SUSTAINABLE DEVELOPMENT

Trade and Environmental Agreements

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Introduction

The relationship between international trade—or more broadly, globalization—and the environment has emerged as one of the most contentious issues in recent international forums. Distrust in the ability of international trade institutions to safeguard social welfare and the environment broke into the global media spotlight when activists in Seattle shut down the 1999 Ministerial Conference of the World Trade Organization (WTO). Protesters voiced concerns about the impact of trade liberalization on environmental quality in developing countries and on labor and environmental standards in the more heavily regulated developed countries.

At the 1992 United Nations Conference on Environment and Development in Rio de Janeiro ("Earth Summit"), developing countries cautioned that trade-environment issues should be considered within wider development commitments. The North-South impasse was temporarily bridged at Rio as the North agreed to provide greater development assistance in exchange for the South's commitment to integrate environmental protections in their development processes. Although "greening trade" has gained momentum in the decade since Rio, it continues to be perceived as an agenda of the North.

The source of developing countries' skepticism lies in a perception that tough environmental standards on imports from developing countries have protectionist motives behind them. In discussions since Rio, the South has stiffened its stance in response to declining levels of development assistance and continuing fears of green protectionism in developed countries. Meanwhile, the North, responding to domestic pressure, has pushed for tying environmental components to the trade agenda. As a very recent example, the Bali preparatory meeting for the World Summit on Sustainable Development (Rio+10) failed to finalize the preparation process largely because of the North-South impasse on trade and the environment.

As we review the decade since Rio, it is important to consider the role of trade institutions in achieving sustainable development. This paper seeks to break free of the simplistic dichotomy of the Northern agenda for the environment versus the Southern agenda for economic growth and development. In particular, we focus on how these agendas intersect with each other and interact with broader developments in global trade discussions.

International Trade Institutions

Global trade is governed by the General Agreement on Tariffs and Trade (GATT) and related trade agreements under WTO auspices. The issues of trade and the environment drew attention in the Uruguay Round of GATT negotiations (1986–94), which culminated in formation of the WTO.

The primary goal of those institutions is reducing barriers to trade by lowering tariffs and controlling regulation that inhibits trade and is unjustified on nontrade grounds. Since these rules establish the structure for global economic interaction, they will shape future development in both currently industrialized and less industrialized countries. International trade policy and sustainable development interact in two significant ways. First, international trade rules affect the ways countries can act to protect human and ecosystem health and sustainable use of nonrenewable resources. Second, national environmental regulation and product standards can affect developing countries' access to global markets, thereby shaping their development paths. In either case, trade policy can have both positive and negative impacts on environment and development, and the ultimate goal is achieving a balance between these two desirable and sometimes conflicting ends.

Principle of National Treatment

The fundamental constraint that THE GATT imposes on national policymaking is nondiscriminatory treatment of goods traded between participating countries. This guiding principle of "national treatment" (enunciated in Article III) requires importing countries to treat foreign goods the same way they treat "like domestic products," and not in a "less favorable" way by imposing different regulatory standards or taxes.

Environmentalists in developed nations often blame national treatment for tying the hands of governments to cope with "ecodumping" by trade partners. National treatment, they say, requires imports from countries with lax environmental standards to be treated equally with domestic products made in compliance with strict (and costly) domestic pollution regulation. No adjustment can be made on imported products to offset a cost differential attributable to unequal pollution policies in two countries.

In effect, the principle of national treatment supports the position that countries should be free to choose their own level of environmental protection within their borders and not have another country impose its views through trade restrictions. For local pollution problems in developed countries, this nondiscrimination requirement is perfectly reasonable. The environmental effects are generated and retained within that country's borders; other countries are not harmed and should not interfere. But for products produced in a way that generates cross-border pollution—chlorofluorocarbons (CFCs) and greenhouse gases are prime examples—the nondiscrimination principle is not unambiguously appropriate. National treatment of imported goods removes one policy instrument importing countries might have to control cross-border pollution in the absence of cooperation from the producing country. Truly successful regulation of a transboundary pollutant inevitably requires international coordination and is not ultimately amenable to unilateral action. Another problem arises, though: if developing countries do not have the capacity to protect their own environment, the national treatment rule prevents developed countries from using trade policy to help. For example, even though Indonesia may be unable to prevent illegal logging, the United Kingdom cannot impose tariffs on Indonesian wood of suspicious origin. Ultimately, capacity building and other direct responses can better target environmental problems in developing countries than trade policy, but the rules do imply one less option in the meantime.

Principal Exceptions

In choosing its own level of environmental protection, a country may need to discriminate against imported products. The GATT makes accommodations for nontrade concerns by spelling out exceptions to the principle of national treatment in Article XX. Three exemptions relate to environmental issues: regulation necessary to protect human, animal, or plant life or health; policies to conserve scarce natural resources; and actions necessary to implement regulations with legitimate nontrade purposes.

The exemptions come with conditions to ensure a good-faith effort, lest environmental issues be used to camouflage a "disguised restriction on international trade." For implementing actions to be exempt, the underlying national regulations must comply with the basic rules of nondiscrimination. For example, Thailand's ban on cigarette imports was struck down by a 1990 GATT panel as an inappropriate action to protect health, since domestic cigarettes were not likewise

regulated. Conservation measures that discriminate must be combined with other restrictions on domestic production or consumption. In the 1998 "shrimp-turtle" dispute, the WTO found that the United States could restrict imports of shrimp caught in a way that harms endangered sea turtles, since the law intends to conserve an exhaustible resource and requires domestic producers to use turtle exclusion devices.

Finally, countries are required to choose the "least trade-restrictive" policy option in addressing an environmental problem. This standard has been evolving and was recently interpreted as a proportionality test: the environmental gains of the measures must be proportional to the restrictions the measure imposes upon trade.

Through the principle of national treatment and its exemptions, the GATT attempts to balance free exchange and free policymaking. But doing so is complicated, and trade and environment are not always on separate sides. Following the basic trade principles can promote more efficient and consistent environmental policies, at home and in competing countries, by preventing protectionist motives from distorting environmental regulation. On the other hand, blunt trade rules may have subtle costs if they disable or distort policy tools for addressing environmental problems. Thus, at issue are not only the quantity but also the quality of protection.

SPS and TBT Agreements

Governments frequently protect environmental and human health through product standards. Implicitly, by trying to lower barriers to trade between countries, the WTO also encourages coordination and harmonization of domestic product standards among countries. The most prominent outcomes are the Agreement on Technical Barriers to Trade (TBT) and the Agreement on Sanitary and Phytosanitary Measures (SPS), both finalized in the Uruguay Round.

The TBT agreement sets criteria for imposing domestic technical standards and regulations on imported products. The SPS agreement lays ground rules for coordinating national measures that protect human, animal, and plant health. Both are designed to govern attributes of final products, such as their physical, biological, or chemical composition. For example, standards can be set for ingredients or a method of pasteurization, but not generally for the process of production, which is the domain of regulators in the producing nation. This distinction between product and process standards was at the heart of the 1991 tuna-dolphin dispute: the GATT panel ruled that the United States could regulate the quality or content of tuna from Mexico, but not the way the fish were caught abroad (i.e., in a dolphin-safe manner).

Most product standards aim to reduce risks to consumers (e.g., from pesticide residues on foods) or to the domestic environment (e.g., from invasive insects on imported fruit). Since views may differ regarding what risks are acceptable, a country can maintain national standards that are higher than the common international standards—as long as they are based on scientific evidence. With the burden on the regulating country to justify its standards, purely precautionary strategies may be difficult to implement. For example, the European Union (EU) did not meet the "scientific basis" requirement in attempting to ban imported beef raised with growth-promoting hormones. Interpretation of these trade rules will affect EU policies for products derived from genetically modified organisms (GMO). Labeling, which was approved for dolphin-safe tuna, is being disputed as a potential trade barrier that needs scientific basis when it takes a negative form like a GMO warning.

For developing countries, restrictions on raising product standards are not as directly relevant as the standards themselves, which determine the accessibility of markets for their products, particularly agricultural exports. Since many developing countries look to exports to drive economic growth and development, the main goal of the SPS and TBT agreements—to simplify and harmonize standards across countries—is a boon to them, provided they can meet the minimum standards. Harmonized standards can mean easier access to wider range of markets. But while environmentalists worry that common standards will be too minimal, developing countries remain concerned that environmental standards could be protectionism in disguise.

The response of developing countries' industries to the developed countries' high product standards is multifold. Meeting the standards can be costly, and the necessary techniques can change their competitiveness relative to developed countries. Compliance often requires technology and capital, which can reduce the cost advantage of developing countries' exports and harm export sales. On the other hand, high product standards in developed countries may have positive spillovers to developing countries' environmental quality. If the entire sector upgrades, domestic products and manufacturing may also become cleaner and safer (but also more expensive). Or the sector may divide into domestic and export-oriented producers, with lower-quality (and less expensive) products sold domestically.

For example, the emergence in India of a subsector that specializes in leather exports is an outcome of trade liberalization (see United Nations ESCAP 1999). This subsector is reportedly different from the rest of the Indian leather industry in having modernized production and management techniques, and it caters to foreign customers who once rejected Indian leather products because of their pentachlorophenol (PCP) content. The traditional parts of the sector, mostly small and medium enterprises, continue to sell domestically.

Subsidies

Trade barriers are not the only means of protection; subsidies have also been widely used to favor domestic over foreign industry. The GATT Agreement on Subsidies and Countervailing Measures (Subsidies Code) mandates careful scrutiny of subsidies and allows retaliatory duties against those deemed "actionable." Again, exceptions are made for certain subsidies with environmental motives (Article 8). These include adapting existing plant and equipment to new environmental requirements, as well as industrial research and development activities. However, certain restrictions apply. An adaptation subsidy must be a one-time, nonrecurring allowance limited to 20% of the cost. Although this may be adequate for established firms in industrialized countries, many firms in developing countries cannot afford technology upgrades. Some observers argue for a broader scope of "nonactionability" to support environmental policy development in developing countries (see Rao 2000).

The exemption clause may be limited to regulation governing production processes, not product content. It has not been settled whether the Subsidies Code would define subsidies to assist domestic industries to meet foreign product regulations, such as SPS measures, as nonactionable. Since this type of subsidy would likely be contingent on export performance, it could easily be prohibited under the Subsidies Code.

Nations categorized as least developed countries (LDCs) are not generally subject to the Subsidies Code (Article 27). But even for LDCs, the shelter from countervailing duties against ac-

tionable subsidies is automatically applicable only if the subsidy is 5% or less of the product value. Whether this is positive or negative is a matter of viewpoint. Although developing countries need to promote their industries, they also need the forgone revenues from subsidies to develop their governing and social institutions. Some have noted that the GATT provides developing countries with "virtually no cover against lobbies seeking subsidies" (Finger and Winters 1998).

TRIPS and Technology Transfer

Technology can help reduce environmental impacts as well as raise productivity and product quality. Economists often predict that open trade and investment will benefit both the environment and development as developed countries' technologies, which tend to be more environmentally sound, are disseminated through international trade in goods and services or through the flow of capital, machinery, equipment, and human resources via foreign direct investment. But the spread of technology is also affected by intellectual property protections

The Agreement on Trade Related Intellectual Property Rights (TRIPS), established in the Uruguay Round, attempts to lessen disparities and set ground rules for protecting patents, copyrights, and trademarks. From the perspective of developed countries, TRIPS is crucial to fostering technological innovation by ensuring that innovators reap the gains from the technology they develop. These may include environmentally sound methods of manufacturing, safer agricultural chemicals, or life-saving medicines. However, protection of intellectual property rights also makes new technology less affordable to developing countries, where it may be most needed. Articles 66 and 67 of TRIPS do encourage the transfer of technologies and the provision of technical assistance from developed to developing countries.

Special rules have recently been developed for pharmaceuticals. The Doha Declaration affirmed that countries have the right to protect their public health through, for example, compulsory licensing and parallel importing. This issue came to the fore with the AIDS pandemic, since the drug cocktails widely used in the West have been unaffordable in developing countries, where the highest rates of HIV infection are. Following threats from developing countries to manufacture generic versions of these drugs, pharmaceutical companies have dramatically lowered their prices to these markets. International trade institutions are still negotiating to balance the needs of developing countries with the rights of innovators.

Trade in Domestically Prohibited Goods

The GATT-WTO system allows countries to bar imports that may carry organisms that may harm ecosystems, agriculture, or public health. Trade rules currently focus on restrictions at the point of entry. Parties to the agreements have been slow to address the issue of restricting exports of hazardous products. Chemical and pharmaceutical manufacturers frequently market products banned in developed countries in developing countries.

The impact of such practices on developing countries is mixed (see United Nations ESCAP 1999). Environmentalists' efforts to prevent hazardous imports in developed countries have met with charges of paternalism. Developing countries face a different risk-benefit trade-off than developed countries. Equipment or products judged substandard in developed countries, being inexpensive, may serve the social goals of developing countries. But since developing countries

frequently have limited institutional capacity to regulate trade, imports of products and equipment banned elsewhere—like certain pesticides, machinery lacking safety features, or expired pharmaceuticals—may reflect these limitations more than legitimate social decisions to accept higher risks. This trade can also affect the sustainability of ecosystems globally. Ozone-depleting substances prohibited in developed countries by the Montreal Protocol are still being exported to developing countries in the phaseout period, both legally, as with used refrigerators (which are inexpensive but perpetuate CFC dependence), and illegally through smuggling.

Other multilateral environmental agreements (MEA), such as the Basel Convention on the Transboundary Movement of Hazardous Wastes, have begun to address the movement of "domestically prohibited goods" across borders, independently of the GATT. The United Nations Environment Program has developed a voluntary code of ethics for private sectors on environmentally sound management of toxic chemicals, complementing the amended London Guidelines for the Exchange of Information on Chemicals in International Trade. Within the GATT framework, a 1982 ministerial decision established a notification system on the movement of domestically prohibited goods, but it never functioned properly and has been ignored since 1990. The WTO could help establish an information clearinghouse and notification system not only of MEA requirements for various products, but also of different national standards for imported products.

Directions for the Future

International trade institutions attempt to strike a balance between free trade and free policymaking, recognizing that the latter may be influenced by protectionist goals. For developed countries, the impact of liberalization on the quality of environmental protection has both positive and negative potential. Unable to restrict trade directly, protectionist forces may instead distort environmental policies to win exceptions to trade rules. Trade rules may prevent blatant protectionist efforts, but others can pass muster; at the same time, some good policy efforts may encounter inadvertent restrictions. As environmental policies shift toward market-based incentives like pollution taxes and tradable emissions permits, trade institutions need to become smarter: these instruments are not typical tariffs or quotas but a means to implement the polluter-pays principle. For example, the international effort to design a system of tradable permits for greenhouse gas emissions may necessitate adjustments in international trade rules.

For developing countries, the balance between sovereignty and trade can produce quite different effects when governing institutions are weak. It is sometimes argued that lower environmental standards in developing countries simply reflect local conditions and priorities: economic concerns may be more critical than environmental quality or public health. Ideally, countries choose standards that reflect public demand for safety and environmental protection based on a sound understanding of impacts on health and the environment. However, institutional challenges can make this ideal unrealistic. Without strong democratic institutions and access to sound science, governments may not have the incentive or the ability to set proper standards. Weak governance generally leads to a level of protection lower than the nominal legal standard. Although corruption can be one cause, more banal governance failures, such as lack of testing facilities and inability to monitor and control imports may be even more significant.

Weak legal institutions and the lack of capacity to govern environmental and public health hazards are not inherently a problem of trade, but these challenges do interact with trade. A global

trading system that both promotes the flow of goods and services across borders and supports sustainable development requires that all countries implement effective environmental policies that reflect domestic desires. The key—building governance capacity in developing countries—has to be approached on three fronts. First, the capacity of governments to formulate, implement, and enforce appropriate environmental policies needs to be strengthened. Second, environmental goals should be integrated into the overall growth strategies of all countries, including trade liberalization policies. Third, developed countries can help disseminate information on the environmental standards they impose on imported products and otherwise facilitate compliance.

Particular attention should be paid to the needs of smaller enterprises, whose viability is vital for developing economies. For example, according to the World Bank Group on Small and Medium Enterprises, 99 percent of all private companies in Ecuador have 50 or fewer employees. With economic activity so dispersed, not to mention concentrated in the informal sector, environmental regulation is both more difficult for governments and more burdensome for business. Technical assistance and decentralized policy options—like market-based incentives for environmentally friendly behavior—are then even more important.

In the meantime, trade institutions should build backstops to minimize adverse effects of trade liberalization on sustainable development. For example, the international legal structure should address trade in domestically prohibited goods, and it should accommodate import policies that complement developing countries' environmental enforcement efforts.

The WTO also needs to improve its coordination with international environmental institutions. Multilateral environmental agreements have the specialized task of addressing global and regional environmental questions. Of approximately 200 MEAs in place today, 20flincluding the Montreal Protocol, the Basel Convention, and the Convention on International Trade in Endangered Speciesflcontain explicit trade provisions. The WTO's Committee on Trade and Environment is mandated to conduct new negotiations to clarify the relationship between trade measures taken under the environmental agreements and WTO rules. However, consideration should also be given to MEA and national policy provisions—such as subsidies; tradable emissions permits, their allocation, and trade across countries; emissions taxes, earmarking, and border adjustment; and enforcement problems—that do not explicitly involve trade measures but may nonetheless need coordination with WTO rules.

Similarly, the WTO needs to improve coordination with international development goals. The Doha Declaration (November 2001) lays out an agenda for negotiations on a range of subjects, including interactions with multilateral environmental agreements and such development issues as market access, agricultural subsidies, technology transfer, and technical cooperation. Provisions for assistance are encouraging but do not yet have the force of trade mandates. Improvements on market access issues are proceeding, but slowly. For example, products from the least developed countries can receive waivers for preferential tariff treatment. Tariffs on textiles, an industry where developing countries compete with developed countries, are to be eliminated and subject to general GATT rules by 2005. Export subsidies and tariffs for agriculture were to be reduced by 36% by 2001; however, trade protection for agriculture in developed countries remains substantial, and only soft targets were set for reductions in distorting production subsidies. Continued heavy subsidies in developed countries are as important an issue as tough environmental standards for market access of agricultural products from developing countries.

The WTO remains a work in progress, continuing to evolve through negotiations. As the global community focuses more on environmental and development issues, its international institutions will begin to do so as well. Since its establishment in 1995, the Committee on Trade and Environment has kept the WTO's eye on environmental issues. The Doha agenda in 2001 brought development to the fore of trade negotiations. The challenge for Rio +10 is addressing how policies approaching these two important issues interact.

Further Readings

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