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External Affairs and International Trade Canada

POLICY PLANNING STAFF PAPER

N° 92/11

Trade and the Environment

Dialogue of the Deaf or Scope for Cooperation?

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 ISSN 1188-5041

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Canada

Trade and the Environment:
Dialogue of the Deaf or Scope for Cooperation?

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This paper was originally presented at a Canada-US trade law conference sponsored by the Canada-US Law Institute in Cleveland, Ohio, April 26-28, 1992.

Trade and the Environment: Dialogue of the Deaf or Scope for Cooperation?

The task of statesmanship is ... to attempt to guide the nations, with all their differences in interest, power and fortune, towards a new system more capable of meeting the 'inner limits' of basic human needs for all the world's people and of doing so without violating the 'outer limits' of the planet's resources and environment.

The Cocoyoc Declaration [1]

Is it possible for a trade negotiator and an environmental regulator to work together on the same file? This may strike some as a flippant question. It is not meant to be. Indeed, over the past few years, it has become a pressing question that deserves serious consideration.

In suggesting that environmental regulators must learn to share their file with trade negotiators, our purpose is not to be presumptuous but practical and realistic. It is through the medium of trade that national economies relate to each other and it is the framework of rules negotiated by trade specialists that govern the nature of that relationship. Because of the potential impact of environmental regulation on international competitiveness as well as the desire of environmental regulators to influence behaviour beyond national borders through trade measures, there is now a pressing need for environmental regulators to learn from trade negotiators and vice versa.

For trade negotiators, working with other subject specialists is nothing new. Fifty years ago, trade negotiations dealt largely with tariffs and quotas, i.e., government policy measures applied at the border. Trade negotiators, therefore, were usually drawn from among those people who had some experience in dealing with these matters. But as the boundaries of trade negotiations have expanded, trade negotiators have of necessity learned to deal with a much wider range of issues. Doing so required that they learn to "share" their file. Over the past few years, they have learned to work with industrial policy specialists, government procurement experts, competition lawyers, service industry regulators,

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1 The Cocoyoc Declaration was adopted at the Cocoyoc Symposium on "Patterns of Resources Use, Environment, and Development Strategy," held in Cocoyoc, Mexico, October, 1974.

product health and safety inspectors and more. Each of these fields has its own assumptions, goals and sensitivities. As a result, relations have not always been easy between trade negotiators and other issue specialists, but both sides have adjusted, made the necessary compromises and managed to serve the national interest as defined by the government of the day.

Trade negotiations have now expanded to touch upon the domain of environmental regulators or, put the other way, political pressure to address environmental issues is now affecting issues that may best be addressed through trade negotiations. As a result, it is now necessary for trade negotiators and environmental regulators to learn to share this file and work out common objectives.[2]

The integration of environmental concerns into trade policy and vice versa raises a variety of complex conceptual and practical concerns. The analysis of these issues is still at an early stage of development and much work remains to be done to enlarge our understanding of what is involved. Some early conclusions about the direction that work should take, however, can already be reached. In this paper we propose to explore why these two disparate groups of specialists have come to share a file by looking at developments in the international economy and in thinking about the environment, the problems trade and environmental specialists are likely to encounter and the kinds of compromises they may need to make, with particular reference to the North American Free Trade Negotiations (NAFTA).

Competing Ideologies

The trade/environment interface contains potential for conflict that may run somewhat deeper than, for example, that between trade and competition policies or between trade and industrial policies. The popular conception is that trade and environment specialists bring not only different perspectives to the issues, but in many ways operate from within seemingly incompatible ideologies.

To a trade specialist, trade policy serves the general objective of raising economic welfare. Each facet of the trade file – trade negotiations, dispute settlement, trade relations and trade promotion – is based on the premise that that activity will help bake a bigger pie from which everyone will eventually benefit. Reducing government-imposed barriers to the free flow of goods and services is one of the time-tested ways of achieving greater prosperity through trade. While the path to freer trade may require detours such as quotas, voluntary restraint agreements and countervailing duties, the goal remains trade as unfettered by

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2 The need for this cooperation is now widely recognized. Both GATT and the OECD have established working groups drawing on both trade and environmental specialists. See, for example, GATT, *Trade and Environment: Factual Note by the Secretariat* (L/6896 of 18 September, 1991) and OECD, *Environment and Trade: Major Environmental Issues*, March 1991 (ENV/EC (91) 4) and *Synthesis Report: The Environmental Effects of Trade*, January 1992 (COM/ENV/TD (92) 5).

government-imposed barriers. Environmental regulators, on the other hand, assume that the pie may already be too big and that activities which promote economic growth are dangerous to the long-term ecological health of the planet. Their task is to find policies and programs that will decrease pressure on a fragile biosphere and reverse such damage as has already been done, even if that goal may at times require compromises. If such policies and programs result in barriers to trade, it is a price worth paying. Antoine St. Pierre summarizes the potential for conflict between these competing values as follows:

> ... free-trade advocates contend that many environmental regulations are thinly disguised non-tariff barriers to trade. At the opposite end of the ideological spectrum, environmentalists lobby for environmental measures regardless of cost to industries and consumers. They also distrust the harmonization of policies brought about by trade agreements because it tends to reduce environmental standards to a lowest common denominator and to limit the range of actions available to governments in implementing environmental preservation policies.[3]

From the start, therefore, there seems to exist a basic suspicion between the two groups of specialists which might hinder their capacity to compromise and find common ground. Such suspicion is, of course, not unique. Competition regulators, for example, find international rules about dumping irrational and at odds with their efforts to promote competition. Industrial policy specialists, interested in promoting higher levels of private sector research and development, are uncomfortable with international rules aimed at curbing the ability of governments to provide various incentives. Banking regulators worry that an open trade regime will compromise their ability to maintain fiduciary standards.

Public discussion of the apparent conflict between environmental goals and trade goals provides an excellent example of the extent to which such discussion is often misinformed and even wrong. False assertions and questionable conclusions are often reflected and magnified by the popular media, more because they are sensational than because they are right. Sober and careful analysis is unlikely to gain similar widespread attention because it is often the painstaking work of experts and not readily accessible to generalists.

As a result, there has developed a high degree of public conflict and controversy around the trade/environment interface, largely due to inadequate discussions between those who passionately espouse environmental causes and those interested in promoting trade and related economic issues. Debate about the North American free-trade agreement illustrates the extent to which the issues involved have become misunderstood and thus easy prey for those interested in sterile confrontation and protectionist solutions. The level of conflict apparent during that debate suggests the need both for more research and for more informed public discussion.

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3 Antoine St. Pierre, *Impact of Environmental Measures on International Trade*, Report 76-91-E (Ottawa, Conference Board of Canada, 1991), p. 3.

Decisions about what to negotiate internationally and with whom involve choices from among competing objectives. What will prove an acceptable balance in one jurisdiction, however, may prove unacceptable in another due to differing national values, endowments and priorities. Thus compromises are required not only within societies, but also between societies. The perceived conflict between various public policy objectives, however, is rarely as stark as special interests would like the public to believe. Nevertheless, good public policy requires that issue specialists find common ground and determine the extent to which presumed conflicts are soundly based or proceed from prejudices and popular fallacies.

Such common ground is unlikely to be found by extremists in the trade policy and environmental camps.[4] Little purpose will be served by insisting that the patterns and volumes of trade and production must be determined solely by the dictates of the market. Trade is not just a matter of economics; it is also a matter of politics. Trade takes place within a framework of domestic and international rules set by governments responding to a range of competing interests and values, one of which is protection of the environment. It is, therefore, unrealistic to insist that environmental objectives should not be allowed to compromise trade and economic objectives. The reverse is equally valid: it is not reasonable to insist that environmental objectives take precedence over all other societal goals. Again, public policy involves making choices. In effect, however, there is little need to make choices between environmental and economic goals. Public controversy notwithstanding, it is our view that it is possible in most cases to satisfy both sets of these seemingly incompatible objectives or to find instruments that satisfy one goal while inflicting minimum damage on the other.

Much public discussion seems to be based on a series of questionable assumptions, including that:

- economic growth and environmental degradation are closely linked;
- open markets lead to economic growth and may thus exacerbate environmental degradation;
- open markets lead to pressures to liberalize (i.e., harmonize at a lower level) existing or future regulations aimed at protecting the biosphere;

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4 Notes Stewart Hudson of the National Wildlife Federation in the United States: "Much of the debate on trade and environment has centered on demonstrating the relative merits of free trade or protectionism, or open or closed economies, in dealing with environmental problems. If these problems are discussed in the context of sustainable development, a more optimal use of collective brainpower would be spent in identifying the emerging issues of trade and environment, and raising the questions that need to be resolved in order for world trade to promote sustainable development." See "Trade, Environment, and the Pursuit of Sustainable Development," in Patrick Low, ed., *International Trade and the Environment*, World Bank Discussion Paper 159 (Washington: World Bank, 1992), p. 59.

- trade liberalization between industrialized and poorer countries will encourage the development of pollution havens in the latter countries as companies exploit laxer environmental regulations; and
- more stringent environmental regulation in industrialized countries will reduce the competitiveness of established industries and increase the economic welfare costs of trade liberalization.

Few of these assumptions survive serious analysis. Careful research by economic and environmental specialists alike[5] has demonstrated that:

- economic prosperity is one of the most important determinants leading to a cleaner and more sustainable environment;
- promoting economic development in third-world countries through trade and investment is one of the most efficient ways to raise environmental conditions on a global basis;
- trade-restricting measures are often the least efficient way of ensuring that prices reflect environmental costs and thus rarely achieve environmental goals and may even retard them;
- achieving environmental goals by means of trade measures lends itself too easily to protectionist abuse; and
- there is no fundamental conflict between environmental objectives and the goals and provisions of the GATT-based trade relations system, although there is room for clarification to remove any ambiguities and to strengthen the basis upon which the trade and environmental files can be made more overtly complementary.

Finding an acceptable basis upon which environmental and trade policy specialists can cooperate would thus seem to involve a number of basic concepts: it must proceed from an agreed notion of sustainable development and it must include agreed definitions of the role and limits of trade policy and environmental protection in nurturing sustainable development. We examine each of these elements in turn.

Economic Growth and the Environment

Until the beginning of the industrial revolution, the environmental impact of production and trade was relatively small and limited largely to local effects. Over the past century, however, our use of the planet's finite resources and re-

5 This work is very ably summarized in a series of papers presented at a World Bank Symposium edited by Patrick Low, *International Trade and the Environment*, World Bank Discussion Paper 159 (Washington: World Bank, 1992). Another good overview is provided by Peter A. G. van Bergeijk, "International Trade and the Environmental Challenge," *Journal of World Trade*, vol. 25, no. 6 (December, 1991), pp. 105-115 which includes extensive bibliographic references.

newables has grown exponentially and so has the impact of that use. There is broad agreement today that the result of this intensifying exploitation of our resources is increasing pressure on the environment, both locally and globally. As a result, one of the most fundamental conflicts between the trade and environmental files is the presumed conflict between economic growth and protection of the environment. Is this conflict real or imagined?

The intuitive answer many would give is that there is such a conflict. Careful analysis, however, does not bear out this conclusion. To understand why, one must begin with an appropriate concept of the goal of environmental protection, one that is consonant with public policy in a democratic society. If the goal is to halt all activities that may in any way alter the current state of the environment or return it to earlier conditions, then there may be no alternative to conflict. Such an approach to environmental regulation, however, is neither reasonable nor necessary. From time immemorial man has altered his physical environment, either consciously or unconsciously. The only constant has been continual adaptation. The operative question, therefore, is whether man has altered his environment for better or for worse. More specifically, has the human species, in changing its environment, added to or subtracted from the overall well-being of the species? When viewed from a sufficiently long and broad perspective, the answer is no. As the environment and circumstances have changed, the general well-being of most of the species has improved.

It was Thomas Malthus who first suggested some two hundred years ago that the planet's resources were finite and that if the global population continued to grow, there would eventually not be enough food to feed everyone. Since then, the basic Malthusian thesis has been refined and adapted to a wide variety of predictions about the capacity of the planet to sustain life as we know it, all of them sharing his basic pessimism. Neither Malthus nor his spiritual descendants accept the Darwinian concept of adaptation nor the potential impact of improvements in technology. Malthus' prediction of mass starvation would have happened by now if it had not been for the constant improvement in agricultural techniques as well as transportation and distribution systems, all fueled by economic growth.

A few examples should illustrate why some of the pessimism of environmental extremists is not well founded. When Malthus was writing, the combination of coal fires and the particular climatic conditions in southeastern England produced the infamous London smog. Its impact on human, animal and plant life and health was clearly unacceptable. The addition of industrial and car exhaust fumes in the twentieth century made conditions intolerable. Today, as a result of the introduction of newer technologies and stricter regulation, made possible because the inhabitants found conditions intolerable and were prepared to pay for improvements through higher prices, taxes and regulatory burdens, London smog has become an historical phenomenon. It would not have disappeared,

however, if there had not been economic incentives to discover the necessary technologies and economic growth to pay for their application.

Similarly, the Cayuga River and Lake Erie were for years synonymous with environmental rape. While neither has yet been returned to an acceptable level, it is now safe to light a match when crossing the Cayuga and it will not be long before Lake Erie will once again be safe for swimming.

What these examples have in common is that the human species, having first affected the environment negatively, adapted and learned to affect it positively. The key to both changes in direction came about because markets were allowed to work. At the beginning of the process, the value of exploiting the environment negatively was less than the negative effects, leading to degradation. Once these negative effects became clear and unacceptable, appropriate steps to adapt were taken leading to an improvement.[6] As Marian Radetzki concluded at a recent World Bank symposium:

> There simply is no evidence of general environmental deterioration in consequence of continued economic growth. Empirical observation suggests, if anything, the obverse relationship to be closer to the truth: that the quality of the environment improves as the density of the economy increases.[7]

In developing an acceptable approach to defining how best to achieve a cooperative trade and environment interface, therefore, the first element involves agreeing on an appropriate definition of what constitutes sustainable development. As a working hypothesis for this paper, the definition set out in the Brundtland Commission provides a good starting point:

> Sustainable development is best understood as a process of change in which the use of resources, the direction of investments, the orientation of technological developments, and institutional change all enhance the potential to meet human needs both today and tomorrow. [8]

Sustainable development does not mean that there will be no conflicts or adjustments, particularly at the micro level. The decision to protect the rare spotted owl in the US Northwest, for example, has profound implications for the US and Canadian lumber industries and downstream industries dependent on that lumber. The capture of sulphur from the stacks of smelters and coal-fired generating stations has changed the outlook for sulphur mining. At the same time, higher environmental standards may also lead to new opportunities. Greater environ-

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6 Economists explain this phenomenon in terms of an inverted U curve. Conflict between north and south in the preparations for the UN Conference on the Environment and Development, for example, reflect differences of view on where countries see themselves on this U curve.

7 Marian Radetzki, "Economic Growth and Environment," in Patrick Low, ed., *International Trade and the Environment*, World Bank Discussion Paper 159 (Washington: World Bank, 1992), p. 127.

8 World Commission on the Environment and Development (Brundtland Commission), *Our Common Future* (New York: Oxford University Press, 1987), p. 46.

mental awareness has already proven a spur to welcoming new technologies and processes.[9] Many Canadian and US companies have been among those in the forefront in developing new products and processes that respect the fragile interaction between man and nature.

Trade and Economic Prosperity

While there does not appear to be much evidence to support the proposition that economic growth leads to long-term deterioration of the environment, there is a great deal of evidence to suggest that trade leads to economic growth. Indeed, the positive relationship between trade and economic growth is one of the oldest and most established concepts in economic theory.

Canada and the United States are prosperous countries in part because of their historically strong trade performance. Success in buying and selling on world markets has made each country a major contributor to and beneficiary of the global economy. Since the Second World War, the progressive liberalization of markets has encouraged the two economies to adjust and become more integrated into the world economy. This has allowed producers in both countries to specialize in what they do best and to let consumers buy their other requirements more cheaply from abroad. As a result, incomes in both countries have grown steadily.

Most of us are prepared to accept that exports are an important contributor to our economic well-being. We are less familiar with the importance of imports in giving us the high standard of living we all take for granted. We import in order to obtain more final and intermediate products at lower prices than we would be able to produce such products for ourselves. As a result, we are able to devote the capital, technology, and people which would otherwise be used to produce the goods and services we now import to do the things we do best. Imports help to keep firms competitive and provide both firms and individuals with the latest products and technologies, including those aimed at improving the environment. Our ability to buy a wide range of competitively priced foreign products with the proceeds of our exports has left us with more money to do other things – money to serve both personal and national needs, including protection of the environment.

Trade policies that promote the most efficient use of scarce resources on an international basis will stimulate economic growth on a global basis. Trade policies that restrict access to markets and encourage the uneconomic exploitation of re-

9 Michael Porter in *Canada at the Crossroads: The Reality of a New Competitive Environment* (Ottawa: Business Council on National Issues, 1991), pp. 92-95 points out that the more stringent regulatory requirements, including tougher environmental standards, faced by Scandinavian forest products companies, was a key ingredient in making them more innovative and more competitive than their Canadian counterparts.

sources will retard growth. From an environmental perspective, the most appropriate use of resources would occur if prices were able to reflect the true costs of their production to the environment. That is more likely to happen if markets are allowed to work than if they are not. The world of agricultural trade offers a good example of market failure as a result of inappropriate trade and economic policies and the resultant pressures on the environment. Production subsidies and closed borders have resulted in highly intensive land exploitation in Western Europe at a level that is not compatible with the long-term sustainability of that land. If markets were allowed to work, European agriculture would become less intensive and more sustainable in the long term and European consumers would benefit from the lower costs of imported food products.

The example of agriculture suggests that trade policy decisions do not always make economic sense. Continuing restrictions affecting world trade in textiles and clothing offer a further example of pragmatic and necessary compromises between economic and other objectives. These examples, however, should not be taken as failures of the world trading system. Rather, they indicate the extent to which the international trade rules have managed to contain protectionist zeal and provide a framework within which to address problems arising in sensitive areas such as agriculture and textiles in an orderly manner.

The second element in defining an appropriate trade and environment interface, therefore, involves acceptance of the fact that maintaining an open trade regime is key to maintaining sustainable economic development. Compromises may at times be necessary between economic and other objectives, including environmental objectives, but such compromises should be addressed within the framework of existing rules and should not undermine the basic values of an open trading system.

Environment Policies for Sustainable Development

In the last few decades, awareness of the need to protect the fragile biosphere has approached the top of the public policy agenda. The depletion of the ozone layer, global warming, waste disposal problems and the threatened extinction of plant and animal species are just a few examples of the issues that have made protecting the environment an urgent global priority. No responsible politician today would any longer deny the importance of this issue. Business leaders have become acutely aware of the need to be sensitive to environmental concerns. The issue is no longer whether, but how. A major challenge, therefore, is to find an acceptable balance between environmental and economic goals.

As we noted earlier, the aim of environmental policy is to ensure that the planet remains a viable and rewarding place for the human species. It follows that not all activity that has a negative impact on the environment is necessarily bad nor should environmental concerns always take precedence over other societal goals. For example, modern society devours a considerable amount of en-

ergy on a daily basis. Conservation may reduce but will not eliminate the appetite for vast quantities of energy. Each of the various sources poses environmental risks. Burning coal pollutes the atmosphere; hydro-electric power may require the damming of rivers and the destruction of fragile eco-systems; nuclear power may lead to devastating accidents and requires the disposal of highly hazardous wastes; and the burning of fossil fuels contributes to global warming. Newer, less hazardous forms of energy remain as yet impractical on any large scale. Living without energy is not an acceptable solution. The challenge, therefore, is to find the best combination of imperfect instruments that will least contribute to environmental problems and at the same time not undermine maintenance of an open trading system. Concludes the World Bank's Patrick Low:

> ... the simple idea that environmental standards are not absolutes with infinite values turns out to be very powerful. It implies greater scope for policy flexibility. It undermines some of the less reasoned populist positions on the environment, in particular on trade and the environment, and it weakens the position of protectionists that seek to conceal their demands for trade restrictions in environmental arguments.[10]

In keeping with the goal of ensuring that economic development sustains the capacity of the globe to meet current and future human needs, measures aimed at protecting the environment should be sufficient to the objectives they are meant to achieve but not more than sufficient. Determining sufficiency is a matter both of establishing a scientific basis for the measure and also of investigating least cost alternatives, i.e., costs that reflect appropriate tradeoffs between environmental and other societal goals.

The third element in developing an appropriate approach to the trade/ environment interface thus involves ensuring that environmental policies meet the standard of sufficiency, i.e., that they are a necessary and legitimate response to the problem and proportional to the goals being sought. Given differences in environmental preferences, as well as financial and technological capabilities in different countries, a great deal of analysis and consultation will be required on a case-by-case basis to develop consensus as to what constitutes sufficiency. Despite differences of view as to, for example, risk assessment, suitability and appropriate bench-marks involved in environmental measures, the sufficiency standard should provide a rational basis for dialogue as well as a standard upon which to make informed public choices and resolve intergovernmental conflict.

Environmental Policy and Trade

Environmental problems are now understood to involve a wide range of issues. Efforts to address these can be divided into two broad categories: efforts to protect the physical environment, whether water, air, or land; and efforts to con-

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10 Patrick Low and Raed Safadi, "Trade Policy and Pollution," paper presented at the Symposium on International Trade and the Environment, World Bank, Washington, November 21-22, 1991, pp. 8-9.

serve resources, whether renewable or not, including the protection of endangered or threatened plant and animal species. In each case, the specific problems addressed can be classified as either local, regional (including transboundary) or global. The nature of the problem dictates the solution and the range of interests involved. For example, whether a particular plot of land should be used as a park, as a housing development or as a factory site will in most instances engage only local interests. If that plot of land happens to be on the border between two states and the proposed factory will involve a nuclear power facility, the issue may well engage interests on both sides of the border. If the proposed land use involves a factory that will produce ozone-depleting gases, global interests are engaged.

It is the wide range of problems and solutions and the increasing realization that more than local issues and interests must be met that has made the need to address the environmental/trade interface urgent. For our purposes, however, we need only concern ourselves with those environmental policies and measures that either involve trade policy measures or implicate trade flows.

Generally speaking, trade and environmental policies can be understood to intersect along two axes: meeting environmental goals may require policies that must be enforced either directly or indirectly by trade measures and/or environmental measures may affect the international competitiveness of certain producers. Conflict may thus arise between environmental and trade objectives as a result of:

- the use of trade instruments to enforce compliance with national regulations, such as restrictions on the imports of products that do not meet domestic standards;
- the use of trade measures to enforce international environmental agreements, such as sanctions, against the products of non-complying countries; and
- compliance costs borne by producers in one jurisdiction but not in another.

Controversy in the application of these measures often results from national differences in assessing the need for environmental protection and the choice of instruments used as remedies. While international harmonization would eliminate some of the conflict, it is neither reasonable nor necessary to insist on international harmonization in many instances. There should be room to allow for differences in ecological conditions, comparative advantage, social preferences and political choices among national jurisdictions. Nevertheless, there may be need for the international community to cooperate in developing common basic standards to reduce conflict and provide an improved basis for resolving disputes. International agreements facilitate national decision-making by providing a framework of rules within which to address the demands of domes-

tic special interests. Trade agreements and trade policy measures, however, may not necessarily be the best instruments for setting environmental standards, particularly where the trade dimension is at best marginal or incidental.

Trade is rarely the cause of environmental degradation, although there are circumstances where it may draw attention to an existing environmental problem. Rather, the root cause of environmental degradation lies in the failure of markets fully to reflect environmental costs, often due to inadequate or inappropriate government policies or consumer information. Consequently, the most effective solution lies in implementing measures that will allow markets to reflect these costs more accurately and thus influence the behaviour of producers and consumers away from environmentally hostile decisions.

While trade itself is rarely the cause of an environmental problem, the products traded internationally or the processes by which they are produced may embody an environmental problem. Once a government decides to address an environmental issue that may be embodied in a tradable good or service, therefore, it must first determine whether the solution lies in the product itself or in the process by which it is produced. In deciding what approach works best, a range of instruments may be used. The choice of appropriate instruments – regulations, taxes, standards, subsidies or trade restrictions – is thus not only an environmental issue but also an issue affecting industrial policy, fiscal policy or trade policy. The final decision may ultimately require a choice involving tradeoffs between competing objectives.

Trade Measures to Enforce Compliance with Domestic Standards

All countries have in place a range of measures affecting the production, distribution and sale of domestic output as well as the necessary instruments to ensure that imported products do not undermine these measures. For example, a Canadian law banning the production and sale of a particular toxic product will also include a ban on the importation of that product. Similarly, the imposition of a domestic commodity tax at the production stage will also involve a similar tax on importation. Labeling requirements must be met by both domestic and imported products. Thus there is nothing unusual in a country's insisting that its environmental laws and regulations apply equally to domestic and imported products and using trade measures to enforce such a policy.

Problems may be encountered, however, if such measures differentiate between domestic and imported products, i.e., if the burden of compliance is heavier on imported than domestic products. While international trade law will tolerate some differentiation, it must be shown that such differentiation is necessary to meet the objectives of the policy and does not amount to a disguised restriction on trade. As we shall see below, many of the problems that have been experienced in the environment/trade interface in the past few years can be traced to

the failure of governments to justify the necessity for differentiating between domestic and imported products.

A second problem may arise if the measure regulates the process by which a product is produced, rather than the product itself. If the domestic and imported products is indistinguishable but the process by which they have been produced are different, the temptation to insist that imported products must meet the same process standards will be very high. Producers that do not meet the necessary process standards, and their governments, may well complain that the trade measure being used to enforce the process standard is discriminatory. In effect, extending process standards to imported products amounts to an extraterritorial extension by one state of its laws. The result is likely to be conflict, particularly if there is not broad international consensus on the objectives being pursued by means of the process standard. Recent cases such as the US-EC dispute about beef hormones, the US-Mexico dispute about yellowfin tuna and Canada-EC differences on clear-cut versus selective cut forestry management practices illustrate the difficulties that can be encountered when one country adopts a different process standard from another.

A third problem may be encountered if one country is determined to conserve a particular natural resource and takes steps at its border to enforce such a policy, either through import or export measures that have the effect of differentiating between domestic and foreign producers. Both Canada and the United States, for example, restrict the export of logs. Several Canadian provinces have further processing requirements for minerals extracted in that province. Such measures may serve important environmental objectives but may also serve protectionist ends.

As we shall see below, while there are problems that may be encountered in the application of border measures to enforce domestic environmental laws and regulations, the international trade regime has to date proved adequate to the task of insisting that such measures meet certain basic standards aimed at avoiding intergovernmental conflict. There remains, however, room for improvement by, for example, developing clearer definitions and procedures attuned to new circumstances.

Trade Measures to Enforce Compliance with International Agreements

The use of trade sanctions to enforce internationally agreed environmental standards has a mixed history as regards their effectiveness and conformity with trade rules. As with any international sanctions, their effectiveness is directly related to the degree of international agreement and commitment they enjoy. Sanctions applied by only a few states to influence the behaviour of many states are unlikely to be successful. Sanctions applied by many states to influence the behaviour of a few states are much more likely to succeed.

Such sanctions are not automatically at odds with international trade rules. The experience in enforcing the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) offers a positive example of the use of trade measures to enforce environmental objectives. Depletion in the numbers of an endangered species such as the African elephant may be directly linked to demand for and trade in ivory. In such an event, the solution lies to a large extent in eliminating or strictly controlling that trade through trade restrictions. There has not been much international conflict about either the goal or the means in such an obvious trade-linked example. The Convention is a well established instrument and the need to use trade restrictions along these lines is well provided for in international trade law.[11] Similarly, many countries have since 1906 enforced an international ban on trade in matches made with white phosphorus as a result of an international agreement that recognized the dangers in the manufacturing process involved.[12]

Conflict may arise, however, when there is insufficient international consensus on either the environmental objectives being sought or on the need for trade restrictions to ensure compliance. Trade restrictions aimed not only at enforcing compliance by signatories but also at gaining broader participation may be challenged by non-participants on grounds of discrimination. The Montreal Protocol on Substances which deplete the Ozone Layer, for example, imposes more onerous trade restrictions on non-signatories than signatories in an effort to expand participation and prevent the relocation or expansion of production of the banned substances in non-signatories. Its trade provisions may well be open to challenge by non-signatories.

Even more difficult is the use of trade sanctions by one state or a few in order to influence the environmental policies of other states. Whatever the merits of the environmental objective being sought, the unilateral use of sanctions by a powerful country or by a group of countries sets a potentially dangerous precedent for the validity of international rule making and enforcement. It undermines the important principle that trade measures should not be used to force acceptance of other countries' policies and values except under extreme circumstances and then only when sanctioned by an international body such as the UN Security Council.

The effective use of trade sanctions to enforce compliance with internationally agreed environmental standards thus requires at least three elements: wide acceptance of the standard being enforced, broad consensus on the most appropriate and effective instrument needed to gain compliance, and broad agreement

11 "Trade and Environment: Factual Note by the Secretariat," GATT document L/6896 of 18 September, 1991 provides a good description of CITES from a trade policy perspective.

12 Steve Charnovitz, "Exploring the Environmental Exceptions in GATT Article XX," *Journal of World Trade Law*, vol. 25, no. 5 (October, 1991), provides a number of historical examples of successful environment-based trade restrictions.

that a departure from the principle of non-discrimination is necessary and will be effective. If these conditions are met, there is unlikely to be conflict with the trade rules. If necessary, the GATT's waiver provisions could be successfully invoked. It is only when these conditions are not met that there is likely to be conflict and the trading rules in such circumstances stand as an important barrier to arbitrary and discriminatory behaviour by a minority of states or a powerful state acting unilaterally.

Trade Measures to Level the Environmental Playing Field

One of the most frequently raised concerns is that environmental protection policies undermine the competitiveness of firms because of high compliance costs. Arguments have been advanced that unless there is broad international consensus on particular goals and instruments, governments should be allowed to take steps to "level the playing field" by taking appropriate action in the field of trade, usually by means of countervailing or offsetting duties of one kind or another.

Before considering whether trade policy should be used to level playing fields, we should consider the extent to which environmental regulations undermine competitiveness. Recent analytical and empirical work suggests that the aggregate additional costs of meeting environmental requirements in the United States add less than one percent to the cost of doing business.[13] Aggregate costs, of course, reflect wide variation and in highly competitive industries, additional costs of even one percent can make the difference between profit and loss. But the relative cost of compliance with existing pollution requirements appears to be modest and well within the capacity of most industries to absorb. At the same time, as pointed out by Michael Porter in his study of the Canadian economy, compliance with tough pollution standards can also prove a powerful incentive to innovation and prove an important step toward improving competitiveness.[14]

Related to concern about differential compliance costs is the fear that countries will use lower standards as an investment incentive and thus become pollution havens. Again, the evidence to support such fears is not very robust. While the assimilative capacities of some countries – particularly developing countries – to absorb or tolerate higher levels, for example, of atmospheric pollution may attract some dirty industries to relocate, the cost of relocating has to be taken into account as do other factors such as labour costs, proximity to either suppliers or

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13 Patrick Low indicates that for the United States the weighted average cost to output of pollution abatement and control equipment was 0.54 percent, with the highest ratio, for the cement industry, being just over three percent. See "Trade Measures and Environmental Quality: Implications for Mexico's Exports," in Patrick Low, ed., *International Trade and the Environment*, World Bank Discussion Paper 159 (Washington: World Bank, 1992), p. 107.

14 Michael Porter, *Canada at the Crossroads: The Reality of a New Competitive Environment* (Ottawa: Business Council on National Issues, 1991).

customers, the availability of low-cost energy supplies, fiscal policy and other factors that influence such decisions. Additionally, experience suggests that technological improvements to meet tougher environmental standards usually go hand in hand with broader technological improvements. Thus, new investments in, for example, developing countries to replace old investments in industrialized countries of traditional "dirty" industries are likely to involve the use of the latest technologies and lead to a net reduction in global pollution levels.[15]

The whole question, however, needs to be kept in perspective. Countries trade in order to exploit the comparative advantage they derive from differing factor endowments such as available resources, the quality and price of labour, the policy environment, the costs of inputs and proximity to markets. The international trading rules seek to ensure that comparative advantage can work and lead to a more efficient allocation of scarce resources on a global basis. Efforts to put in place trade barriers aimed at leveling the playing field in effect defeat the whole basis upon which trade takes place.[16]

Pressures to level the playing field, of course, are not new. In the first years of this century, US economists were much preoccupied with developing arguments for and against the so-called scientific tariff. The idea was that the US tariff on individual products should be set at a level high enough to offset the cost advantages enjoyed by foreign producers but no higher.[17] The devilishly clever variable levy used by the EC to protect its agricultural producers works much the same way. The result is very little trade. While the whole concept is an economic nonsense, more sophisticated versions keep cropping up. Current demands that producers facing higher environmental compliance costs in one country should be allowed to seek countervailing duties to offset these costs on imported products fall into the same category.[18] Putting aside the formidable methodological difficulties of measuring comparative costs of pollution compliance in differing

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15 See, for example, Nancy Birdsall and David Wheeler, "Trade Policy and Industrial Pollution in Latin America: Where are the Pollution Havens?" Patrick Low and Alexander Yeats, "Do 'Dirty' Industries Migrate?" and Piritta Sorsa, "GATT and Environment: Basic Issues and Some Developing Country Concerns," in Patrick Low, ed., *International Trade and the Environment*, World Bank Discussion Paper 159 (Washington: World Bank, 1992).

16 See John Jackson, *The World Trading System: Law and Policy of International Economic Relations* (Cambridge, Mass: MIT Press, 1991), particularly pp. 208-210.

17 See Jacob Viner, "The Tariff Question and the Economist," reprinted in *International Economics* (Glencoe, Illinois: The Free Press, 1951).

18 The fact that countervailing duties are assessed for a variety of other, equally dubious reasons, almost exclusively by the United States exercising its economic muscle, in no way justifies the use of this draconian measure for environmental reasons. The whole concept that trade must be "fair," a notion particularly popular among Washington lawyers, lobbyists and legislators, has no intellectual foundation. See James Bovard, The Fair Trade Fraud (New York: St. Martin's Press, 1991) for a devastating survey of what is wrong with the fair trade concept.

jurisdictions, it would involve an intolerable unilateral intrusion into the policies of one country by another. The solution lies in negotiating international rules and standards that respect both the need to promote environmental protection and the desirablity of maintaining an open trading system.

Policy Convergence and Harmonization

To some, of course, the answer lies in a much greater degree of international harmonization of product and process standards at sufficiently high levels so that environmental objectives would not be compromised by agreement around the lowest common denominator. While there has been considerable positive experience over the last ten years in reaching internationally agreed basic standards, it is neither necessary nor desirable to insist on such harmonization in all cases.[19] Indeed, much of the effort in international trade negotiations has been predicated on the desire to reduce the trade-distorting effect of differing regulatory approaches rather than on harmonization per se.

There is broad international acceptance today that different countries may rationally choose different levels of, for example, environmental protection depending on such factors as unique local conditions and different policy priorities. The impact of car exhaust fumes on the environment of Mexico City is markedly different from their impact on the environment of Regina, Saskatchewan. Additionally, there are circumstances in which governments are prepared to agree on ways and means to accept each others' standards where the detail may be different but the effect is the same. Efforts within the EC are probably the most advanced and even within this highly integrated multi-national market, there is broad acceptance that there are legitimate reasons for imposing different standards.

Environmentalists worry that any efforts to achieve harmonization or acceptance of equivalence will lead to acceptance of the lowest common denominator. Experience to date suggests that such fears are unwarranted. International discussions have usually accepted the principle that member states to any international standard are free to impose higher standards than the international norm, sometimes adding the proviso that such higher standards should not constitute a disguised or arbitrary restriction on trade. Additionally, pressures from business interests to accept lower standards are now more than offset by the demands of environmental groups, making such business pressures no longer credible.

Harmonization of standards is a time-consuming and resource-intensive activity and is most likely to be achieved where there is a degree of consensus on the objectives to be achieved. Even then the technical requirements may be

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19 For example, in the World Health Organization (WHO), the Food and Agriculture Organization (FAO) and the International Standards Organization (ISO).

formidable, particularly where there is already a considerable experience with differing standards in different jurisdictions.[20]

Little progress toward greater uniformity in environmental standards is likely to be achieved in the absence of international cooperative efforts. At the same time, resort to unilateral trade measures aimed at enforcing unique environmental standards will likely do little more than undermine healthy international competition and harm global economic prosperity. Notes Patrick Low:

> Environmental diversity and differences in assimilation capacity become part of what countries seek to take advantage of by specializing through trade, rather than what they seek to eradicate through trade restrictions and fatuous harmonization that is destructive of competition. [21]

Much standards-setting activity, of course, falls outside the scope of governments and involves cooperative efforts through industry-sponsored organizations and other private-sector links such as licensing arrangements. The driving force behind this activity is the recognition that markets are global and a proliferation of standards undermines competitiveness.

The desire for greater uniformity should be seen as part of the response by governments and industry toward the globalization of production and markets. On the macro-economic side, there is growing convergence, with all governments pursuing policies aimed at ensuring price stability. On the micro-economic side, there is both convergence and rivalry with governments using a range of policy measures both to protect existing investments and attract new investment. While harmonization per se is not necessarily virtuous, environmental policy rivalry – either to attract or protect investment – would seem an inappropriate and potentially destructive approach similar to the harmful use of subsidies to attract investment. From this perspective, convergence in the use of environmental policy instruments is an important international objective.

Environmental Policy and GATT

Over the past few years, there has developed an active international jurisprudence on the intersection of trade and environmental policy. These cases have involved:

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20 The slow progress in the technical discussions on phyto-sanitary regulations mandated by the Canada-United States FTA provide a valuable object lesson in this regard. Article 708 of the FTA provides for an ambitious work program aimed at reducing to the maximum extent possible barriers to trade resulting from differing health and phyto-sanitary regulations. Canada and the United States, despite enjoying highly integrated markets and very similar philosophies about health protection, have found it very difficult to accept each other's standards or to reach agreement on common or harmonized standards.

21 Patrick Low and Raed Safadi, "Trade Policy and Pollution," paper presented at the World Bank Symposium on International Trade and the Environment, Washington, November 21-22, 1991, pp. 8-9.

- a Canadian challenge of a US embargo on imports of Canadian tuna justified as consistent with the requirements of article XX (g) relating to the conservation of an exhaustible natural resource;[22]
- a US challenge first of Canadian export controls on salmon and herring and subsequently of landing requirements, both justified on the grounds that they were required to back up resource management practices;[23]
- a Canadian challenge of US controls on the imports of lobsters below a minimum size, justified on the grounds that the trade measure was part of a resource management scheme;[24]
- a challenge by the United States of a Thai ban on the importation of cigarettes;[25] and
- a Mexican challenge of US restrictions on imports of yellowfin tuna, justified on the grounds that the measure was necessary to reduce the slaughter of dolphins as a result of the fishing methods used by Mexican and other non-US fishermen.[26]

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22 GATT, *Basic Instruments and Selected Documents* (BISD), vol. 29 (1981-82), pp. 91ff. The panel ruled that the measure had discriminated against Canada and could not be justified under article XX (g) because there was insufficient evidence that the United States had taken steps to conserve tuna either through domestic production or consumption measures.

23 The GATT panel ruled that Canada's export prohibition "could not be deemed to be primarily aimed at the conservation of salmon and herring stocks and rendering effective the restrictions on the harvesting of these fish... [and] were not justified by Article XX(g)." GATT, BISD, vol. 35 (1987-88), pp. 98ff. The FTA panel ruled that the landing requirement was similarly inconsistent because it also was not aimed primarily at conservation. The landing requirement could be made consistent if a certain percentage was made available for export at a level that would still allow the remaining catch to be landed and counted as part of a conservation management scheme. "In the Matter of Canada's Landing Requirement for Pacific Coast Salmon and Herring," Final Report of panel constituted under chapter 18 of the Canada-United States FTA, October 16, 1989.

24 "In the Matter of United States Minimum Size Requirement for Atlantic Coast Lobster," Final Report of panel constituted under chapter 18 of the Canada-United States FTA, May 25, 1990. The panel ruled that the United States requirement was consistent with its GATT obligations because it applied equally to both imports and domestic production.

25 GATT, BISD, vol. 37 (1989-90), pp. 200ff. The panel ruled that the import ban on cigarettes was inconsistent with article XX (b) because other means were available to Thailand to control the quantity and quality of cigarettes consumed consistent with its health objectives without discriminating against imported products.

26 Gary Clyde Hufbauer and Jeffrey J. Schott, *North American Free Trade: Issues and Recommendations* (Washington: Institute for International Economics, 1992), p. 143. The panel report rejected the US claim that its measure was consistent with its GATT requirements, ruling that it could not extend a process requirement extraterritorially to products indistinguishable from those produced by domestic producers. In effect, it ruled that GATT applies to like products, not processes.

Environmental critics of the GATT-based trade rules have suggested that these and other cases indicate that the trading rules are insensitive to modern concerns about the environment and need to be overhauled in order more clearly to establish the precedence of environmental goals over trade goals. Our reading of this jurisprudence, however, is somewhat different. In our view, these cases suggest the ease with which environmental concerns can be subverted to pursue less noble objectives. The problem, therefore, may not lie in the rules but in their interpretation or abuse. Notes Steve Charnovitz:

> If the "greening" of the GATT means that the Contracting Parties should respect environmental objectives in administering Article XX, then greening is a good idea. But if greening means that the Contracting Parties should subordinate economic goals to ecological imperatives, then greening is a bad idea – for the environment and for the GATT. It is a bad idea for the environment because the GATT does not have the scientific expertise to judge what ecological measures are appropriate. It is a bad idea for the GATT because environmental policy would be too divisive for GATT's current decision-making structure. [27]

While not perfect, the GATT rules, first negotiated in 1947, provide a very solid foundation upon which to develop more detailed and more modern rules. Their genius lies in the fact that they start with an enunciation of some very basic principles which can be summarized as follows. The trade regimes of member states must be:

- non-discriminatory;
- transparent; and
- appropriate to the agreed goal of developing an open, liberal international trading system.

Should any conflict arise among member states in the application of these principles, GATT provides more detailed rules spelling out more specific obligations as well as procedures for the resolution of disputes consonant with these principles.

At least seven GATT provisions can be invoked to address trade-related environmental issues. The first is that the trade measures used by member states must be non-discriminatory. Any trade measure must apply equally to all member states (the most-favoured-nation requirement of article I) and must not discriminate between goods of national origin and imported goods except for those GATT-sanctioned measures – largely tariffs – applied at the border (the national treatment requirement of article III). The requirements of article III are spelled out in much greater detail as regards the use of product standards, including the

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27 Steve Charnovitz, "Exploring the Environmental Exceptions in GATT Article XX," *Journal of World Trade Law*, vol. 25, no. 5 (October, 1991), p. 55. This article provides a detailed and convincing discussion of GATT law and environmental protection. Typical of negative environmental assessments of the GATT is Steven Shrybman, "International Trade and the Environment: An Environmental Assessment of Present GATT Negotiations," *Alternatives*, vol. 17, no. 2 (1990), pp. 20-29.

requirement that such regulations may not be used as a disguised restriction on trade and must serve a legitimate domestic objective. The GATT Technical Barriers Code does not involve the establishment of standards but it encourages international harmonization. Current Uruguay Round negotiations, however, involve improvements in the Code that may include more robust provisions leading to greater harmonization.

Second, GATT measures must be applied transparently (article X). Both domestic producers and international traders must have equal and open access to those laws, regulations and procedures that affect their ability to transact business in any market. The frequently voiced complaint by environmentalists that the trade regime discourages the use of information about the environmental impact of various products misreads the GATT. The GATT places a very high premium on information, and enjoins its members from imposing differential regulations that discriminate between domestic and imported products.

Third, GATT contracting parties (CPs) may not use quantitative restrictions (QRs) except in clearly delineated circumstances (article XI). When quantitative restrictions are used, they must not discriminate among foreign suppliers (article XIII). The strong bias against QRs reflects GATT philosophy that such measures are likely to be more restrictive, less transparent and more discriminatory than measures that have a direct price effect, such as tariffs. This GATT bias makes sense in an environmental context. For example, GATT allows a country to impose a tax on imported products to reflect its desire to let the final price more closely reflect environmental costs, so long as that tax is also applied to domestically produced goods. GATT does not want CPs to use QRs to achieve such objectives.

Fourth, CPs may use subsidies to achieve various domestic objectives, including environmental goals, but may not use export subsidies except for primary products (article XVI). Subsidies must be notified but can be limited to domestic producers and products (article III). Products that benefit from subsidies may be countervailed – a special tariff to offset the price effect of the subsidy – if imports of the subsidized product can be shown to cause material injury to domestic producers (article VI). The rules relating to subsidies are amplified in the much more detailed subsidies code negotiated during the Tokyo Round negotiations. A new, much improved code may emerge from the current Uruguay Round multilateral trade negotiations.

Fifth, should there be conflict between any GATT article and the desire of any contracting party to protect the environment (to protect animal, plant or human life or health; to conserve exhaustible resources; or to take action to ensure compliance with a domestic regulatory requirement not otherwise inconsistent with the General Agreement), article XX allows member states to implement the environmental protection measure so long as the measure does not constitute a dis-

guised restriction to trade and does not unjustifiably or arbitrarily discriminate among member states.

Sixth, in the event that none of the provisions outlined above is sufficient to justify a particular course of action, the waiver provisions (article XXV:5) allow the Contracting Parties by two-thirds vote constituting at least half of all CPs to waive any obligation contained in the agreement. The waiver route provides GATT members with the opportunity to pass collective judgment on a particular set of circumstances and avoids the need for amendment to the text. The discriminatory aspects of the sanctions enjoined by the Montreal Protocol, for example, could be regularized by a waiver should the necessary number of countries agree.

Finally, in order to prevent abuse of these various provisions, but particularly resort to article XX, GATT's dispute settlement provisions (articles XXII and XXIII) provide the right to challenge the policies and practices of other CPs on the ground that they "nullify or impair" benefits that could reasonably be anticipated as a result of the provisions of the agreement.

In addition to the plain language of the text, GATT law involves the interpretations placed on these rules by various GATT decisions and panel rulings. For example, the requirements of article XX have been interpreted to include the test that any measure justified under that article must not only not be a disguised restriction on trade, but must also be necessary to meet the stated goal and involve the least restrictive alternative.[28]

Over the years, GATT has proven a dynamic instrument capable of adapting to a range of changing requirements and circumstances, as a result of periodic negotiations, decisions, panel rulings and acceptance of regional and other arrangements imposing more stringent requirements. The need to strengthen and modernize the GATT-based trading system may be particularly acute today as a result of the explosion in international commerce and the changing nature of international business, but the basic principles remain sound. The current Uruguay Round marks the latest opportunity to modernize and improve the GATT in response to these changing circumstances. Better rules to address environmental concerns are included on the agenda, e.g., in the subsidies code.

Despite our conclusion that recent cases do not indicate a pressing need to change the rules, we see a broader utility in considering whether the existing

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28 This was the conclusion reached by the panel appointed under the terms of chapter 18 of the Canada-US FTA to adjudicate the Canada-US dispute about landing requirements for salmon and herring in the West Coast fishery. "In the Matter of Canada's Landing Requirement for Pacific Coast Salmon and Herring," Final Report, October 16, 1989. While not a GATT panel, its findings interpreted GATT law as applied between Canada and the United States and thus forms part of the interpretations and rulings that will guide the policies of member states as well as any GATT panel constituted to adjudicate any similar issue.

trade rules can be adapted to accommodate environmental concerns. Efforts to use trade measures to achieve environmental goals are likely to continue to increase. Consequently, it makes sense to effect such changes as can be made in order to ensure that environmental concerns can be addressed without destroying the carefully developed but fragile consensus favouring an open global economy. Additionally, environment-driven improvements in the trade rules must be considered in the broader context of remaking the trading system to address the problems generated by today's international economy.

The Environment and Trade Negotiations

Trade agreements are fundamentally about regulating government behaviour. They set out rules about what governments can do to regulate and influence the flow of goods, services, investment, technology and labour across national frontiers. The success of earlier negotiations in reducing barriers has led to a tremendous growth in world trade and in global economic integration. That increased integration has identified new areas of friction and conflict. As a result, the focus of trade negotiations is changing from measures applied at the border – tariffs and quotas – to measures and policies used by governments to regulate and influence behaviour in the domestic market. Efforts to negotiate rules about trade and the environment, therefore, are part of a larger effort to develop international standards and consensus on a wide range of issues traditionally considered to be domestic in character, such as competition policy, social policy and labour policy. These raise very difficult issues, not the least of which is the extent to which governments are prepared to raise the level of international agreement and accept new inroads into domestic economic decision-making.[29]

This evolving agenda represents a fundamental shift in focus and will only succeed if approached carefully and incrementally. It took years to develop the current rules about border measures. It is unrealistic to expect that the necessary intellectual capital and international consensus can be developed in a few short years to address an even more complex set of issues. The major challenge today, therefore, is not <u>whether</u> we should negotiate about some of these difficult issues, but <u>how</u>. A fundamental consideration in determining how to begin to address these issues is the requirement that governments must be careful not to undermine the basic principles that underpin the global trading system.

The GATT-based system provides a framework of rules, a negotiating forum and an institutional setting aimed at promoting competition and specialization through trade. These rules may need modernization to reflect today's much more

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29 Michael Hart explored the trend toward an ever-widening ambit for trade negotiations in greater detail and outlined some of the challenges to negotiators and researchers posed by these developments at an October 25 conference at Queen's University. See "After NAFTA: Trade Policy and Research Challenges for the 1990s," to be published in a conference volume edited by William Watson.

integrated and complex international economy. At the same time, governments will need to ensure that the trading system is not destroyed on the basis of questionable arguments that will ultimately undermine the capacity of governments to pursue policies that will lead to the greater prosperity that is critical to achieving a whole range of societal goals including environmental protection.

The experience in addressing subsidies and product standards shows how difficult the negotiations of the future will be. In the Tokyo Round of GATT negotiations (1973-79), governments agreed on procedural codes that aimed at reducing the ability of governments to use subsidies, countervailing duties and product standards capriciously as barriers to international trade. The Uruguay Round has sought to take the next step – agreement on subsidies and standards. This has proven much more difficult. Similarly, it has proven very difficult to fit rules about intellectual property protection into the framework of GATT rules because the underlying goals of intellectual property protection are very different from those found in the GATT. Rather than reducing discrimination and increasing competition, intellectual property rules seek to do the opposite.

There is, of course, international experience in negotiating rules about the environment or labour. Generally speaking, international agreements on these issues have become largely political and hortatory without the enforcement mechanisms that are central to much more contractual trade agreements. Thus while it is recognized that we must address these difficult issues, we must equally recognize that progress will be slow and include many false starts and noisy conflicts, at home and abroad. As a start, we need to accept that negotiations will only succeed if they proceed on the basis of the two themes explored in this paper. Environment-oriented trade rules:

- should proceed on the basis of the concept of sustainable economic development, i.e., they should be both ecologically and economically sound; and
- they should not undermine the basic principles of the open trading system, i.e., they should build on and clarify existing trading rules rather than change them.

More specifically, efforts should proceed among environmental experts to reach cooperative solutions to global environmental degradation. To the extent that such cooperation needs to be enforced by means of trade instruments, trade experts should ensure that the necessary provisions are included in the trade regime. Such provisions should build on the basic principles of GATT including non-discrimination and transparency and involve the least possible distortion of international trade.

The Environment and NAFTA

The North American free-trade negotiations mark the first time that environmental considerations have been confronted directly in the context of a major trade negotiation. There are a number of reasons why:

- The appalling environmental and social conditions prevailing on the Mexican side of the Mexico-US border provided a ready target for those opposed to the agreement for both environmental and other reasons.
- The fact that these conditions could be related directly to a trade program – the maquiladora program based on US tariff and Mexican tariff and tax concessions – sharpened calls for addressing environmental issues in the context of the negotiations.
- Added to this was concern that lower environmental standards and/or enforcement in Mexico could act both as an incentive for pollution-intensive industries to relocate there as well as offer "unfair" competition to industries meeting higher levels in Canada and the United States.
- There was also the related concern that lower standards and/or enforcement in Mexico could either lead to a reduction in standards throughout the free-trade area or flood the Canadian and US markets with lower cost and lower standard Mexican products.
- Finally, there was the general worry that trade agreements lead to more economic activity at a time when the biosphere needs less economic activity.

Some of these factors had, of course, been present in previous trade negotiations and had been taken into account. But these negotiations mark the first time that a developing country has agreed to negotiate a free-trade agreement with industrialized countries on a fully reciprocal basis raising broad concerns about how the wide disparity in social, political, environmental and other conditions could be accommodated in the context of a trade agreement. These anxieties were readily exploited by those opposed to the agreement for other reasons, particularly those worried about competing with low-cost imports. The result was insistent demands that environmental concerns be addressed in the agreement. US congressional support for these demands ensured that the NAFTA negotiators would have to pay close attention to this file.

From the outset, all three countries have committed themselves to ensuring the highest level of cooperation in meeting environmental objectives, both in the agreement for trade-related environmental issues and in parallel discussion for broader environmental issues. In all three countries, the views and concerns of environmental activists have been actively solicited to ensure that the discussions would be informed and productive. The NAFTA negotiations thus offer a concrete opportunity to determine how the competing objectives of trade negotiators

and environmental regulators can be accommodated within or alongside a trade agreement.

To set the stage, however, we must first dismiss any notion that Mexico has any interest in ignoring its environmental problems or in becoming a pollution haven. Mexico is determined to achieve as high a standard of environmental protection and clean-up as its economic circumstances will allow. The main impediment to moving faster and more thoroughly is money; a trade agreement offering higher prosperity remains a key ingredient in Mexico's long-term approach to environmental protection, a point noted by the National Wildlife Federation in the United States in its endorsement of the negotiations.[30]

As we have seen, the existing GATT-based international trade regime already provides a good basis upon which to resolve most conflicts between environmental and trade objectives. The rules, however, are not perfect and could benefit from clarification. For example, the international community has sought for more than thirty years to reach consensus on what constitutes a subsidy in order to develop more sensible rules about which kinds of government practices should be subject to the discipline of international subsidy rules.[31] Once agreement is reached on this central issue, it should prove possible to agree that certain kinds of government assistance aimed at promoting better environmental practices should be exempt from countervailing duties. Such a provision was included in the December 1990 Brussels text which was meant to conclude the Uruguay Round of GATT but disappeared a year later in the so-called Dunkel text, issued on the authority of GATT Director-General but reflecting a further year of negotiations.[32]

The NAFTA provides a further opportunity to strengthen and clarify the existing trade rules along similar lines. As a result, negotiators from all three countries are seized with the need to meet this objective. Their efforts are concentrated in three areas:

- ensuring that each country can maintain or create, as necessary, the highest environmental standards for traded goods compatible with their domestic requirements and international agreements, including all technical regulations and related approval procedures affecting human health, safety and environment;

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30 Gary Clyde Hufbauer and Jeffrey J. Schott, *North American Free Trade: Issues and Recommendations* (Washington: Institute for International Economics, 1992), p. 131. Hufbauer and Schott provide a detailed account of Mexican environmental laws and policies as well as efforts to improve the enforcement of these laws on pp. 135-143.

31 Michael Hart discusses the difficulties encountered in reaching consensus on international rules regarding subsidies in "The Canada-United States Working Group on Subsidies: Problem, Opportunity or Solution," Occasional Paper number 3, Centre for Trade Policy and Law (Ottawa, 1990).

32 See the draft subsidies code in MTN.TNC/W/35/Rev 1 of December 3, 1990, pp. 83-134.

- improving the GATT-based provisions setting out the environmental exceptions (article XX: b and g); and
- ensuring that the dispute settlement and institutional provisions are adequate to the task of resolving conflicts that may arise in the environmental area.

Once the negotiations are concluded, analysts will need to consider carefully the extent to which these efforts were successful in advancing the cause of trade-environment cooperation. At this stage, however, it must be accepted that the negotiating goals are modest since neither the intellectual capital nor negotiating experience is as yet sufficient to go much further. NAFTA represents, however, an important incremental step toward gaining both the intellectual capital and negotiating experience necessary for possibly more ambitious negotiations in the future.

In addition to devising better rules to resolve potential conflict between trade and environmental goals, environmental concerns affect the NAFTA negotiations in three other ways.

- Concern has been expressed about Mexico's capacity to enforce its environmental laws and regulations and the consequent threat that Mexico could become a pollution haven and a source of unfair competition. Mexico's capacity to enforce its laws – environmental or other – will be enhanced as it becomes more prosperous. To the extent that the NAFTA will increase trade and other economic opportunities, it should increase Mexico's prosperity and thus its enforcement capacities. Reaching an acceptable level of enforcement can be further enhanced by Canada and the United States through technical cooperation. By means of parallel discussions on environmental issues, Canadian and US environmental officials are working with Mexican officials to find the most effective ways to provide technical assistance.
- There is broad consensus today that the rapid economic development of the Mexico-US border region through the maquiladora program placed unacceptable environmental pressures on the region, particularly on its water supplies. This is largely an issue between the United States and Mexico and is being addressed bilaterally. The United States has to date committed $700 million and Mexico $500 million to phase one of an extensive clean-up program. Experts suggest that more may be required.[33]
- Both Canada and the United States have committed themselves to conducting an environmental assessment of the agreement. This may prove a

33 Gary Clyde Hufbauer and Jeffrey J. Schott, *North American Free Trade: Issues and Recommendations* (Washington: Institute for International Economics, 1992), pp. 144-146 offer a range of sensible suggestions on further steps than can be taken to clean up the border region.

formidable task. In the case of projects such as dams, roads and buildings, such a review is relatively straightforward to implement. When it comes to a comprehensive trade agreement involving changes to potentially several dozen statutes and even more policies and programs, the task can be complex and vast. In effect, such an audit seeks to determine the future impact of a policy instrument that sets out rules about how governments will regulate the conduct of private parties. The number of possible variations is immense.

Fascination with predicting results is, of course, not limited to environmental concerns. Economists have long tried to model the impact of trade agreements on the economy as a whole, on individual sectors and on job creation, usually with not very precise outcomes. The results of these models tend to be most credible at high levels of aggregation and become less so as they become more detailed. Environmental assessments are likely to suffer from the same basic defect. Nevertheless, NAFTA will provide an important opportunity to explore some of the methodological problems and the limits of what can usefully be done along these lines.

While technically not part of the formal trade negotiations, all three issues are linked to them and would not have been pursued in the absence of the negotiations. A more formal link could be established between the first two and the trade negotiations by means of the preamble to the trade agreement as well as by ensuring that the consultation provisions of the agreement can be used to advance environmental cooperation in both trade-related and other aspects of environmental protection.

The final results of the NAFTA environment discussions are likely to be modest, for the reasons stated above. Nevertheless, the NAFTA negotiations mark an important step in the evolution of trade and environmental policy. In the approach they have taken, the three governments have provided important guidance for the future. They have accepted the legitimacy of addressing environmental issues within the context of a trade negotiation, but they have also indicated that while some issues are integral to the negotiating agenda, such as standards-setting rules, others can best be addressed in parallel discussions, such as technical assistance to improve enforcement of domestic rules.

Conclusions

In the years to come, as global economic integration deepens and awareness of environmental issues intensifies, potential conflicts between trade and environmental goals and practices are likely to proliferate, both domestically and internationally. In response, it will be important that governments develop the necessary tools and policy instruments to resolve these conflicts equitably and quickly. As this paper has suggested, there is no inherent reason why there need necessarily be conflict. Nevertheless, there is scope to improve and strengthen

the international legal framework within which inter-state conflict arising out of the trade/environment interface will need to be addressed. The basic principles enshrined in the GATT provide a sound basis upon which to build. The NAFTA negotiations provide an opportunity to begin to work out some of the practical difficulties involved. The answer to the question posed at the beginning, therefore, is yes. Trade negotiators and environmentalists can work together. Indeed, they have already started working together and the results to date are encouraging.