January 1992

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The Future: The Impact of Environmental Regulations on Trade

J. Christopher Thomas*

In the international trade area, there are few issues as central to the future of the international trading system as the relationship between trade and the environment. It is timely to consider this topic, because we are beginning to see an increasing awareness of the public, of corporations and of governments of the impact that environmental issues have on the economic structures of our society. The basic international trade rules, which have existed since 1947, are under some pressure to respond to increasing concern for the environment.

I want to first make it clear that I am going to speculate more about the future of the international trade regime as opposed to the future of the international environmental regime. It is very difficult to predict what will happen even in an environmental negotiation that is one or two months away from completion.

I propose to focus on the General Agreement on Tariffs and Trade ("GATT"), talk a little bit about the GATT rules, discuss the intersection between environmental concerns and the existing trade rules, and identify the areas where the rules could require some adjustment. I also want to identify areas where the rules do not require adjustment; they are not properly understood by people who are criticizing them.

A few general observations must be made at the outset. The first is that the GATT is a very peculiar international agreement. It was negotiated in 1947 as an interim agreement. It was really one chapter of the more comprehensive international agreement known as the Havana Charter. The Charter was designed to deal with the post-war international trading system. It was going to be one of the three legs of a "tripod" of international organizations. There was the International Monetary Fund ("IMF") and the World Bank, and the third leg of the tripod was to be the International Trade Organization ("ITO").

The negotiations for the ITO took place over a couple of years. Prior to the final diplomatic conference at which the Charter was to be completed, the United States proposed to twenty-two other countries that an agreement to reduce tariffs amongst those countries be negotiated, based on one of the chapters of the ITO Charter. This turned out

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The following text was compiled from the transcript of the remarks made by Mr. Thomas at the Conference.
to be a most fortuitous proposition, because as events transpired, although the Havana Charter was completed, it was never ratified and did not enter into force. The international community was left with the GATT, which is really based on one of six chapters of the ITO Charter (the other chapters dealt with such issues as investment, restrictive business practices, national employment policies affecting trade, commodity stabilization and the establishment of a more elaborate institutional structure for multilateral supervision of trade).

The point to take from this is that the GATT really deals with one slice of governmental commercial policy or trade policy. It is not an exhaustive or comprehensive trade agreement; rather, it deals with one area of government intervention into the economy, and that is the ability to intervene to control imports and exports.

The second point to note is that the GATT, although originally designed as a tariff agreement of provisional application, was concerned not only with those initial tariff concessions (there have subsequently been a number of rounds of negotiations to reduce tariffs between the countries), but also with establishing a body of rules aimed at maintaining the integrity of these bargains. It should not be surprising that the GATT has something to say about actions which governments take to restrict imports or exports, whether they are motivated by environmental concerns or other concerns. The point here is that GATT contains a series of rules which are designed to impose discipline of governmental trade policy and to maintain the integrity of their commercial bargains.

What are these rules? Without getting too technical, three rules should be kept in mind. The first is that the GATT sets out the basic principle holding that if a country has reduced a tariff on a particular good and has bound that tariff against future increases, it can impose no additional duties, charges or taxes.

Consider the example of an overhead projector. If the United States has reduced its tariff on overhead projectors from fifteen to five percent and has bound that at five percent, it cannot subsequently impose a new tax change of greater than five percent on the importation of an overhead projector. This rule is "no new duties," except in some limited circumstances not relevant to this discussion.

The second rule is that states should not be able to use quantitative restrictions on imports or exports. This, again, makes sense in that if we negotiate a reduction on the duty from fifteen to five percent, but then allow only 500 units to enter the country, such quantitative restrictions have the effect of "nullifying" the tariff concession. So, the basic rule of the GATT is that states may not impose quantitative restrictions on imports or exports, except in some limited circumstances, which again are not relevant to this discussion.

The third rule is that once imported goods cross the border and enter into the domestic stream of commerce, they are to be treated no
less favorably than the like domestic product. Once again, to use the overhead projector as an illustration, if it enters into the United States, and the five percent duty is paid, but then there is a discriminatory sales tax (one which applies only to imported overhead projectors) or there are restrictive rules which relate to the sale of imported overhead projectors, or other rules which apply only to imports and not to domestically produced projectors, such discriminatory rules will run afoul of the National Treatment rule, one of the central obligations of the GATT. It is the obligation of signatories to accord treatment no less favorable than that accorded to the like domestic product.

These three rules are central to the GATT. They are designed to maintain the integrity of the commercial bargains which governments have struck. We should not be surprised, therefore, when actions that restrict imports or exports come under GATT scrutiny to determine their inconsistency with a country's obligations under the GATT.

Note that all of these obligations are subject to a "general exceptions" clause. Article XX of the GATT says that a country's failure to adhere to a provision of the GATT can be justified if the measure falls within one of the exceptions listed in Article XX. One exception, for example, allows a country to take measures necessary to protect human, animal, or plant life or health. Similarly, a country can take measures relating to conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic consumption or production. There are a number of exceptions in Article XX which will justify a country taking action which would otherwise be inconsistent with its GATT obligations.

Let me turn to some of the concerns that have been raised by various people in the environmental camp about the GATT and how it operates. I want to initially discuss some of the concerns which I believe can be quite easily addressed, and then I want to move to the more difficult areas where there is a genuine problem that has to be addressed in order to meet these concerns.

Let me begin by identifying three areas where critics have said that the GATT interferes with the state's ability to deal with environmental concerns. First, there is the argument that countries are constrained in their ability to control the pace of resource exploitation. A second concern is that the GATT rules require countries to sacrifice their national standards — that they are driven to reduce their technical standards to the lowest common denominator — and, therefore, it is not open to a country to have higher than internationally-accepted standards for goods. The third criticism is that the GATT constrains the ability of countries to assist their producers to adjust to the higher cost of environmental compliance.

In my view, all three of these concerns are not well grounded. As to the question of resource exploitation, keeping in mind that the GATT is a trade agreement and deals with governmental actions relating to im-

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Published by Case Western Reserve University School of Law Scholarly Commons, 1992
ports and exports, if one studies the GATT carefully, one sees that the GATT says nothing about the sovereign right to determine whether or not resources should be exploited in the first place. If one were to look at state practice around the world, it would be seen that governments use all sorts of laws and policies to regulate the pace of resource exploitation. There are annual allowable cuts in timber, annual catches or fishing quotas in the fishery and environmental standards that must be met when it comes to damming rivers. There are all sorts of policies and laws which governments use to control the pace of exploitation, or even to refuse to allow resource exploitation in the first place.

Just because many (probably all) governments make ill-informed decisions or decisions that can be criticized on environmental grounds, that does not mean that the GATT is the causal factor. In fact, the GATT says nothing about resource exploitation. What the GATT does say is that if a government permits a resource to be exploited, once the resource is alienated, and is put in a form which is capable of being traded, certain obligations will arise. Specifically, on the export side, a country cannot use government intervention to control the destination of exports.

Consider the concrete example of the obligation which arose in the *Salmon and Herring* case. This was a dispute — actually a two-part dispute between Canada and the United States — which originated in the GATT and concluded under the Free Trade Agreement ("FTA"). Canada had a longstanding export prohibition applying to unprocessed salmon and herring caught off the Pacific Coast. If a person wished to process the resource, it had to be landed and processed in Canada. It was unlawful, under Canada's Fisheries Act to export the unprocessed resource in commercial volumes.

For many years, Canadian fish processors had been importing unprocessed fish from Alaska, processing it and shipping it to world markets. A seafood processor in Juneau, Alaska, tried to buy Canadian salmon and encountered this Canadian export prohibition. The processor complained to the United States Trade Representative ("U.S.T.R."), and the U.S.T.R. said rather than seek mirror legislation in the United States, the U.S would challenge the GATT-consistency of the Canadian law, and it proceeded to do so. It was clear that the Canadian law contravened Article XI of the GATT in that it was an export prohibition, and Canada did not contest that fact before the GATT panel. What Canada did attempt to argue was that the measure was justified as a conservation measure. For a variety of reasons, including statements by ministers and fisheries officials that the prohibition was a good employment-creating measure, the panel did not agree that it was an environmental or resource conservation measure so much as one designed to protect the interests of Canadian fish processors to be able to access one hundred percent of the catch.

Canada agreed to bring itself into compliance with the GATT, and it took action to do so. However, in the view of the United States, Can-
ada's new measure had the effect of replacing one GATT-inconsistent measure with another. Therefore, the United States took Canada to the First Panel under the FTA. The Panel held that the measure was an export restriction, but that with some adjustments, it could be brought into compliance with the FTA. The case was subsequently settled.

The point to note is that the governmental measure in question affected the resource once it had been exploited — once it had been alienated from the sea. This was impugned under the GATT, but the more fundamental question of whether or not the resource should be exploited in the first place is something which is beyond the purview of the GATT.

As an illustration, in the Pacific Northwest, there has been a major battle over the commercial cutting of old growth timber. The spotted owl, which is on the endangered species list in the United States, inhabits, and only inhabits, old growth timber. Environmental activists have been able to use the law protecting endangered species to enjoin the logging of old growth timber in the Pacific Northwest.

At the present time, either through judicial or executive order, the United States has taken much of this old growth timber off the market; the logging of this timber is simply not permitted. It is beyond the realm of possibility that any GATT contracting party would challenge the United States' decision to conserve the resource on the ground that it constitutes a restriction on exports. Why? Because nobody is allowed to exploit it. No logging is permitted to occur in these particular areas. It is not a question of the resource being exploited for domestic consumption but not for export consumption. That is the distinction drawn by the GATT.

Let me turn to the second concern, namely, the concern about technical standards. It is agreed that the GATT constrains the country's ability to impose technical standards upon products.

This is an interesting criticism because, if anything, from the trade policy perspective, the GATT rule which applies to technical standards is considered to be a sovereignty-preserving or sovereignty-enhancing rule. In fact, it may go too far in permitting states to maintain unique national standards. The GATT states in the National Treatment rule, as indicated previously, that once imported goods cross the border, they must be treated no less favorably than the like domestic product. That means that a country is free to regulate as it sees fit with respect to a particular product so long as it does not discriminate against imports. If it wishes to have a fuel consumption standard that requires one hundred miles per gallon of fuel, the state may hold any imported car to that standard so long as it holds the like domestic product to the same standard.

The problem arises in the GATT, for obvious reasons, when the imported product is held to a higher standard than the like domestic product; then, a legitimate question arises as to whether the imported
product is being held to the higher standard in order to afford protection to domestic producers. The essential point is that the GATT rules allow countries to maintain unique and higher-than-internationally-accepted standards so long as they apply the standards in a nondiscriminatory fashion.

There is a provision in the GATT’s Technical Standards Code that raises the concept of “unnecessary obstacles to trade”. However, the Code does not alter the basic right of a party to have high domestic standards consistent with the National Treatment rule. One of the issues that the international community will have to address in the 1990s, which I will just note parenthetically, is the question of scientific justification in determining whether unnecessary obstacles to trade exist.

There has already been a dispute between the United States and the European Community over the use of hormones in the production of beef. The Community permits certain hormones to be used, but they do not happen to be those used by U.S. farmers. Thus, the EC threatened to block the importation of U.S. manufactured beef. The United States argued that its FDA-approved hormones were as efficacious and as safe in terms of human consumption as those permitted in the Community, but the Community responded that they do not meet the standard that it has stipulated.

So, the question arises whether there should be a requirement of scientific justification that disciplines a contracting party’s ability to create its own distinctive national standards. To date, the GATT members have declined to adopt a scientific justification rule. In my view, however, it will be one of the major issues of the 1990s. The acceptance of such a rule will impose more of a constraint on national sovereignty than the existing GATT rule, which says that a state is free to prescribe its own standard so long as it is applied in a nondiscriminatory fashion. I will explain shortly just how significant the existing GATT rule can be in terms of environmental regulations.

The third issue raises the question of adjustment. What happens if a country significantly increases its environmental standards and wants to assist its domestic producers in meeting such standards? The GATT has very weak rules with respect to discipline of subsidies, and it is open to a contracting party to confer a subsidy on domestic producers with a view to assisting them in meeting the increased costs of compliance. In fact, if one refers to the Subsidies Code, an agreement which elaborates upon the basic obligations of the GATT, Article 11 of the Code specifically refers to environmental purposes as one reason why a signatory might want to confer a subsidy. So there is no real prohibition on a contracting party’s ability to subsidize its domestic producers to meet increased costs and achieve environmental compliance.

Consider, however, these two caveats. The first is that if the subsidy is so large as to seriously prejudice the trading interests of another country, then that other country has a right to seek multilateral consultations.
with respect to the subsidy. The second is that if, for example, the United States conferred a subsidy on a certain industrial sector, and producers in that sector shipped products into Canada, there may be exposure to a countervailing duty to offset the effect of the subsidy on the goods if they caused or threatened material injury to domestic production in Canada.

Thus, I do not want to leave the impression that a state is completely free of constraints, but the basic right to confer subsidies for environmental or other purposes is well recognized in the GATT.

I will now turn to the areas that are problematical in terms of the intersection of environmental and trade concerns. There is absolutely no question that the GATT does constrain a state's ability to impose trade restrictive measures, even if they are imposed for environmental purposes. In certain circumstances, such restrictions will be permissible; in others, they will not. Here, it is important to distinguish between two sets of actions. The first are those designed to preserve the environment of the importing state. The second — the more difficult issue in international trade — are those taken to induce changes in foreign behavior or to protect the global commons.

With respect to the first set of actions, there is little to be concerned about. Countries maintain all sorts of standards on imported (and domestic) goods; there are emission standards on automobiles, packaging requirements, performance standards for certain types of products and standards dealing with the composition of products. All of these, as indicated previously, are perfectly acceptable so long as they are applied in a nondiscriminatory fashion. In the environmental context, there is an excellent example which demonstrates that this kind of law or policy can withstand GATT challenge yet have enormous effects on the conditions of competition that exist between imports and the like domestic product: the U.S. state newspaper recycling laws and policies.

A number of U.S. states have decided that they have such an urban landfill problem with used newsprint that they must address the issue by having a minimum recycled content for certain types of pulp and paper consumed in the state. These jurisdictions have required that thirty-five or forty percent of the newsprint consumed within the state contain recycled fiber.

Who could argue with the merits of a law like that? It deals with the landfill problem; to some extent, it leads to recycling of the resource; it may lead to a reduction of the amount of virgin fiber required to make newsprint. It applies on a nondiscriminatory basis. The states have not held only importers to the standard. They have required that all newsprint being consumed in the state contain recycled fiber without distinction as to the origin of the goods.

From the Canadian trading perspective, this law is problematical, because the Canadian newsprint mills are a long way from the "urban
forest” in the United States. Many of our pulp and paper mills have been built in the North or in the nether regions of the country, close to the supply of virgin material. The U.S. state laws and policies are forcing our pulp and paper industry to restructure, either by disinvesting in Canada and investing in the United States to be closer to the source of recyclable material or by shifting to other markets. The Canadian producers are finding that this law or policy, depending on the proximity of the state in question, has had a major impact on their ability to meet the recycled content of the product. They are being confronted with a situation where they may have to import into Canada used newsprint from the United States, de-ink it in Canada (which, by the way, is a very toxic process) and then recycle it for export back to the United States.

This effectively adds another leg of transportation and cost to the production of newsprint. However, the regulation is almost certainly not challengeable under the GATT, as it applies on a national treatment basis. The dramatic economic consequences for Canadian pulp and paper producers are legally irrelevant to the validity of the regulation under the GATT.

That is a good illustration of how the National Treatment rule serves to enhance the state’s ability to deal with this kind of issue. Note further that even if there were a restriction on imports that was contrary to a GATT rule, there is always the possibility that it could be justified under one of the Article XX exceptions.

Let me turn to a much more difficult issue. It arises where a country decides that there is an undesirable element in the production process which should lead to trade restrictions on goods which emanate from that process. This is exemplified by the GATT Tuna and Dolphins case—a case of some notoriety.

The United States Congress has been very concerned about the killing of dolphins when tuna is harvested. Dolphins tend to swim with tuna, and when the tuna is harvested, the dolphins get caught in the same nets as the tuna. The nets entrap the them, and they perish.

The United States Congress enacted a law which deals with the level of permissible “dolphin kills” when harvesting tuna. The U.S. Marine Mammal Protection Act contains a provision which says that if foreign fishermen exceed by a certain percentage the U.S. level of permitted dolphin kills (I believe that in the case of Mexico it is twenty-five percent), then there shall be an import restriction on the tuna which is harvested and exported to the United States. Mexico challenged this provision under the GATT. It was quite clear that this restriction on the importation of tuna, pursuant to the U.S. act, was contrary to Article XI of the GATT. It was an import restriction, and there was little disagreement between the parties on that.

The central question was whether the United States could rely upon the Article XX exceptions of the General Agreement to justify an action
which was otherwise inconsistent with its obligations under the Agreement. The GATT panel said, "No," because the two relevant exceptions upon which the United States relied applied to measures taken to protect the territory of the importing country; that is, the United States' territory, as opposed to the territory of the exporting country or, indeed, the global commons.

The U.S. attempted to argue that the measure was necessary to protect animal life, and therefore fell within GATT Article XX(b). The U.S. also argued that the measure was justified because it related to the conservation of an exhaustible natural resource (i.e., dolphins). The GATT panel rejected the arguments because those exceptions do not have extra-jurisdictional effect, but rather are concerned with actions taken by states to protect their own resources or their own animal life.

Why would the panel have been concerned about extra-jurisdictional effect? At the end of the day, the panel was really concerned with unilateralism. The relevant passages of the panel report note the concern that if the broad interpretation of Article XX suggested by the United States were accepted, each contracting party could unilaterally determine the life or health protection policies from which other contracting parties could not deviate without jeopardizing their rights under the General Agreement. Thus, the panel was concerned about the prospect that unilateral action taken by one country would affect the regulatory policies of another country.

The panel went on to say that the General Agreement would then no longer constitute a multilateral framework for trade among all contracting parties, but would provide legal security only with respect to trade between a limited number of contracting parties with identical internal regulations.

Let me suggest why, on the basis of the existing GATT law, the panel's decision was correct, even though it was met with great outrage in the United States. First, the decision is justifiable because it was concerned with maintaining the integrity of the negotiated rights of access that Mexico had with respect to tuna exports to the United States. Secondly, and more fundamentally, with respect to the GATT exceptions, the fear of unilateralism is well-justified, because once this door is opened, there is the potential for a substantial deterioration of the international trading system — a system which already is not operating as it should due to the ability of states to take unilateral action.

Consider a couple of examples. Cleveland is part of the industrial heartland of the United States. It is common knowledge that one of the longstanding and contentious environmental issues between Canada and the United States has been acid rain. Canadians are convinced that a lot of the acid rain faced in Canada comes from factories or power-generating utilities in the United States which use dirty coal.

What if Canada were to impose a ten percent across-the-board
surcharge on imports of products from the United States because of its failure to deal with the acid rain problem? This would be a clear violation of GATT Article II, but Canada would seek to justify the surcharge, as the United States did in *Tuna*, on the basis of Article XX.

There is a problem of causation. How do we know that the goods produced at Plant A situated in Cleveland have in any way benefitted from dirty coal? Perhaps the plant is the most environmentally clean plant around; it may be using natural gas with no emissions to speak of. The company has a legitimate interest in asking why its market access to Canada should be threatened by a ten percent import surcharge. This illustrates the problem of trade restrictions imposed for production process reasons.

Consider another example. British Columbia has a great deal of water. For argument's sake, assume that the farmers of British Columbia claim to be concerned about the depletion of the Colorado River and the California aquifer. They do not like to see California fruit and vegetable growers benefitting from federal subsidies provided to such an extent that the aquifer is so depleted that the Colorado River never makes it to the Pacific Ocean. Since British Columbia disapproves of U.S. water use policies, Canada decides to impose an import restriction on all fruits and vegetables coming from California. This example is a little easier on the causation side, because we know that one of the major beneficiaries of the depletion of the California aquifer is the horticultural industry.

So, Canada imposes a ten percent surcharge on the importation of fruits and vegetables from California; the farming community wraps itself in the flag of environmental concern for the California aquifer. The United States then responds in kind. One can see that unilateral national determinations of the efficacy of environmental policies of other countries and the imposition of trade restrictive measures as a result could lead to a major undermining of predictability and certainty in the international trade relationship.

There are all sorts of national regulatory policies which deviate from those of other countries, but that has always been recognized as an attribute of national sovereignty. Thus, it is a very slippery slope to begin to permit states to make unilateral determinations of the efficacy of other states' internal regulatory policies. What is the solution? It is not a very happy one, because it is time-consuming and difficult. In my view, however, the issues are addressed in negotiations. We should have some concern for the integrity of the trade system and think very carefully about whether or not we open it up to the kind of unilateral determinations made in *Tuna*. We should be concerned about whether it is the appropriate forum for examining states' differing environmental policies and laws. Environmental issues addressed in the fora which have the expertise, the government constituencies and public interest constituencies that are most knowledgeable about the resolution of the problems, even though
everyone knows it is an extremely wieldy, time-consuming and lengthy process.

Now, this is a state-centric model which respects national sovereignty. To some people that is inadequate, but it is a fact that sovereignty continues to exist even though problems do not respect national territorial boundaries. The environment is the classic example of a set of problems (a set of issues) that do not respect national boundaries. The question is whether or not we should use a state-centric trading model to resolve environmental issues, or whether there should be environmental negotiations which result in multilaterally agreed, rather than unilateral, trade sanctions in the event of noncompliance.

Let me conclude by just noting that for certain concerns raised by critics on the environmental side, the GATT really cannot be faulted. It really does not force the exploitation of natural resources; it does not preclude the maintenance of higher-than-international standards so long as such standards are nondiscriminatory. Although there are some constraints with respect to the question of a state being able to subsidize its domestic producers to deal with environmental compliance issues, I would suggest that they are pretty minimal. Where the GATT does have something to say — and, in my view, quite rightly so — is where states begin to use trade restrictions in order to achieve external environmental goals. If the trade restrictions deal with internal, intra-territorial concerns, they are likely to be GATT consistent. If they are concerned with inducing extra-territorial change, they are likely to be found to be inconsistent with a state's international obligations. The area where I see the greatest need to deal with this intersection between the GATT and the environment is that of how we deal with global commons or pollution problems: environmental problems which do not respect national boundaries. Should we use trade sanctions and, if so, under what circumstances? Do we use them only when we have internationally-agreed standards, or do we allow unilateralism?

I am very concerned about the prospect of unilateralism, however well-motivated it may be in any particular case — and it almost always is. The problem is that we have seen enough erosion of the international trading rules over the last forty years to be concerned about further erosion, even on the basis of well-motivated policies. Do not abandon the policies. The real question is what is the appropriate forum to reach a resolution of the issues.