“Trade and the Environment: What’s the Connection?”

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Over past 15 years, heated debate over links between trade and environmental policy:

- Debate over NAFTA
- Tuna/dolphin case in GATT

- What is the connection?
- Why such controversy over the connection?
Links between trade and the environment

- If trade affects production and consumption, creating *local* pollution, trade can affect the environment.

- Production and consumption can generate *global* pollution which can be affected by both trade and trade policies.

- Trade policies may be used to enforce international environmental agreements, e.g., CITES, Montreal Protocol.
Why such controversy?

- Economists argue trade and growth may be good for the environment
  - e.g., evidence air-quality falls and then rises with income/capita

- Environmentalists claim benefits of freer trade outweighed by damage to environment
  - e.g., Greenpeace claims about McDonalds and destruction of Amazon rain-forest
Why such controversy?

- In absence of trade policy, governments will *harmonize down* environmental standards
  
  - e.g., shrimp/turtle case – “...the WTO is creating the path for the rapid destruction of our global resources...” (Sea Turtle Restoration Project, 2004)

- Requires use of trade policies to countervail a *race to the bottom* – a WTO “social clause”
  
  - e.g., failure to implement US energy tax in early-1990s due to competitiveness concerns
Overall focus is economics of a race to the bottom in environmental standards:

- Traditional economic analysis
- Pollution havens
- Tariff substitution
- Border tax adjustments

Key conclusion: extension of existing GATT/WTO rules would minimize incentives for a race to the bottom.
Traditional economic analysis

- Target local environmental problems directly with emissions taxes/standards
- Under certain circumstances trade policy may substitute for environmental policy
- Environmental policies can differ across countries due to technology/preferences
- No support for race to bottom arguments
Problems with traditional analysis

- Assumes capital is immobile, and ignores environmental policy substituting for trade policy

- With *capital flight*, FDI can be targeted at countries with weaker environmental policies, i.e., *pollution haven* effects

- *Tariff substitution*, i.e., with freer trade, governments may weaken environmental policy as a substitute for trade policy
Pollution Havens

• “Just between you and me, shouldn’t the World Bank be encouraging more migration of dirty industries to the less developed countries…” (Larry Summers, 1991, World Bank internal memo)

• Key question: which countries attract dirty industries with freer trade?

• Competing theories: pollution havens vs. comparative advantage
Pollution havens

- Theory suggests impact of environmental policies mitigated by other factors affecting trade, i.e., a *pollution haven effect*

- Support provided by empirical research – evidence for trade and investment flows being affected by environmental policy and other factors

- If freer trade creates pollution haven effects, there is an incentive for a race to the bottom
Tariff substitution

- Unilaterally countries will implement tariffs
- GATT/WTO is solution to this via tariff bindings and exchange of market access
- With environmental standards – is there a race to the bottom in such a set-up?
- Only if GATT/WTO allows complete sovereignty over standards
Under GATT/WTO, countries do not have total sovereignty over environmental standards.

If a country’s negotiated market access is reduced by standards, a *non-violation* complaint can be filed (GATT/WTO Article XXIII).

This should prevent a race to the bottom.

What if a country wants to raise its standards, allowing more market access, but its tariffs are bound?
Some economists suggest allowing renegotiation of bound tariffs

- Basic principle already allowed through border tax adjustments for environmental excise taxes (GATT/WTO Articles III and XVI)

- Not yet extended to other domestic environmental policies, i.e., carbon taxes

- Difficulty in evaluating trade impact of domestic policies
A race to the bottom?

- Not under standard economic analysis
- Assumes immobile factors and no tariff substitution
- Evidence supports pollution haven effects – an incentive for a race to the bottom
- Solution may lie in extending existing GATT/WTO rules – non-violation complaints and border tax adjustments