



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

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**Agribusiness Leadership Plus Program,
Washington DC September 11-15, 2006**

Trade and the environment

- **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

Presentation

- **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**

Tariff substitution: race to the bottom

- Under GATT/WTO, countries do not have total sovereignty over environmental standards
- If 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?

Border tax adjustments/environmental taxes

- **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**