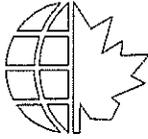


INTERNATIONAL TRADE - THE SUSTAINABILITY DIMENSION

**AN ADDRESS BY
THOMAS P d'AQUINO
PRESIDENT AND CHIEF EXECUTIVE
BUSINESS COUNCIL ON NATIONAL ISSUES**

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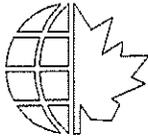


INTRODUCTION

The trade/environment linkage is fast becoming a major public policy issue of global proportions. The issue figures prominently on the agenda of the General Agreement on Tariffs and Trade (GATT), and the Organization for Economic Cooperation and Development (OECD). The need to reconcile trade and environmental policies was also a major theme of the recent United Nations Conference on Environment and Development (UNCED). The issue has leapt into prominence quickly -- a decade ago, when I was teaching a course on the law of international trade, the relationship between the environment and international trade was barely talked about, even in academic circles.

The growing importance of the relationship between trade and environment results from a number of factors:

- The international dimension of many environmental issues (acid rain, climate change, ozone layer depletion), means that there is increasing potential for interaction, and potentially conflict, with trade policy.
- Some current trade-related policies -- particularly, growing protectionism in the North and subsidization of certain resource activities -- lead to inefficient and environmentally harmful use of resources.
- Protectionists are increasingly tempted to use the environment, and strategic alliances with environmental interest groups, as a creative instrument to keep competitors out of their markets.
- Domestic industries, no longer afforded tariff protection and hit by stringent compliance requirements, are demanding a level playing field against competitors abroad.



- The growth of regional trading blocks, notably the FTA/NAFTA and the Single European Act, has led to greater focus on harmonization of environmental and other standards.
- There is increasing political pressure for countries to use trade measures in an attempt to influence what are considered to be inappropriate environmental policies in other jurisdictions.

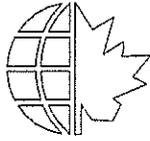
My comments today will be devoted to three principal subjects:

- First, to some general observations on trade and sustainable development, and the linkages between them;
- Second, to the relevance of this issue to Canadian industry; and,
- Finally, to how public policy can be shaped to respond to the challenges raised by this issue.

TRADE AND SUSTAINABLE DEVELOPMENT -- AN OVERVIEW

I start from the assumption that the concept of sustainable development means that open trade, competitive markets and environmental protection are mutually supportive objectives. Trade provides opportunities to improve economic and social conditions, and the additional resources needed to take environmental protection measures. Trade is also a means to stimulate innovation and increase efficiency, and is a primary mechanism for the diffusion of cleaner technologies. A sound environment, on the other hand, provides the ecological and other resources needed to sustain economic growth and expand trade.

The irony is that the countries which have traditionally championed the cause of freer trade, namely the members of the OECD, now seem to be

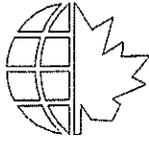


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more protectionist in orientation, whereas it is developing nations and those of Eastern Europe which see the benefits of more open trade as the means to spur economic development. Protectionist policies and subsidization of certain activities in the developed world can lead to economic inefficiencies, as well as being environmentally harmful.

It is also unfortunate that, as the trade and environment issue has moved to the forefront of the sustainable development agenda, we have seen a polarization of views develop. On the one hand, staunch free traders suggest that trade agreements are about trade, and have little to do with the environment. On the other side are many environmental groups who maintain that trade liberalization leads to environmental degradation.

It is my view that trade, in and of itself, is not a root cause of environmental problems. As pointed out in the GATT paper "Trade and the Environment"¹, it is almost always domestic policy which encourages overexploitation of a resource. In some instances, trade may magnify the extent of the problem. But restricting trade will not, by itself, cure the underlying policy defect, nor will it alleviate other domestic problems which result from inappropriate environmental policies.

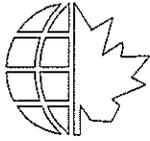


IMPORTANCE OF THE ISSUE TO CANADA

The trade/environment interface is of particular importance to Canada, both because we are a trading nation, and because much of our trade has been in natural resource products, industries which have been particularly affected by environmental concerns. Trade has always been a mainstay of the Canadian economy, and a vital motor of our economic and social prosperity. Almost 30 percent of our GDP and three million jobs depend upon exports. In fact, Canada's reliance on trade is growing -- between 1980 and 1991, the proportion of Canadian manufacturing output sold abroad increased from 23% to 43%.² This dependence on trade is greater than for many other developed countries, and makes Canada more vulnerable to shifts in trade patterns.

In his recent analysis of Canada's competitive position, Professor Michael Porter³ has demonstrated that our reliance on natural resource exports is significant and increasing. Given the size of the Canadian market relative to international markets, we are essentially a "price taker" with respect to many of these products. Increasingly stringent environmental regulations in industries such as forest products, petroleum, mining, steel and chemicals, can impact upon the competitive position of these industries, since they are not able to pass on the costs of meeting these regulations to their customers in international markets. Without the market power of the United States, Japan and the European Community, Canada stands to be disproportionately affected by a failure to develop clear international agreements and/or understandings on these issues.

Many of these same resource-based industries have also come to realize the extent to which consumer actions and public perception in other countries concerning Canada's environmental record can have an impact upon their ability to sell into those markets. Examples include the European Community's ban on Canadian seal products, and the



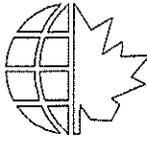
cancellation of power supply contracts between Hydro Quebec and the state of New York.

Finally, the issue is important for Canada since opportunities exist for the development and export of Canadian environmental technologies, products and services. The OECD has estimated that the world market for environmental equipment and services will increase at an average annual rate of 5-6% to \$300 billion by the year 2000.⁴

TRADE, SUSTAINABLE DEVELOPMENT AND COMPETITIVENESS
- SOME FUTURE DIRECTIONS

I turn now to the question of some broad policy directions which I believe should shape the debate about trade and the environment. The most important issues are the following:

1. the extent to which trade measures should be used, either on a multilateral basis or unilaterally, to try to encourage changes in environmental policies;
2. the need to clarify the role of environment within the GATT;
3. how environmental issues should be treated within regional trade agreements;
4. the harmonization of environmental standards, and the extent to which this should be pursued as a goal of international agreements; and,
5. the effects which differing environmental standards may have upon competitiveness.

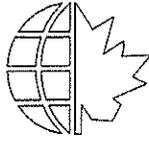


I will briefly describe some of the more important policies relative to each issue.

1. Trade and Environmental Policy - The Carrot or the Stick?

The question of the appropriate means to achieve adherence to a particular set of environmental norms is perhaps the most difficult issue in the trade/environment field. International environmental issues are best dealt with through broad international agreement. Maximizing the number of signatories to international conventions not only strengthens their effectiveness, but also distributes equitably the burden of compliance. Nonetheless, trade measures will always hold considerable appeal (particularly to domestic protectionist elements). But rather than regarding trade measures as a first choice, it is appropriate to ask whether, in the particular circumstances, they would be truly effective, both economically and environmentally. The GATT paper argues that non-discriminatory domestic environmental policies are usually the best way to deal with the problem -- "...revising GATT rules to "legalize" inferior policies...would remove an important incentive for countries to adopt appropriate domestic environmental policies."⁵

Positive incentives are often more effective than negative trade sanctions in upgrading environmental performance. Greater consideration should be given to providing assistance to developing countries to help them improve environmental policies and actions. These include broad economic measures such as debt forgiveness, multilateral aid, and non-discriminatory reductions in trade barriers. They also include more specific mechanisms tied to particular environmental problems, such as funding through the Global Environmental Facility, "debt for nature" swaps, transfers of technology, training and management systems, and assistance in the development of environmental laws and policies, environmental impact assessments and environmental auditing systems.



As a general rule, unilateral actions to deal with environmental issues outside of a country's jurisdiction should be avoided. Establishing appropriate environmental policies and internalizing environmental costs is primarily a national responsibility. A host of unilateral actions by developed countries is likely to be regarded as "environmental imperialism" by developing countries, and at the very least will attract allegations that such actions are really designed to restrict access to developed country markets. Moreover, the reality is that it is only certain countries or blocks of countries (EC, US and Japan) may have the power to unilaterally enforce their view of what constitute appropriate policies. Canada, and many other countries, do not have such power. Use of the trade system should not become power based, ie. by those who have the power to impose their environmental standards on others. GATT, and other such mechanisms, aim to establish a set of neutral rules to ensure that trade does not become the preserve of those who have sufficient economic power.

It must be recognized, however, that moral suasion and offers of assistance may not be enough to encourage adherence to international environmental standards. In some cases, having exhausted other possibilities, trade sanctions, or the threat of trade sanctions, may be the only effective way to enforce an international agreement. But these should have the backing of an international agreement with broad representative membership, and should be subject to the normal GATT rules concerning transparency, national treatment and non-discrimination.

2. Environment and the GATT

There is some question whether the current GATT rules are sufficiently precise to ensure that environmental measures are backed by sound science and are not taken for trade-distorting purposes. Dispute resolution panels under GATT should be provided with criteria for the objective assessment of the scientific basis of a regulation.

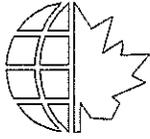


The resolution of trade/environment issues within the GATT system must be in accordance with the normal GATT rules of transparency and non-discrimination. To the extent that environmental measures do have an impact on trade, they should meet the following criteria:

- the effects of the measure on trade should be incidental to its main objective, and should not be excessive in relation to the environmental benefit; and,
- the objective could not be achieved in a less trade-distorting way.

3. Environment Within Trade Agreements

As I indicated earlier, environmental issues will increasingly be a focus of regional trade agreements. The recently concluded North American Free Trade Agreement (NAFTA) commits all three governments to implement the agreement in a manner consistent with protection of the environment. It also contains some important provisions which will likely set a precedent for how these issues are dealt with in of trade agreements in the future. First, it recognizes the right of each country to maintain standards which it considers necessary for the protection of its environment, including those more stringent than international standards. Second, there is a commitment that no NAFTA country should lower its health, safety or environmental standards for the purpose of attracting investment. Finally, it is widely acknowledged that Mexican standards, as written, are often comparable to those existing in Canada and the U.S. What is often missing is the means to enforce them, and NAFTA is accompanied by a series of arrangements for technical cooperation between the three countries. Again, these types of arrangements are increasingly likely to be found in trade agreements between developed and developing countries.



4. International Harmonization of Environmental Standards

In recent years, increasing attention has been directed to the harmonization of environmental standards. International negotiations on environmental issues bring pressure for like commitments and standards from signatory countries. As well, the growth of regional trading blocks results in efforts to seek common rules among the parties.

While, generally, harmonization is the preferred approach to cross-boundary issues, this does not mean that standards have to be harmonized in every respect. Differences in environmental standards can arise because of differing perceptions of the risks associated with certain products or standards, and where significant scientific uncertainty still exists. Countries will have different priorities and differing levels of resources to address environmental issues. This may mean lower standards in some jurisdictions, but could also mean higher standards than the international norm for particularly sensitive environments. In the Montreal Protocol, it was recognized that developing countries would not be ready to sign on to commitments equivalent to those of developed countries, at least in the initial stages. The multilateral negotiation process will have to determine whether different standards are to apply, or simply more time allowed to certain countries to meet common standards.

Even among countries at equivalent levels of development, harmonization will be a difficult process. Rather than absolute harmonization and identical standards, countries should work towards recognition of equivalent and compatible measures. GATT and the OECD should be encouraging a standards development process that is open and accessible.



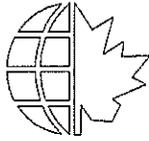
5. Competitive Impact of Variances in Environmental Standards

As the cost of complying with stringent environmental regulations has grown, consideration is increasingly given to the question of whether lower environmental standards in a particular jurisdiction might give a competitive advantage to domestic producers. Already, legislation has been introduced in the U. S. Congress that would put a tariff on goods coming into the United States from countries with weaker environmental standards. Aside from the difficult task of computing the quantum of alleged subsidy, there is a real danger that such an approach could be easily distorted to suit protectionist pressures.

As I indicated earlier, some differences in standards between nations are inevitable, and are not necessarily undesirable. There have always been differences between competing jurisdictions in the policy choices they make, be it taxation, education, R&D, or labour laws. Generally speaking, these have not been considered to be trade distorting. To permit states unilaterally to attempt to make up for these differences is a recipe for trade chaos and economic inefficiency.

Nor is it clear that differences in environmental standards will influence companies in their choice of plant location. In a recent study⁶ on trade and the environment, the World Bank has pointed out that closed protectionist economies, and those in lower states of industrialization, tend to have the most polluting industries (for example in Eastern Europe, Latin America and West Asia). There are several reasons why environmental standards tend not to be a significant factor in investment decisions:

- First, costs of environmental compliance are generally low in comparison to total costs and other factors affecting investment decisions;



- Second, companies are concerned about their reputation in the home market, and potential legal liability;
- Third, "green" consumers in export markets will demand products of a higher environmental standard;
- Fourth, common production methods and processes across plant locations make economic sense; and,

Finally, standards in developing countries are likely to rise over time in any event, and so starting with the cleanest technology makes sense.⁷

CONCLUSION

I have attempted to chart some directions on broad policy issues related to trade and environment. Clearly it will be a major item on the agenda of the United Nations and bodies like the GATT and the OECD. As the trade/environment debate takes shape I believe there are priority issues which need to be examined. These include:

- the appropriate institutional structure at the international level to deal with trade and environment;
- mechanisms to increase the transparency of negotiations on trade and environment issues;
- the impact upon trade of the use of economic instruments to achieve environmental objectives;
- harmonization of environmental standards, and related concepts such as equivalency and mutual recognition;

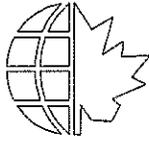


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- the role of sound science and common approaches to risk assessment;
- subsidies and the use of countervailing measures;
- unilateral action and extraterritoriality; and,
- packaging and labelling requirements with respect to the environment, and their potential impact upon trade.

Within Canada, there is an urgent need to consider the implications of the issue for the traded goods sector of the Canadian economy. It will certainly be in Canada's interest to have an articulated policy position on the interaction between trade and environment, and to ensure that, internationally, we have a clear and defined set of rules that prevent environmental measures from becoming non-tariff barriers to trade.

There is no question that we are moving to a world of greater trade liberalization, both within the GATT and through regional trade agreements, and to a greater focus on environmental issues of international significance. Thus, the interrelationship between trade and the environment will increasingly be one of the key items on the sustainable development agenda. How we resolve the interrelationship between trade and environment will be one of the keys to success in fostering greater economic and social progress in all parts of the world.



ENDNOTES

1. General Agreement on Tariffs and Trade, "Trade and the Environment", Chapter 3 of International Trade 1990/91, (Geneva: GATT, 1992).
2. The Canadian Manufacturers' Association, The Aggressive Economy (Toronto: CMA, 1992), pp. 45-47.
3. Michael E. Porter and Monitor Company, Canada at the Crossroads: The Reality of a New Competitive Environment. A study prepared for the Business Council on National Issues and the Government of Canada, 1992. Available from Gilmore Reproductions, Ottawa.
4. OECD, The OECD Observer, Number 177, August/September, 1992.
5. GATT, "Trade and Environment:", op. cit., p. 35.
6. Patrick Low, ed., "International Trade and the Environment:", a report prepared for the World Bank (Washington: The World Bank, 1992).
7. Ibid., p.