

Initial Environmental Assessment (EA) of the Canada-Peru Foreign Investment Protection and Promotion Agreement (FIPA)

I. Executive Summary

This report outlines the results of the Initial Environmental Assessment (EA) of the Canada-Peru FIPA negotiations. Canada re-engaged Peru in FIPA negotiations in December 2003 after a hiatus of several years. The negotiators are using Canada's new FIPA model as the basis for the negotiations. It is anticipated the negotiations will conclude successfully by the end of September 2005.

The Canada-Peru FIPA is the first of such agreements to benefit from an EA. FIPA EAs follow the process outlined in the 2001 *Framework for the Environmental Assessment of Trade Negotiations*. The process focuses on the environmental impacts in Canada and normally involves three phases – the initial, draft and final assessments. The middle, or draft, phase is not undertaken if the FIPA is not expected to generate significant economic effects in Canada. Public consultations are an integral part of the EA and are undertaken throughout the process.

The Initial EA of the Canada-Peru FIPA negotiations identifies the likely economic effects of the FIPA and, on this basis, draws conclusions about the potential environmental impacts in Canada. The report also considers the impact of the FIPA on the ability of Canada to regulate in the interest of environmental protection. Other environmental issues are discussed as well. Stakeholder input was taken into consideration.

The results of the Initial EA indicate that significant changes to investment flows into Canada are not expected as a result of these negotiations. As such, the economic effects and resulting environmental impact in Canada are expected to be minimal to non-existent.

The Canada-Peru FIPA will not have a negative effect on Canada's ability to develop and implement environmental policies and regulations. Canada will safeguard its ability to maintain and expand the current framework of policies, regulations, and legislation for protection of the environment in a manner consistent with its domestic and international obligations.

The Government of Canada welcomes comments on this Initial EA. A Draft EA will not be carried out as the economic effects in Canada of the Canada-Peru FIPA are expected to be insignificant. The Final EA will coincide with the conclusions of the negotiations. Please submit comments to: consultations@international.gc.ca.

II. Introduction

Enhancing Canada's investment opportunities is essential to Canada's ongoing international competitiveness. FIPAs provide important disciplines that help to open international markets and make them more secure for Canadian investors. This has attendant benefits for Canadian job creation, the encouragement of increased domestic economy efficiencies and opportunities to attract new investment and technology in support of Canadian competitiveness, economic growth and prosperity.

Emerging economies and those in transition are increasingly important destinations for Canadian investment abroad. By specifying the rights and obligations of the signatories respecting treatment of foreign investment, a FIPA contributes to a predictable investment framework and engenders a stable business environment.

From the perspective of developing countries, investment has a positive impact on development. FIPAs are a positive and useful vehicle in that regard. Developing countries need and want the capital that investment brings and they want to ensure that investment flows predictably to their countries. FIPAs provide for that necessary signal of stability.

In 2003, Cabinet approved a FIPA model that serves as a template for Canada's discussions with investment partners on bilateral investment rules. This model is available at <http://www.dfait-maeci.gc.ca/tna-nac/fipa-en.asp>. More background on Canada's FIPA program is available in Annex I of this report.

The Canadian government is committed to integrating sustainable development into domestic and foreign policy, and the environmental assessment of trade and investment negotiations is one mechanism for doing so. We are therefore committed to conducting environmental assessments (EAs) of trade negotiations using a process that requires interdepartmental coordination along with public and stakeholder consultations, including provincial and territorial governments. The 2001 *Framework for the Environmental Assessment of Trade Negotiations* details this process. It was developed in response to the 1999 *Cabinet Directive on Environmental Assessment of Policy, Plan and Program Proposals*¹, which requires that all initiatives considered by Ministers or Cabinet must be assessed if implementation of the proposal may result in important environmental effects, either positive or negative. Detailed guidance for applying the Framework is contained in the *Handbook for the Environmental Assessment of Trade*².

¹ Available at: http://www.ceaa-acee.gc.ca/016/directive_e.htm

² Available at: <http://www.dfait-maeci.gc.ca/tna-nac/env/env-ea-en.asp>.

III. Background on the EA Process

The Framework provides a methodology for conducting an EA of a trade negotiation. It is intentionally flexible so that it can be applied to different types of negotiations (e.g., multilateral, bilateral, regional) while ensuring a systematic and consistent approach to meet two key objectives.

The first objective is to assist Canadian negotiators to integrate environmental considerations into the negotiating process by providing information on the possible environmental impacts of the proposed trade agreement. As such, trade negotiators and environmental experts are involved in the EA and work proceeds in tandem to the negotiations.

The second objective is to respond to the environmental concerns expressed by the public. The Framework contains a strong commitment to communications and consultations throughout each EA of trade negotiations.

Three phases of assessment are generally undertaken: the Initial, Draft, and Final EA. These phases correspond to progress within the negotiations. The Initial EA is a preliminary examination to identify key issues. It occurs early on in the negotiations. The Draft EA builds on the findings of the Initial EA and requires detailed analysis. A Draft EA is not undertaken if the negotiations are not expected to yield large economic changes. The Final EA takes place at the end of the negotiations. At the conclusion of each phase, a public report is issued with a request for feedback.

A consistent analytical methodology is applied during each phase. The Framework recognizes that economic and environmental effects can relate to changes in the level and pattern of economic activity, the type of products traded, technology changes, as well as regulatory and policy implications.

The Government of Canada has completed Initial EAs of the WTO, FTAA, Singapore, and CA4 trade negotiations, and is currently undertaking the Draft EA for the WTO negotiations. The Government of Canada will continue to apply the Framework to future trade and investment negotiations.

This is the first FIPA concluded since the Framework was issued. As such, this report marks the first EA of a FIPA negotiation. The findings of this Initial EA have been communicated to Canada's lead negotiator and to an Environmental Assessment Committee. Any comments the public has on this report will inform the Final EA. EAs of FIPAs will continue to evolve based on our experience and feedback from experts and the public.

IV. Invitation to Submit Comments

In keeping with the Framework, an Environmental Assessment Committee (EAC) has been formed to undertake the analysis of the FIPA. Coordinated by Foreign Affairs Canada and International Trade Canada, the Canada-Peru FIPA Environmental Assessment Committee includes representatives from other federal government departments. An important responsibility of the EAC is to gather input from provinces and territories, stakeholders representing business, academics, and non-governmental organization, as well as the general public.

As part of its commitment to an open and transparent process, the Government is opening this Initial EA for public comment from September 1 to September 16, 2005. Feedback on the likely economic effects and the likelihood and significance of resultant environmental impacts are especially welcome. Keep in mind that the assessment is focused on the possible environmental impacts in Canada.

Comments on this document may be sent by email, mail or fax to:

Trade Policy Consultations and Liaison Division (EBC)

Initial Environmental Assessment of the Canada-Peru Foreign Investment Protection Agreement (FIPA)

International Trade Canada

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Email: consultations@international.gc.ca

V. Analysis of the Canada-Peru FIPA

Canada re-engaged Peru in FIPA negotiations in December 2003 after a hiatus of several years. The Canada-Peru FIPA negotiations are anticipated to conclude by September 2005. The treaty will need to be ratified by both Parties.

a) Identification of Likely Economic Effects

The first step in the EA process is the identification of the likely economic effects of the FIPA. Peru's total investment in Canada is small, at only \$1 million in 2003. The Canada-Peru FIPA is not likely to result in a significant increase of investment flows into Canada.

The stock of Canadian foreign direct investment (FDI) in Peru is significant, totalling \$1,790 million in 2003. Investments in the mining sector dominate Canada's investment presence in Peru. In 2003, it ranked third in an examination of where large Canadian

mining companies spent their exploration budgets. It ranked fourth in mineral property owned by Canadian companies abroad. Large investments also exist in hydro-electric transmission projects and printing facilities.

While the existence of a FIPA should be a positive and important factor in investors' decisions on whether to invest in the territory of the other party, it will be but one of many factors. The main effect of a FIPA is likely to be greater protection for existing Canadian investment in Peru. Large changes in investment are not expected to result from these negotiations.

b) Identification and Assessment of Likely Environmental Impacts in Canada and the Context for these Impacts

The Framework calls for the identification and assessment of the environmental impacts that could stem from the anticipated economic effects of the FIPA. The likelihood and significance of such impacts would depend on the degree of increase in investment, the sectors of the investment, and the measures in place to protect the environment in relation to those activities.

As noted above, Peru's stock of investment in Canada is modest. Significant new flows of investment into Canada as a result of the FIPA are not anticipated. Therefore, it is concluded that the environmental effects of the Canada-Peru FIPA will be minimal to non-existent.

c) Policy and Regulatory Context

The Framework calls for consideration of the potential policy and regulatory effects of the FIPA. Foreign investors in Canada are bound by the same environmental protection regulations that govern the activities of domestic investors. Proposed projects resulting from inward investment would be subject to applicable environmental assessment legislation, including the Canadian Environmental Assessment Act and provincial environmental assessment regulations.

Recent revisions to the Government of Canada's FIPA model have clarified governments' right to regulate in the public interest. The new model includes a general exception that permits a Party to take measures necessary to protect human, animal or plant life or health, the environment and safety, or measures primarily aimed at the conservation of exhaustible natural resources, provided that these measures are not applied in an arbitrary or unjustifiable manner and are not disguised restrictions on trade or investment. In addition, the model clarifies the rules governing direct and indirect expropriation with regard to governments' right to regulate. FIPA parties may also reserve existing laws and regulations such that they are not subject to specified obligations of the treaty, and they may reserve sensitive sectors for future regulation.

The revised FIPA model is the basis for Canada's position in the Canada-Peru negotiations. We anticipate, therefore, that the final agreement will not have a negative

effect on Canada's ability to develop and implement environmental policies and regulations. Canada will safeguard its ability to maintain and expand the current framework of policies, regulations, and legislation for protection of the environment in a manner consistent with its domestic and international obligations.

In the past, stakeholders have raised pollution havens and regulatory chill as issues of concern related to the environmental impacts of investment treaties. Please see Annex II of this report for a summary literature review of these issues.

VI. Other Environmental Considerations – Transboundary Effects

Canada's *Framework for Conducting EAs of Trade Negotiations* calls for national assessments, and allows for consideration of transboundary, regional, and global environmental impacts if they have a direct impact on the Canadian environment. However, it is outside of the scope of this study to assess the potential for positive or negative environmental impacts that could occur in Peru because of these negotiations, or to judge the measures in place within Peru to enhance or mitigate such impacts.

Mining is a prime sector of interest to Canadian companies operating in Peru. We therefore focus on this sector to identify potential transboundary environmental effects of these investments on the Canadian environment. Each stage of the mineral production process (exploration, extraction, processing, closure, and abandonment) has the potential to have negative environmental impacts (e.g., air emissions, water contamination and sedimentation, soil contamination, and habitat destruction). The geographic scale of these impacts will vary from local to global. The transboundary environmental impacts of concern that could most directly affect the Canadian environment relate to air emissions, which can result in the deposition of heavy metals thousands of miles from the primary source. Emissions from mining can also contribute to global issues such as global warming. To our knowledge, there is no specific evidence that mining in Peru has transboundary impacts on Canada.

VII. Stakeholder Feedback

The notice of intent to conduct an EA of the Canada-Peru FIPA was posted on the website of International Trade Canada on June 2, 2005. The notice included an invitation to interested parties to submit their views on the likely environmental impacts of the Canada-Peru FIPA on Canada. The majority of comments received pertained to the environmental impact of Canadian investment in Peru and concerns regarding governance issues in Peru. All of the comments received were distributed to the interdepartmental EA Committee for the Canada-Peru FIPA and to the negotiators. The comments will also inform the ongoing efforts to improve the EA process associated with trade negotiations.

While it is outside the scope of this study to analyze the potential environmental effects

of the Canada-Peru FIPA on Peru, the following is a review of information and resources on issues raised in the consultations respecting investment activity in Peru. Issues relating to mining activity were of particular interest to stakeholders.

The environmental impacts of mining can be identified and partially mitigated via environmental impact assessments, use of new technologies, and ongoing environmental management and reclamation processes. Domestic regulations, multilateral agreements, and voluntary initiatives work in concert to promote higher standards in the mining sector. To this end, it is pertinent to note that Article 8 of Peru's *Environment and Natural Resources Code* requires an environmental impact study be submitted to the Ministry of Energy and Mines prior to the development of a mine, or when an existing mine expands production by more than 50%. Some Canadian mining companies have been recognized for Environmental Impact Assessments (EIAs) conducted in association with operations in Peru. For example, an independently produced environmental impact assessment study for a Canadian mining project recently received high regards from the local environmental authorities responsible for the issuance of mining permits. Moreover, elements considered in this study have been taken as a new standard by Peruvian authorities for new mining projects.

The Environmental Policy of the Mining Association of Canada (MAC) applies to all operations of member companies regardless of location. MAC recently issued *Towards Sustainable Mining Progress Report 2004*, which provides an overview of the environmental performance of members. The OECD Guidelines for Multinational Enterprises includes a recommendation addressing the importance of EIAs where companies' activities may have significant environmental impacts.

Since March 1999, the Canadian International Development Agency has funded a bilateral project designed to improve the capacity of the Ministry of Energy and Mines (MEM) to monitor and control the environment and the occupational health and safety in Peruvian mines, improve emergency response capabilities, and digitalise access to the mining titles and permits. The project was implemented by the British Columbia Ministry of Energy and Mines until March 2002. In 2003, CIDA committed another 9.6M\$ for 4 years to provide technical assistance to Peru's Ministry of Energy and Mines on policy and regulatory reform issues related to the minerals and metals sector. The project is helping the Government of Peru improve the enforcement of environmental and health regulations in the mining sector, decentralize services to mine-producing regions, and mitigate the impact of mineral activities on local communities.

a) Third Party Documents

Documents by third parties provide further insight into the environmental impacts associated with Canadian mining operations in Peru. A case study of a large Canadian mining company's social responsibility work in Peru illustrates the importance of effective stakeholder engagement and community development initiatives.

http://www.nrcan-rncan.gc.ca/sd-dd/pubs/csr-rse/pdf/cas/tc_e.pdf

York University's Centre for America and the Caribbean and Mining Watch Canada hosted a conference in May 2002 to examine the actions of Canadian mining companies in the Latin American region, including Peru. The conference report focuses on issues related to community rights and CSR.
http://www.miningwatch.ca/updir/CERLAC_mining_report.pdf

VIII. Conclusion and Next Steps

The Initial EA concludes that significant changes to investment in Canada are not expected as a result of the Canada-Peru FIPA negotiations. As such, the environmental impacts on Canada are expected to be minimal.

The Initial EA will be circulated to decision makers to inform the conclusion of the Canada-Peru FIPA negotiations as well as other policy development activities.

Following the receipt of public comments on the Initial EA, the Final EA will be completed taking into account the consultative findings. In the light of the Initial EA's conclusions regarding the unlikelihood of significant economic activity and environmental impacts in Canada, preparation of a Draft EA is deemed to be unnecessary. The Final EA will coincide with the conclusion of the negotiations with Peru.

Annex 1

Canada's FIPA Program

a) Background on Canada's FIPA Program

A FIPA (Foreign Investment Promotion and Protection Agreement) is a bilateral agreement aimed at protecting and promoting foreign investment through legally-binding rights and obligations.

FIPAs accomplish their objectives by setting out the respective rights and obligations of the countries that are parties to the treaty with respect to the treatment of foreign investment. Typically, there are agreed exceptions to the obligations. FIPAs seek to ensure that foreign investors: will not be treated worse than similarly situated domestic investors or other foreign investors; will not have their investments expropriated without prompt and adequate compensation; and, in any case, will not be subject to treatment lower than the minimum standard established in customary international law. As well, in most circumstances, investors should be free to invest capital and repatriate their investments and returns.

Canada's policy is to promote and protect investment through a transparent rules-based system in a manner that reaffirms the right of Governments to regulate in the public interest, including developmental interests. As an instrument that supports the rule of law and fosters fairness, transparency, non-discrimination and accountability, a FIPA encourages good governance. A FIPA also promotes sustainable development principles by exhorting Governments to not lower health, safety or environmental measures in order to attract investment.

Canada began negotiating FIPAs in 1989 to secure investment liberalisation and protection commitments on the basis of a model agreement developed under the auspices of the OECD (Organization for Economic Cooperation and Development). In 1994, Canada introduced a FIPA model incorporating the enhanced investment protection afforded under the NAFTA (North American Free Trade Agreement). Canada signed 5 agreements using the OECD model and signed 18 FIPAs based on the 1994 model for a total of 23 FIPAs to date.

b) Canada's New FIPA Model

In 2003, Canada began updating its FIPA model to reflect lessons learned from its experience with the implementation and operation of the investment chapter of the NAFTA. The principal objectives of this exercise were: to enhance clarity in the substantive obligations; to maximize openness and transparency in the dispute settlement process; and to discipline and improve efficiency in the dispute settlement procedures. Canada also sought to enhance transparency in the listing of reservations and exceptions from the substantive disciplines of the Agreement.

In May 2004, Canada's new model for the negotiation of FIPAs was published on ITCan's website <http://www.international.gc.ca/tna-nac/fipa-en.asp>. The new FIPA model provides for a high standard of investment protection and incorporates several key principles: treatment that is non-discriminatory and that meets a minimum standard; protection against expropriation without compensation and restraints on the transfer of funds; transparency of measures affecting investment; and dispute settlement procedures. The new model serves as a template for Canada in discussions with investment partners on bilateral investment rules. As a template, the provisions contained therein remain subject to negotiation and further refinement by negotiating parties. Thus, although all FIPAs can be expected to follow this approach, it is highly unlikely that any two agreements will be identical.

Canada's FIPA negotiating program is intended to reflect the priorities of Canadian investors. With many countries expressing great interest in negotiating FIPAs with Canada, we are currently undertaking a comprehensive priority setting exercise to consider potential FIPA partners based on the following factors: 1) likelihood of engagement 2) commercial and economic interests 3) lack of investor protection 4) trade policy interests 5) political / developmental interests.

c) Environmental Issues Related to the new FIPA Model

Underlying Canada's new FIPA model are renewed commitments to transparency, including with respect to crosswalks between investment agreements and environmental issues. For instance, Canada seeks commitments whereby Parties would agree to publish laws, regulations and other procedures respecting any matter covered by the FIPA. We also seek to allow Parties an opportunity for prior comment on future legislation covering inward investment.

Canada also recognizes the benefits of transparency with respect to procedural arrangements associated with our investment agreements. This includes investor-state dispute settlement procedures, whereby Canada seeks to facilitate third-party (*amicus*) submissions to tribunals, for example.

Canada's new FIPA model incorporates various safeguards aimed at protecting Canada's right to regulate for legitimate public welfare objectives. It also includes a statement in the preamble on the consistency of the agreement with sustainable development, and general exceptions with respect to human, animal or plant life or health based on GATT article XX/GATS article XIV.

The revised FIPA model clarifies Canada's position that non-discriminatory measures, such as a regulation, designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute an indirect expropriation. This provision is intended to ensure that crucial regulations (including environmental) are not stifled by the obligation to provide costly compensation. For example, unless a measure is so severe that it cannot be reasonably viewed as having

been adopted and applied in good faith, a non-discriminatory environmental regulation that may adversely affect an investor would not constitute a breach of indirect expropriation rules and would not require compensation under the treaty.

The revised FIPA model strengthened a clause on "not lowering standards", whereby signatories recognize that it is inappropriate to attract investment through lowering health, safety, and environmental standards. Specifically, this clause recognizes that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. In the event a Party has offered such encouragement, the other party may request consultation.

Annex II

Public Concerns Regarding the Environmental Impact of Investment

Canada's *Framework for Conducting EAs of Trade Negotiations* indicates that addressing public concerns is a key objective of an EA of trade negotiations. Therefore, in this section, we consider two key public concerns regarding environmental impacts of investment treaties: pollution havens and regulatory chills. We provide an overview of the evidence for each concern based on a review of existing literature and identify how the new FIPA model and other Government of Canada initiatives respond to the concerns.

The pollution havens hypothesis anticipates the purposeful movement of companies to locations with lower environmental regulations and standards due to opportunities for cost savings. Another description for this concern is 'a race to the bottom'. While the Government of Canada respects the right of each country to set their own environmental standards, our FIPA model does include clauses that asks partners not to lower their environmental standards to attract investment, and to enforce the laws they have in place. We also encourage Canadian companies to operate at a high standard while operating abroad, for example, by following the *OECD Guidelines for Multinational Corporations*.

There is debate over whether the pollution haven hypothesis is well founded. The literature on the subject contains the following arguments against it.

- Environmental compliance costs are estimated to be minor compared to overall costs with only a few industries likely to receive a cost saving from lower environmental regulations.
- Multinational corporations may use the most recent technology and equivalent standards regardless of location. They maintain a proactive environmental strategy for reasons of competitiveness and in response to stakeholder demands.
- Benefits associated with use of lower environmental standards can be offset by the uncertainty of management and potential costs to reputation.
- Producers in locations with low standards may be at a disadvantage if they want to compete in a foreign market that demands higher standards.
- Certain sectors have limited mobility because of inputs to production or transportation costs.

The evidence regarding pollution havens is not conclusive. Studies generally indicate an absence of systematic empirical evidence of a general movement of industry to locations where environmental standards are lower. However, studies focusing on specific sectors and regions have found an indication of such evidence. Alternatively, some sectors and companies have demonstrated a purposeful 'race to the top' and use higher environmental standards due to cost savings, reduced risk, and expectations of stakeholders. Management experts have underscored the potential for companies with

proactive environmental strategies to be able to easily respond to new consumer demands and market requirements and be at an advantage, therefore supporting the potential for a race to the top where proper incentives and disincentives are in place. In addition, studies have found that technology associated with FDI can offset scale impacts.

A lack of conclusive evidence does not negate the need to recognize the potential for pollution haven seeking behaviour in the future. Therefore, the Government of Canada will continue its strategy to incorporate environment-related provisions within investment agreements, encourage Canadian firms to use high standards regardless of where they are located, and engage in discussions at the national and multilateral level to facilitate the mutual supportiveness of environmental and economic goals during investment liberalization.

Concerns regarding 'regulatory chill' refer to limitations on the ability of governments to regulate because of commitments within trade and investment agreements, and the ability or will of governments to increase environmental regulations and standards due to competitiveness concerns.

Studies have found anecdotal evidence of environmental standards being reduced or not improved as a result of international trade and FDI activities. However, there are no definitive trends. Specific regulatory chill concerns have been raised in relation to investor-state disputes under Chapter 11 of the NAFTA. The North American Commission for Environmental Cooperation has indicated that the evidence does not warrant a conclusion that an environmental regulatory chill exists, but does warrant consideration by policy makers and continued examination. As discussed in this report, the new FIPA model has clarified the right of governments to regulate in the public interest.