5 billion worth of Brady Bonds. To facilitate the Border Authority proposal the U.S. would waive the limiting agreement upon the condition that some percentage of Mexico's profit on bond retirements and redemptions of collateral would be contributed to the Border Authority for infrastructure projects. While there is no way to estimate how much revenue this might generate, assuming Mexican interest rates and foreign exchange reserves remain roughly at current levels, the proposal should be attractive to Mexico and generate a significant amount of money for the border cleanup even if the profit split is only 25/75.

Drafted:KAThomas-OES/ENV
7 June 1993 (DOC. SEENV #3661)

APPENDIX I

ISSUE PAPER: STRUCTURE FOR IMPLEMENTATION OF FINANCING FOR U.S.-MEXICO BORDER ENVIRONMENTAL INFRASTRUCTURE PROJECTS

ISSUE

Through what form of financing, and through what structure, should available financial resources be disbursed to fund U.S.-Mexico border environmental infrastructure projects?

BACKGROUND

I. Context

The infrastructure needed to address environmental degradation in the U.S.-Mexico border zone (100 KM on either side of the boundary) is not unique: water and sewage systems, solid waste disposal sites, roads, flood control projects, etc.. The physical setting and governmental context, however, are unique. In addition, the nature and size of the problem present special considerations. Any plan for the financing of such border infrastructure projects should take into account the following:

1. The central feature of the area is an international boundary. This very real, but arbitrary, line of demarcation creates an artificiality not fully present inside a country -- even countries like Mexico and the U.S., which both have federal systems.

2. Equally important, the area contains numerous levels of governmental jurisdictions (two Federal governments, four U.S. state governments, six Mexican state governments and dozens of county and municipal governments).

3. The problem to be dealt with, environmental pollution, cuts across and is not inhibited by any of the numerous jurisdictional boundaries in the border zone.

4. The amount of work to be done is very large and covers an enormous geographical area.

5. The geographical area of interest includes two significantly different cultures, political systems and economies.

II. Implications For Financing Structure

The foregoing factors should affect the form and structure of the required financing. In fact, if they are not adequately addressed in the implementation of any financing package, they could unnecessarily raise the total cost of the infrastructure project. This is so because, in the context of overlapping jurisdictions, the nature of the problem, i.e., related cross-border pollution sources, can lead to duplication of facilities. In addition, unless regional planning is used, there is no guarantee that facilities will be designed and sited in the most cost efficient manner.

Given current U.S. and Mexican federal budgetary constraints, the sheer size of the proposed projects means that any financing mechanism should be ultimately self-sustaining. This implies that the financing mechanism be structured so as to allow for private funds and for use of cashflows from the projects. It also implies a structure that will implement the projects over time, since it is not possible to spend efficiently in a short period the gross dollar amount required. Therefore, the financing structure should encourage steady, locally based cashflows which can be monetized through private capital.

The type of infrastructure involved requires continuous expansion, maintenance and upgrade. To finance individual projects without standardization of equipment or coordination of future design and construction of all infrastructure in the border zone would risk inconsistent and inadequate operation. This could lead in turn to increased costs for retrofitting and maintenance. Because money will be expended in two countries and multiple sub-jurisdictions, each with different approaches to public projects, there should be a common accountability for the construction and ongoing operation of the projects. This accountability should be comparable, without regard to national or local differences, wherever the project is constructed.

Finally, because the users (and ultimate financiers) of such infrastructure are local, and because these types of projects have been traditionally funded and administered by local governments in both the U.S. and Mexico, the form and structure of any financing should be able to accommodate participation by local jurisdictions. (It is important to note in this regard that the greatest criticism of the joint EPA-SEDESOL Integrated Border Plan has been that local participants had no access to its development process.)

KEY ELEMENTS OF FORM AND STRUCTURE

Based on the foregoing, any financing structure for border infrastructure projects should have at least the following key elements:

1. The ability to coordinate all jurisdictions in the border zone in connection with the siting, design and construction of infrastructure projects.

2. The capacity to provide independent and standardized engineering expertise throughout the border zone.

3. The mechanism to include local jurisdictions in the planning process and utilize their existing governmental structures for the administration of the individual projects and the collection of the cashflows therefrom.

4. The capacity to monitor and supervise the construction and operation of all projects, both as a matter of technical efficiency and as a matter of public accountability.

5. The power to provide financial incentives (short of outright direct investment) that will facilitate access to private capital for the construction of the projects and allow the monetization of cashflows from the operation of the projects or other local revenues.

PRECEDENTS

As noted, the border zone is unique and no single existing entity has all of the listed key elements. However, this type of problem is not without analogous solutions and precedents. (It is interesting to note that the concept of a "border authority" as a mechanism to coordinate more general activities in the border area was suggested by then-Sen. Bentsen of Texas some years ago.)

Interstate compacts have long dealt with cross-boundary infrastructure projects. The best example is probably the Port Authority of New York and New Jersey, which has successfully constructed and operated numerous joint facilities. Two well known Federal authorities that deal with interstate infrastructure projects are the Tennessee Valley Authority and the Bonneville Power Administration. In the international area, the St. Lawrence Seaway is a jointly administered infrastructure project, and the International Boundary and Water Commission constructs and operates basic infrastructure projects along the U.S.-Mexico border. While none of these examples individually addresses every issue raised by the proposed projects, a combination of their elements would.

The examples mentioned have structural elements that would address the unique jurisdictional issues in the border zone. Local municipal authorities provide a fiscal example to address the basic financial requirements of the financing structure. The same kind of bonding authority used by local institutions could facilitate the use of private capital and monetization of local, project-based cashflows. This structure is highly familiar to, and accepted by, local governments, Wall Street financiers and North American investors.

RECOMMENDATIONS

1. A new institution should be created, jointly by the U.S. and Mexico, to implement the financing, completion and supervision of the proposed border infrastructure projects.

2. The form of such an institution should be that of a "Border Authority," containing elements of a number of existing entities that deal with cross-boundary infrastructue projects.

3. Two essential powers of such a "Border Authority" would be the right to approve design and siting decisions for projects in the border zone and the authorization to issue bonds and/or guarantees of bonds used to finance the projects. The bonds/guarantees would provide for some limited recourse to the cashflows from the projects, the projects themselves and the U.S. and Mexican governments, in that order.

The exact form and structure of such a "Border Authority" should be delineated as soon as there is a consensus on the concept.

DRAFTED:KATHOMAS
OES/ENV DOC. #3661
31 May 1993

LA RED FRONTERIZA DE SALUD Y AMBIENTE, A.C.
PROYECTO FRONTERIZO DE EDUCACION AMBIENTAL, A.C.
COMITE CIVICO DE DIVULGACION ECOLOGICA, A.C.
ENLACE ECOLOGICO, A.C.
BIOCONSERVACION, A.C.
ARIZONA TOXICS INFORMATION
BORDER ECOLOGY PROJECT

July 2, 1993

To: Canadian, U.S. and Mexican trade negotiators on the North American Free Trade Agreement (NAFTA)

NACE Must Strengthen Mexico's Environmental Management
if Sanctions are to be Applied

The negotiating process for the NAFTA has produced many proposals from Mexican and U.S. groups to protect human health and to prevent and remediate environmental damage and prevent resource abuse throughout North America. Not surprisingly, there has been a great deal of diversity and evolution in both concepts and concrete proposals, including an accelerated and positive discussion of sustainable development.

Unfortunately, environmental negotiations between Mexico, Canada, and the United States appear to be deadlocked, principally over the U.S. proposal to develop a three stage process under the North American Commission on Environment (NACE) to investigate, arbitrate and (when no other resolution is forthcoming) recommend sanctions to be applied when a persistent and unjustifiable pattern of non-enforcement of domestic environmental law exists.

The negotiations should continue and, if possible, expand in scope while the United States government determines how to respond to the recent court decision requiring a National Environmental Policy Act assessment of the impacts of a NAFTA.

The structure and capacity of the NACE should reflect the many governmental and non-governmental groups in all three countries. Some of the proposals currently circulating consider the NACE not only as an instrument of investigation and arbitration but also a means of facilitating and promoting continuous exchange of information among both governmental and non-governmental groups or, as in the Mexican case, as a link to proposed national commissions created with plural representation and executive capacity.

In its investigative and arbitration capacity the NACE could be charged with determining if a claim is a disguised attempt to suppress commerce or is a legitimate environmental complaint; if a "threshold" of persistent environmental non-enforcement has been reached; the nature, level and duration of appropriate remedies; if a remedy is appropriately applied against a private or governmental entity; and funding options for the prevention and remediation of the problems brought before the NACE. Unquestionably, great emphasis should be put on finding the means to resolve problems through domestic remedies.

Many of this letter's signatories have worked for decades in the border region, where there is a high degree of interdependence and collaboration between the U.S. and Mexico. We are acutely aware that we cannot isolate our strategies for the border region from those being developed for the interior of Mexico and the North American continent in general. New bilateral mechanisms are needed in the border region to increase participation of border communities in the collection and management of funds to prevent and remediate environmental health and natural resource problems, and to implement solutions. Options have been proposed in both countries to restructure government agencies and establish new environmental commissions with strong public participation. Many of these programs in the border region should remain outside the jurisdiction of a NACE.

The signatories to this letter believe that a vital function of the NACE should be to cooperate with a Mexico-coordinated program to strengthen Mexico's capacity to protect its environment through a phasing-in of decentralized networks for environmental monitoring, analysis, enforcement, and compliance. Integral to this program should be strong national right-to-know laws and procedures. The implementation of this program should give special attention to ensuring transparency, community-based education and a high degree of public participation. The program should also address the upward movement of standards throughout North America to ultimately ensure that lower levels of environmental safeguards will not constitute the basis for pollution havens or unfair trade subsidies.

We believe that Mexico needs to implement such a program and lacks required financial and technical resources to do so; therefore, funding should be developed by applying the "polluter pays" and "user pays" principles to investors under the NAFTA to leverage investment revenues for environmental programs. External resources, such as technical training provided by the United States and Canada, can help to create networks of regional and local environmental experts, pay for laboratories and monitoring equipment and implement a system of publicly accountable enforcement and compliance.

The United States, Mexico and Canada should establish such a program in order to make Mexico an "equal partner" in the NACE with respect to capacity for enforcing environmental norms, and to do so within Mexico's own political and legal framework. By assisting in oversight and coordination of the phasing-in of such a program, we believe that the NACE can become a positive and helpful player in promoting sustainable development on this continent--rather than simply being a court of arbitration.

The more transparent and accessible to the public the NACE is, the better these tasks can be accomplished. We concur with many in Mexico that a major goal of a NACE should be to create sufficient public scrutiny to ensure compliance with environmental obligations. The NACE should dramatically increase the capacity of North American citizens to prevent and mitigate adverse environmental impacts of development.

We agree that domestic programs to protect human health and the environment should be primary lines of defense and that it is essential to protect national sovereignty. We note, however, that rejecting environmentally-based trade sanctions on the basis of protecting national sovereignty is inconsistent with compliance strategies (including sanctions) accepted by the three trading partners within the strictly commercial aspects of the NAFTA. The application of legal remedies to protect the environment should be given equivalent force.

In general, the use of environmentally-based sanctions should not be used as a penalty against Mexico, but as a means within the NACE to complement Mexico's domestic enforcement of environmental norms. In order to accomplish this goal, remedies proposed by the NACE involving trade sanctions (such as financial penalties or other punitive actions taken against individual polluters or other natural resource abusers) should include a direct linkage between the use of revenues collected and the remediation and prevention of Mexico's environmental and health problems. Where possible, revenues attained as a result of environmental dispute resolution should be used to resolve the specific problems in question. We are concerned that such revenues should not become negative "user fees" that allow continued pollution in return for paying a penalty.

A major purpose of a NACE should be to complement national enforcement of laws and regulations. The NACE should facilitate development of mechanisms for funding, public participation and transparency, as well as help resolve problems of natural resource exploitation and pollution. In our era of global economic integration, environmental protection must also be global.

COUNSELOR'S OFFICE

FACSIMILE COVERSHEET

To: Katie McGinty / Christian Marsh

Officer | Phone Number | Bureau/Agency

From: David Harwood | | State

Officer | Phone Number | Bureau/Agency

Subject:

Addressee Fax Number: 456-2710

Date/Time of Transmission:

Transmitted By:

Number of Pages Excluding Coversheet: 5

Remarks: A copy of this was sent to Michele in the VP's office to be included in his briefing book for tomorrow

Counselor's Office Fax #
202/647-0753

BACKGROUND MEMORANDUM

I. Current Situation

NAFTA, an historic agreement with a broad range of benefits to the United States, is at a critical juncture. The Administration now faces a political dilemma:

- o The Administration has put forward in negotiations a proposal for the NAFTA supplemental agreements that would authorize the use of trade sanctions if a party demonstrates a persistent and unjustified pattern of non-enforcement of its law in violation of its obligations under the agreement. A few key interests (some NGOs and a number of Congressional Democrats) have indicated that this may be a prerequisite for support of the NAFTA and supplemental agreements.

- o These proposals, in turn, raise sovereignty concerns for all NAFTA partners and have been strongly resisted by our Mexican and Canadian counterparts. Even if a sanctions proposal were negotiable, the political calculus remains complicated: Congressional Republicans may reverse their support for NAFTA, perhaps splitting the necessary coalition of Republicans and Democrats at the center of the spectrum.

The rationale for the U.S. position presumes that a sanctions proposal, successfully negotiated with our partners, will make the NAFTA stronger -- substantively and perhaps politically -- garnering more support from a coalition of environmental groups in particular. However, if, as expected, our NAFTA partners refuse to entertain the very notion of sanctions and extraterritorial enforcement powers, there is a significant danger that some in the environmental community (and Democratic allies who want to strengthen their environmental credentials) will be tempted to walk away from any NAFTA agreement. This would be an enormous loss -- for the Administration and the environment.

This situation places the Administration in a corner of sorts -- seemingly damned if it supports sanctions and damned if it does not. To successfully emerge from this box, the Administration must ensure that the environmental strengths of the agreement are well understood and that a strategy is adopted for enabling the agreement to succeed absent sanctions.

Environmental provisions

NAFTA is the most environmentally sound trade agreement ever negotiated. Among other things NAFTA is the first trade agreement to contain provisions that:

- affirm our right to: (1) prohibit the importation of products that do not meet our environmental standards; and (2) use trade sanctions mandated by international environmental agreements (e.g. the Montreal Protocol);

- prohibit NAFTA parties from weakening their environmental standards in order to attract foreign investment, while encouraging cooperation in strengthening such standards;

- establish dispute resolution procedures that place the burden of proving that an environmental measure is a disguished non-tariff barrier on the party challenging the measure.

The supplemental agreement on the environment can indeed buttress NAFTA in ways that are important to us without getting into the sanctions issue -- the latest enviro coalition position advocates a number of viable improvements. The key is to give enough functions to the NACE, while avoiding being pressed so far that we: (1) reopen the deal struck in NAFTA itself; (2) undercut U.S. business support for NAFTA; or (3) become so intrusive as to cause Canada or Mexico to back off on sovereignty grounds.

Elements of a New Border Initiative

An alternative to the diplomatically difficult proposal on trade sanctions, may be found in a strong package of measures to clean up and ensure the environmental integrity of the U.S.-Mexican border area. More politically and substantively powerful than sanctions, resources for border environmental needs could replace sanctions as the centerpiece of the Administration's environmental and overall strategy on NAFTA.

The environmental infrastructure needs on the border are enormous. One great promise of NAFTA is that it will help enable Mexico to enhance per capita income and devote more resources to environmental protection. In recent years, Mexico has responded to this challenge by devoting increasing resources to environmental needs (currently 1% of GDP on the environment -- unprecedented for a developing nation). If NAFTA negotiations collapse, there will be little leverage for maintaining these crucial investments. A completed NAFTA will encourage Mexico to continue and expand its environmental programs along the border and throughout Mexico. It would also ease environmental pressures on the border by phasing out incentives for industries to locate in this region.

Unfortunately, this underlying promise of NAFTA does not assuage the fears, nor guarantee, that there will not be a high environmental price on the border for a completed NAFTA. In an attempt to address some of these needs, EPA and its counterpart have developed an integrated border plan. While an ambitious undertaking, the border plan has been criticized as incomplete and woefully underfunded. The funding problem has been exponentially compounded by recent House subcommittee action to strip all funding for EPA's environmental work on the border.

The impetus for this action is twofold: a) members who want to kill the NAFTA recognize that without a border plan, environmental pressure will intensify; and b) those same members refuse to allow general taxpayer revenues to finance environmental needs at the municipal level in Texas, New Mexico and Arizona.

Port Auth.

In order to capture the political and substantive power of a significant border initiative, we must think creatively about means for financing border cleanup and infrastructure investments that will protect the environment.

One idea that is emerging would not require the imposition of a trade tax or large appropriations from general revenues, but instead would draw on existing mechanisms to leverage the power of the marketplace.

The International Boundary and Water Commission (IBWC) was established 75 years ago to foster U.S.-Mexican cooperation on water flows between the two countries. The IBWC has emerged into something of a quasi-government entity, with some powers of its own, and some powers reserved to the sovereign governments. The IBWC has also diversified its activities and currently owns and operates a wide array of public utility projects, including flood control districts, wastewater treatment plants and even hydroelectric dams. In general, the capital costs of these projects have been paid by the two nations, and no user fees are charged for the ongoing operation of the projects.

Second, we have two major assets to employ in border protection: 1) the National Labs, which have extensive environmental remediation efforts; and 2) our environmental goods and services industry.

Within these elements -- the IBWC, the labs, and our industry -- lie the seeds of an ambitious and meaningful border protection effort, as follows:

Many of the IBWC assets could be privatized to provide a revenue stream to finance border infrastructure and environmental investments. Essentially, under this kind of proposal, the IBWC would operate as something of a "Port Authority" -- using existing assets to generate seed money for major investments flows. These resources would be used to guarantee or provide other financial concessions for loans from private financial markets. Financial experts believe that the interest on Wall Street and in industry is sufficient enough that major investments could be leveraged through loan guarantees or other concessions. Since the IBWC assets are owned jointly by Mexico and the U.S., use of them for this purpose would have the benefit of not requiring the identification of new resources on the U.S. or Mexican side.

There are several other important pieces to this package. First, states on both sides of the border would need to be encouraged to establish minimum land use and development standards for new residential and industrial construction -- in order to ensure that future development will not recreate problems that exist today. Second, the U.S. would want to mobilize our environmental industry to help meet the demand for technologies and services, and to develop new technologies for use in Mexico (these same technologies should have export potential throughout the world). Third, and related, is the involvement of the National Labs, who could help assist and guide efforts with private industry.

This package of border proposals could provide the basis for an imaginative and attractive border program. The political benefit of turning discussion away from sanctions and toward the real problems of the border are obvious. In addition, the economic and environmental opportunity should not be underestimated.

Finally, note that these ideas are being further developed and defined at this time, but not as part of our NAFTA strategy.

<u>Ideas for next steps</u>

U.S. negotiators put forward two weeks ago a sanctions proposal for consideration by Mexican and Canadian counterparts. It was received by our partners as a reopening of the basic agreement and strongly resisted. The Administration must be prepared now to work with environmentalists to establish support for an agreement that does not include sanctions, perhaps emphasizing instead a border initiative such as that outlined above.

We must be prepared to reach out at the CEO level among the major enviro organizations, where there is more significant support for a NAFTA than might be evident at the working level of environmental NGOs. We need to explain that sanctions are untenable with our partners, but that we can still win approval of important provisions that will reinforce the historic environmental accomplishments of the NAFTA, perhaps including a major border initiative. We can galvanize this coalition in support of moving forward with the agreement and engage environmental leaders in our efforts to maintain a politically viable coalition in Congress. Environmentalists can help us prevent Democratic members from rejecting the agreement on environmental grounds.

Informal consultations have revealed a significant amount of support for a NAFTA at the highest levels of the environmental community. Specifically, it appears that National Audubon, NRDC, NWF and WWF are solidly behind an agreement. Given its constituency and philosophy, EDF would be hard pressed to walk. The Sierra Club and some of the smaller, more hard-line groups are unlikely to support any NAFTA agreement and thus should be prodded toward a position of neutrality. A border effort may move some of these groups.

With environmental support, the only coalition that could effectively block the agreement -- labor and environmentalists -- would be split. Democratic members on the Hill trying to rebuild their credentials with the environmental community would find themselves at odds with the community itself. A similar unveiling would occur for members with thin clear economic and environmental benefits of the NAFTA.

Conclusion

NAFTA and its supplemental agreements are strongly in the U.S. interest. The only obstacle to realizing the agreement's benefits is the establishment of a political coalition in support of it. The successful negotiation of sanctions provisions as part of the labor and environmental side agreements -- a highly unlikely proposition -- might produce such a coalition if the Republicans stay on board. But should the sanctions proposal fail, the Administration might be threatened with a significant diminution of support for the agreement by key constituencies. In order to rebuild a coalition, a concerted strategy for reaching out to and engaging the environmental community on behalf of a NAFTA is essential. A fully developed border initiative might form the centerpiece of this effort.

The necessary ingredients for establishing environmental support for an agreement without sanctions does exist. Properly tapped, this support will be critical for building the necessary political coalition to conclude and pass a NAFTA agreement.

DAOB

Eileen Claussen

THE WHITE HOUSE

WASHINGTON

June 10, 1993

MEMORANDUM TO CAT~~HY ZO~~I, ENVIRONMENTAL POLICY

FROM: TOM EPSTEIN, SPECIAL ASSISTANT TO THE PRESIDENT FOR POLITICAL AFFAIRS

SUBJECT: BORDER ENVIRONMENTAL COMMERCE ZONE IN SOUTHERN CALIFORNIA

I would appreciate your input on this proposed plan for a Border Environmental Commerce Zone in Southern California. Please contact my assistant, Bill Woodyard at your earliest convenience. He may be contacted at 456-2607 or room 112 in the OEOB. Thank you.

Eileen / Dan -
What do you think of this? In your NAFTA dealings do you run across ideas like these? Is this feasible? I need to get back to Tom, so your input would be very helpful.

- CZ
6/19

THE WHITE HOUSE

WASHINGTON

June 8, 1993

MEMORANDUM TO TOM EPSTEIN

FROM: BILL WOODYARD

SUBJECT: BORDER ENVIRONMENTAL COMMERCE ZONE, BECZ

This is a summary of the concept paper sent to you by Michael Shames, Chairman of the Political Committee for the San Diego chapter of the Sierra Club. He feels that the BECZ is important for four reasons:

1. " The Administration has sought to promote environmental technology development. This is an example of how local entities can do it.
2. The Administration is sensitive to NAFTA impacts. This is a means of addressing and diminishing the potentially deleterious impacts.
3. The Administration is trying to address the military reduction/base closure impacts in California. This proposal represents the kind of economic conversion activity that the Administration should promote.
4. San Diego is a potential swing region for Clinton and any Administration activities to support the local economy is always useful."

The Border Environmental Commerce Zone will be designed to "create an environment in which innovative, minimal-impact processes and/or end-use products can be developed and utilized to help clean our air, water and land by providing incentives for companies that manufacture products or provide services that are environmentally beneficial, in a manner that is environmentally friendly." Qualifying industries are producers of environmentally-sound products, users of environmentally-sound technology, and service providers that utilizes environmentally-sound processes. Qualifying businesses must utilize the highest level of pollution prevention technology and processes with a zero discharge goal or minimum depletion of natural resources. These businesses must receive a threshold score on an Environmental Audit (outlined in the paper) and promote environmental education while maintaining its high level of environmental standards.

The BECZ is a block that extends 15 miles north from the Mexican border, and is bound by the major transit systems on all three sides. The zone includes Chula Vista, southern San Diego, and most of National City and Imperial Beach. The BECZ would offer business assistance and state and federal incentives to businesses in the zone outlined above that meet the designated environmental standards. These incentives are listed in the paper.

An Environmental Technology Resource Center/Incubator is proposed to provide assistance as an "incubator" to businesses within the zone that wish to incorporate the criteria of the BECZ. This assistance includes space and shared services, business development services, marketing development services, and advanced growth services. The BECK proposes that it get its funding from President's Economic Development stimulus package and other federal agencies.

SIERRA CLUB, SAN DIEGO CHAPTER
San Diego and Imperial Counties
3820 Ray Street
San Diego, CA 92104

June 1, 1993

Tom Epstein
Special Asst. to the President
White House
1600 Pennsylvania Ave.
Washington D.C.

RE: Environmental Commerce Zone

Dear Tom:

There is some action being taken by San Diego County cities, the Sierra Club and the local Chambers of Commerce that warrant the attention to the White House. These cities have designated a geographic area near the US-Mexican border likely to be affected by NAFTA and have created an "Environmental Commerce Zone" that will provide incentives and assistance specifically for environmental technology businesses. I've enclosed documents that explain the details of the proposal.

Tom, I believe that this proposal is notable for a number of reasons:

1) The Administration has sought to promote environmental technology development. This is an example of how local entities can do it.

2) The Administration is sensitive to NAFTA impacts. This is a means of addressing and diminishing the potentially deleterious impacts.

3) The Administration is trying to address the military reduction/base closure impacts in California. This proposal represents the kind of economic conversion activity that the Administration should promote.

4) San Diego is a potential swing region for Clinton and any Administration activities to support the local economy is always useful.

I recommend that you distribute this concept to others in the Administration as a model worth developing in other regions. Also, to the extent that the Administration can help promote this concept -- verbally, formally, financially etc. -- I strongly recommend it.

Continued good luck in your efforts.

Sincerely,

Michael Shames
Chair, Political Committee

CONCEPT PAPER
BORDER ENVIRONMENTAL COMMERCE ZONE (BECZ)

Prepared by the Chula Vista Environmental Zone Task Force
May 3, 1993

This paper has been prepared by staff to outline the proposed Border Environmental Commerce Zone (BECZ) as currently envisioned by the Chula Vista Environmental Zone Task Force.

I. BORDER ENVIRONMENTAL COMMERCE ZONE (BECZ) GOALS

The proposed BECZ will be designed to assist environmental technologies/services and thus strengthen an emerging, high-growth-potential economic base (see "Future of Environmental Industries," Exhibit A). More specifically, the BECZ is intended to create an environment in which innovative, minimal-impact processes and/or end-use products can be developed and utilized to help clean our air, water and land by providing incentives for companies that manufacture products or provide services that are environmentally beneficial, in a manner that is environmentally friendly.

The BECZ is envisioned to address the proposed North American Free Trade Agreement (NAFTA) in terms of attracting both "clean" industries and "clean-up" technologies to the border area in anticipation of increased demand for these technologies and services on both sides of the U.S./Mexico border.

Finally, the BECZ is envisioned as a "testing ground" for a partnership of local, regional, state and federal entities to join together in a Demonstration Program. Based upon the Pilot Program's experience, the program can be modified and replicated throughout the state. The Zone will bring the entities of Chula Vista, City of San Diego, County of San Diego, Imperial Beach, and National City together in a border-oriented, regional approach which utilizes local incentives and resources as well as state-enabling legislation and resources. BECZ initiatives will support existing and proposed state economic development and environmental technology related efforts, including the California Enterprise Zone and Recycling Zone Programs (already operating in San Diego County) and the state's CalEPA Environmental Technology Partnership Program, and will support national efforts such as economic conversion/technology transfer programs.

II. BORDER ENVIRONMENTAL COMMERCE ZONE (BECZ) OBJECTIVES

In order to accomplish the above goals, the BECZ will be designed to encourage:

1. Research and development of innovative environmental technology.
2. Commercialization of new environmental technology.
3. Start up of environmentally sound businesses.
4. Export of U.S.-based environmental technologies, goods and services.
5. Attraction and expansion of environmentally sound businesses having a significant economic impact.

A variety of assistance programs will be offered within the Zone in order to achieve its goals and objectives.

III. QUALIFYING INDUSTRIES

The criteria established in this section determine a business' eligibility for BECZ assistance and incentives. Types of eligible businesses include "producers", "users", or "service providers", as defined below.

- Producer
  A company which innovates, develops or manufactures an environmentally-sound product for one of the categories under Section B.

- User
  Any business which uses environmentally sound technology, defined as technology that goes above and beyond the required control technologies.

- Service Provider
  Any business which provides for and utilizes environmentally sound processes.

A. Criteria Level I (Environmental Factors)

A qualifying business MUST:

1. Demonstrate that it utilizes the highest level of pollution prevention technology/processes with a zero discharge goal. For those that do not use control technology, a qualifying business must demonstrate that it strives for minimal depletion of the natural resources it uses.

2. Achieve a threshold score on an Environmental Audit measuring environmental impacts. Audit criteria will include, but not be limited to such factors as:

   a) Historical environmental compliance record
   b) Projected measurement of discharge to air, land and water
   c) Storage and utilization of chemicals
   d) Projected environmental contribution of product
   e) Production process
   f) Air Pollution Emission requirements:
      (1) Compliance with one of the following measures - if the company is subject to the Air Pollution Control District's New Source Review requirements:
         - Best Available Control Technology
         - Reasonable Available Control Technology

(2) Participation in the State-mandated Permit Assistance Program - if the company meets the Small Business Permit Assistance definition of "small business"*:

g) Performance of a Health Risk Assessment - if required by the APCD under the Toxic Hot Spots Program.

3. Meet minimum economic viability criteria.

A qualifying business MUST NOT:

1. Import or collect, for the primary purpose of disposal and/or transport of toxic, hazardous or radioactive wastes. Non-catalytic thermal destruction technologies would not qualify. The Zone is not intended to encourage <u>off-site</u> treatment, storage, disposal or recycling (TSDR).

B. Criteria Level 2 (Categories of Business)

A qualifying business must fall into one of the following categories.

1. research, development and manufacturing of pollution control equipment
2. technologies or strategies that prevent pollution or decrease waste generation AND emit small amounts of pollutants in the production phase
3. businesses producing products or processes promoting the conservation of natural resources, such as water reclamation and sewage treatment technologies
4. development of alternative energy/fuel sources
5. pesticide and herbicide alternatives
6. non-point source treatment technologies
7. industries utilizing innovative low emission technologies
8. a business that exports products or services using environmentally-sound technology
9. consultant services

C. Criteria Level 3 (Non-qualifying business/Reapplication)

A non-qualifying business may consult with the Environmental Technology Resource Center (ETRC) in order to identify methods to successfully achieve compliance with Zone eligibility criteria (i.e.: addition of pollution control technology, reduction of waste stream discharge, conversion to toxic-free processes, etc.). The company may subsequently reapply and be eligible for BECZ incentives.

D. Criteria Level 4 (Training Requirement)

The BECZ will become a leader in environmental education and awareness in Southern California for the business community. The Center will accomplish this through the

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* defined as a business which employs less than 100 people and/or which emits less than 10 tons a year of any 1 pollutant and less than 20 tons per year of all pollutants

Environmental Technology Resource Center/Incubator Program

An Environmental Technology Resource Center/Incubator is proposed to offer centralized environmental educational business assistance programs. The ETRC would become a source for state-of-the-art environmental technology education, information, and training for the business community in Southern California. The ETRC will be an integral part of the Environmental Zone, providing leading-edge pollution prevention and control training to all participating businesses. The technical assistance and financial assistance programs would be tailored to the type of industry, the individual business' stage of development, and the anticipated economic impact. The ETRC and Incubator ideally would be co-located in one facility. The ETRC's role would be to:

- Serve as an information clearinghouse/referral system
- Provide access to financial assistance and technical assistance
- Provide regulatory compliance and permit processing assistance
- Provide centralized resource for displaced/transitioning workers and businesses

The proposed program entails both an "Incubator with walls" and "Incubator without walls" concept. As proposed, the Incubator Program would be operated by a regionally-based non-profit entity which potentially would act as an umbrella organization for one or more for-profit subsidiaries.

1. "INCUBATOR WITH WALLS"/TECHNICAL ASSISTANCE

This program would entail the construction of one or more R&D/industrial incubator facilities. The facility(ies) would offer space to qualifying start-up, re-emerging and small businesses. The non-profit's charter would require that these physical facilities be located within the City of Chula Vista.

The incubator facility would offer a range of advantages and on-site services to start-up, re-emerging businesses, and small businesses including, but not limited to: inexpensive and flexible space, shared equipment, capacity image enhancement and convenient on-site networking and mentoring.

Additionally, business development and marketing development services would be made available on- and off-site. Examples of general technical assistance which would be offered to incubator tenants are highlighted below in order of "evolution of need" by individual companies:

Space and Shared Services

- inexpensive, flexible and convenient space
- shared services, such as equipment and inventory control
- capacity image enhancement

Business Development Services

- planning
- basic financial services

- basic marketing
- introduction and mentoring
- technology application
- regulatory approval fast track

Marketing Development Services

- market definition
- getting products to market
- import/export
- sales support systems
- order fulfillment support systems

Advanced Growth Services

- reordering the company for growth
- developing partnerships and joint ventures
- creating new organization and ownership
- developing venture capital strategies
- valuation of the company

It would be the intent of the program to provide an environmentally-permitted facility to the extent possible to avoid environmental review delays and costs for individual tenants. The incubator would also facilitate testing of product prototypes both on- and off-site. The building would be customized to meet the environmental industry's specific needs including "clean room" space.

The incubator facility would be managed by an on-site Incubator Coordinator who would be responsible for providing centralized management of the facility's operations including overhead and leasing as well as providing a package of incentives for tenants and access to technical and professional services. Such services could be provided pro-bono or at a discount to resident tenants.

In order to qualify to located within an incubator facility, candidate tenants would be required to be screened by both a Technical Advisory Council and a Financial Advisory Council. Tenants would be required to meet certain criteria including preparation of an acceptable business plan, demonstration of need, business efficacy and product viability. Tenants would also be required to "contract" with the incubator program to undergo a program of technical training (for example, via Southwestern College or some other identified consulting entity) or to link with a skilled team of advisors. An exit policy would be developed regarding turnover of incubator tenants.

2. "INCUBATOR WITHOUT WALLS"/TECHNICAL ASSISTANCE

The Incubator program as described above entails a Technical Assistance delivery system based upon a networking of for-profit and non-profit resources which would be offered through the Environmental Technology Resource Center (these could be co-located in the same facility). This network of services would also provide assistance to qualifying businesses within the Zone which are <u>not</u> tenants of the incubator facility.

- total quality management and related competitiveness training
- exporting
- research and development
- conversion and technology transfer strategies (e.g. feasibility; product development; commercialization; linkages with defense and other industry, federal labs, etc.) **NOTE: This ties into President Clinton's proposed manufacturing extension program.**
- procurement assistance to businesses seeking government contracts
- displaced worker training/entrepreneurial training
- permit facilitation

3. FINANCIAL ASSISTANCE PROGRAMS

In addition to Technical Assistance, the BECZ is proposed to offer direct financial incentives which as mentioned earlier would be tailored to the businesses' needs, stage of development and level of risk.

Examples of contemplated incentive programs are as follows:

- State "mandated" CALEPA Regional One Stop Permit Center
- State "mandated" Cal Environmental Technology Partnership (CETP) Special Project
- Targeted Environmental Technology demonstration grant program (existing - CalEPA and Trade and Commerce)
- Recycled Products Market Development Program (being developed by Integrated Waste Management Board)
- Extension of Recycled Products Investment Tax Credit (existing Statewide; expires 6/30/93)
- Seed Capital Fund (loan/grant/guarantees) for start-ups and re-emerging "spin-offs
- Venture capital pools (equity financing)
- Industrial Development Bond (IDB) Credit Enhancement
- IDB Issuance Fee Waivers
- Banker's CDC loan preferential treatment
- State Enterprise Zone incentives (existing - City of San Diego Enterprise Zone)
- State Recycling Zone incentives (existing - City of San Diego Enterprise Zone)
- State tax deduction for net operating loss (front-loaded)
- State sales tax exemption for qualified equipment (e.g. pollution control)
- State corporate income shelter
- State tax credits to lenders (personal, commercial and bond) and to investors (equity and stock), allowing 5 year carry forward
- State preference for Industrial Development Bond allocations
- Redevelopment land or predevelopment subsidies
- Revolving loan fund (Real estate/working capital)
- Loan guarantees (Real estate/working capital)
- Import/Export Revolving Loan Fund
- Government contract preference
- Long term lender CRA focus

Exhibits C and D illustrate the proposed Tiered Incentive Process which correlates business needs and risk levels with assistance available.

VI. BECZ ADMINISTRATION

BECZ Joint Power Authority (JPA Board)

As referenced earlier, the Zone envisions a multi-jurisdictional, *regional authority* as the umbrella organization. This body would be formed as a Joint Powers Authority (JPA). The JPA would be a municipal corporation whose primary roles would be to:

1) Provide a vehicle for program coordination among the 5 jurisdictions.
2) Provide a regional, geographically-based entity for designation as a State Incentive zone.
3) Act as the general policy-making oversight board for the Zone and the contractor to a non-profit administrative entity.
4) Provide a regional tax-exempt bond issuance mechanism.
5) Provide a regional governmental conduit for state, federal and/or private funds, as needed.
6) Act as a liaison to other governmental entities as appropriate.

However, it should be noted that the JPA would have no greater authority than the powers of the respective jurisdictions and then only to the degree that such powers are actually delegated to the JPA. The JPA board would be composed of representatives from each of the participating entities' legislative bodies.

BECZ Non-profit

The JPA would transact its daily business through a contractual relationship with a separate non-profit organization. The non-profit's Board would be comprised of primarily private sector constituents. The primary roles of the non-profit entity would be to:

1) Adopt and implement the goals of the BECZ (as initially outlined herein).
2) Adopt the BECZ's Incentive Eligibility Criteria (as initially outlined herein) and insure that eligibility criteria reflect the stated BECZ environmental and economic goals.
3) Establish an Environmental Technology Research Center (ERTC) to further BECZ goals.
4) Establish an Incubator Program to further BECZ goals.
5) Create other for profit and/or non-profit subsidiary organizations/programs to further BECZ goals.
6) Establish a Technical Advisory Council to advise the Non-profit regarding technical issues relating to general program policy, incentive eligibility criteria, program compliance issues, etc.
7) Establish a Financial Advisory Council to advise the Non-profit regarding business management and financial assistance matters, including financial incentive structuring and eligibility.
8) Administer BECZ technical assistance and financial assistance programs.
9) Solicit and administer program funding - public and private; for both operating costs and business assistance programs.
10) Fill Non-profit Board vacancies.
11) Advocate for a business climate conducive to targeted environmental industries (within non-profit guidelines).

As a non-profit, this entity could be a conduit for public and private grants and contributions and would have greater flexibility than a governmental organization in terms of such items as procurement policies and practices.

As mentioned, the Non-profit could act as an umbrella organization for one or more for-profit or non-profit organizations. The purpose of these entities would be to generate revenues to contribute to the program's costs while concurrently pursuing environmental zone goals and objectives. An example of this might be the following scenario:

1. A private land owner donates contaminated property to the Incubator Non-profit.
2. Private companies donate remediation investigation and clean-up services in exchange for equity participation.
3. The Bankers CDC makes loans to private buyers of the cleaned up property in return for CRA credit.
4. The cleaned up property generates income for the Incubator Program and "investors."

VII. PROGRAM COSTS/FUNDING SOURCES

<u>Costs</u>

The Zone as proposed would require very significant funding commitments. In the immediate stages, funds would be needed to pay for a full-time Zone Coordinator to develop and refine the overall Zone concept, to assemble a team of experts, to mobilize the participating entities and establish the organizational structure to identify and secure funding sources, to identify and secure a location for the ETC/Incubator, and to pursue State legislation as needed. A possible source of seed money under consideration for recommendation is the anticipated new Community Development Block Grant monies to be allocated to the City of Chula Vista under President Clinton's Economic Development stimulus package. (The City of Chula Vista expects to receive approximately $1 million in <u>new</u> CDBG funds.)

Costs of the Zone program's overall implementation and management are difficult to identify at this time. However, funding is anticipated to be needed at a minimum for the following:

1. ETC/Incubator
   - Land acquisition and improvement
   - Facility construction
   - Equipment
   - Operating and maintenance costs
   - Staffing
     - Incubator Manager
     - Clerical support

2. Technical and Financial Advisory Councils
   - Staffing (to provide support for such activities as Incubator tenant screening, background checks, monitoring)
   - Consultant services

3. Environmental Border Zone JPA
   - Staffing (to support public meetings, bond issuances, and general administration)

<u>Funding Sources</u>

Funding is anticipated to be secured from both public and private sources. Currently, the Task Force envisions the City of Chula Vista and/or other participating entities contributing up-front seed money for a BECZ Coordinator as discussed previously. Assuming funding is allocated up front, the BECZ Coordinator and team will further develop and implement the initial ETRC/Incubator program.

Subsequent revenues are anticipated to be a combination of state, federal, local and private funding with the emphasis on private corporate dollars. Further investigation of potential governmental grant programs and private funding sources is necessary to develop a budget strategy. Possible federal sources include DOC, DOE, EDA, DOT, DOL with an emphasis on President Clinton's Economic Stimulus/Economic Conversion programs. Possible state sources include the California Environmental Partnership Program as well as specific direct financial incentives via state tax benefits for individual businesses. Other state-related possibilities include such items as targeting revenues from Air Quality Management Districts, waiving state bond issuance fees, etc.

Potential corporate funding could come from budgeted Outplacement Programs, which currently account for significant dollars.

The ETRC/Incubator facility(ies) itself could be acquired through purchasing, leasing or private donations. Potential funding sources include federal, state, and local governments, private corporations, foundations, and venture capital. Financing mechanisms could include:

- public/private partnership
- debt financing
- equity financing
- cash or in-kind contributions
- grants or loans
- public stock offerings
- limited R&D partnership

VIII. STATE LEGISLATION

The Task Force currently recommends immediately pursuing state legislation which would at a minimum, identify the BORDER Environmental ~~Technology~~ Commerc~~ial~~e Zone as a state authorized regionally based incentive zone. The legislation would identify the JPA and non-profit ETC/Incubator program, and establish a legislative framework under which State Enterprise Zone/Recycling Zone incentives can be linked and additional State Environmental Commerce Zone incentives developed. As the Environmental Zone is further developed by the BECZ Coordinator, additional legislative authority may be requested.

IX. SUMMARY OF PROPOSED RECOMMENDATIONS

A brief summary of the Task Force's recommendations is as follows:

1) Request the Chula Vista City Council to authorize a FY 93/94 allocation in City of Chula Vista CDBG funds to hire a full-time BECZ Coordinator (as staff to the proposed non-profit administering agency; see #2 below) and related consulting services to fully develop and implement the Zone program. The approval of CDBG funds would be contingent upon receipt of matching public and/or private funds.

2) File Articles of Incorporation for a Non-profit organization to act as the umbrella administrative entity for the ETRC/Incubator Program. (The individual filer of the articles of incorporation would constitute the Board until the full Board is appointed; the initial Board member could be the Chula Vista City Manager.)

   Identify the composition by category of expertise and geographic representation of the non-profit Board. (Note: Appointment to the Board could be tied to financial participation.)

3) Form a Joint Power Authority in conjunction with National City, Imperial Beach, City of San Diego, County of San Diego and City of Chula Vista to coordinate the multiple jurisdictions' participation, with the capacity to issue tax-exempt bonds. (Note: Appointment could be tied to financial participation.)

4) Submit legislation seeking state designation of the JPA as a Border Environmental Commerce Zone, and designating the Zone and the Environmental Technology Research Center/Incubator Program as a State Pilot Project. (Note: Linkage with the Silicon Valley ETRC/Incubator Program which is also in its embryonic stage should be considered.)

5) Pursue federal funding.

6) Pursue State legislation authorizing specific State incentives for BECZ eligible businesses.

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EXHIBIT A

February 3, 1993

MEMO TO: The Honorable City Council

FROM: Councilman Bob Fox Bob

SUBJECT: ENVIRONMENTAL ENTERPISE ZONE TASK FORCE

Enclosed for your approval are the individuals the Mayor would like appointed to the Environmental Enterpise Zone Task Force.

RF:pw
Encls.
zone

cc: City Manager Goss
Barbara Bamberger

ENVIRONMENTAL ENTERPRIZE ZONE TASK FORCE
REPRESENTATIVES

a) 14 members
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b) 5 members from the Business Community:

1 - Banking
1 - Commercial Real Estate
1 - Business
1 - Chamber of Commerce
1 - Enviromental Technology

c) 5 members from Environmental/Community organizations/local universities:

2 - Environmental Organizations
1 - Non-profit Community Development Corp
1 - UCSD
1 - Southwestern College

d) 4 members from Governmental Agencies:
2 - City Council Members
1 - City/County Reinvestment Task Force
1 - Economic Development Commission

BUSINESS COMMUNITY REPRESENTATIVES:

1. Banking - ENRIQUE MELGAR
   Manager, Chula Vista Branch for International Savings Bank

2. Real Estate - BERNIE RHEINERSON
   Chairman of Legislative Committee - Construction Industry Federation and Building Industry Association Board of Directors

3. Business - SHEILA WASHINGTON
   California Business Incubator Network

4. Chamber of Commerce - DON BLIND
   Laidlaw Inc.

5. Environmental Technology - GRANT FERRIER DAN NOBLE
   Editor-in-Chief Environmental Business Publishing Co.

ENVIRONMENTAL/COMMUNITY/UNIVERSITY/ REPRESENTATIVES

1. Environmental Organization - DIANE TAKVORIAN
   Environmental Health Coalition

2. Environmental Organization - MICHAEL SHAMES
   Sierra Club

3. Community Development Corp. - JAY POWELL
   City Heights Community Development Corp

4. Southwestern College - VICTOR CASTILLO
   Project Coordinator, Business International Education Program

5. University of California San Diego - GORDON MCDONALD
   Institute for Global Conflic and Change - Environmental Studies

GOVERNMENTAL AGENCIES

1. City County Reinvestment Task Force - JIM BLIESNER
   Reinvestment Director

2. Councilperson SHIRLEY HORTON

3. Councilperson BOB FOX

4. Economic Development Commission -

BORDER ENVIRONMENTAL COMMERCE ZONE (BECZ)

BECZ COORDINATOR BUDGET
FY 93-94

Coordinator Salary	$ 75,000
Fringes @ 20%	15,000
Consultants:	
Attorney	20,000
Legislative Advocate	20,000
Technical and Financial Assistance	20,000
Marketing	20,000
Clerical Support @ $10.00/hour	20,800
Overhead	
Rent	donated
Utilities	5,500
Total	$195,500
ROUNDED TO	$200,000

[C:\WP51\COUNCIL\113S\ZONE-1.TBL]