

January 1993

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Discussion

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Recommended Citation

Discussion, *Discussion after the Speeches of E. Donald Elliott and John L. Howard*, 19 Can.-U.S. L.J. 343 (1993)

Available at: <https://scholarlycommons.law.case.edu/cuslj/vol19/iss/34>

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Discussion After the Speeches of E. Donald Elliott and John L. Howard

QUESTION, *Professor King*: I had a question for Don Elliott. You have a separate set of rules under NAFTA regarding the environment. The GATT has Article 20 which allows regulations under more stringent circumstances. Is this difference going to last or is it workable for the North American countries to operate on this basis and have another set of rules governing world trade?

ANSWER, *Mr. Elliott*: I think we are really just beginning in that area. I do not think one can make too much of the language either. NAFTA would appear on its face to be more favorable to environmental regulation than GATT. Among other things, there are strong provisions in NAFTA that place the burden of proof on the party challenging environmental or other types of regulation. A lot depends on how substantial that burden of proof is ultimately interpreted to be. Similarly, we do not have a lot of experience under the GATT with challenges to environmental regulation and to the extent that there have been challenges they have been decisions in the European Community. I am thinking primarily about the Danish Bottles case.¹ They have been very highly deferential to regulation. One of the key questions has been if there is both a protectionist justification and a plausible environmental justification should the measure be struck down? Is there any sense of attempting to adjudicate? How much of the motivation is for protectionists' purposes? Does a mere scintilla of environmental justification suffice? So far the jurisprudence has said yes. For example, as with the Danish Bottles case, which was concerned with the requirements for recycling measures in Europe, there is a plausible environmental justification but there is also an awareness of the trade benefits that has been sufficient to pass muster.

It remains to be seen whether or not the actual application of the law by the expert panels under NAFTA will be a more searching and probing review. I think a lot more depends on how the principles will actually be applied than on the difference in language between the two.

QUESTION, *Professor King*: John, do you want to comment on that?

ANSWER, *Mr. Howard*: Two things. I do not think there are very many environmental havens left in the world. Most firms, when they want to set up a plant, particularly if it is an environmentally-sensitive plant (such as a Kraft pulp mill), are going to put in the best available environmental technology. When you are building a new

¹ Case 302/86, EUR. COURT REP. 4607 (Judgment of Sept. 20, 1988)

plant it is not a big issue. Virtually all of the serious problems happen when you have an existing plant that is worth \$800 million and is old. It is something you are maintaining, but do not want to put three or four hundred million dollars more environmental expenditure in without improving quality, quantity or productivity of that plant. That is the difficult problem. I do not see all of this trading off in terms of shopping around for an environmental haven. I do not think it is going to happen very often.

On the more specific issue of the decisions by NAFTA, I am optimistic that the very structure of the NAFTA agreement is going to force a contextual analysis by the panels and that they are going to understand the political nature of the decision making concerning the environment and various preferences that are made in different countries in connection with environmental problems. All over British Columbia we have gone crazy with an AOX standard. That is a general organochlorine standard with respect to Kraft mills that should not be confused with the dioxin, which is a specific biocumulative chlorine compound everybody agreed was noxious, to say the least. Throughout this continent Kraft mills substituted chlorine dioxide for elemental chlorine. They are making progress and are close to eliminating the dioxin problem. Nevertheless, without analysis, British Columbia has gone to the level of a zero AOX standard that nobody else in this world has even thought about. The EPA, I believe, is going to put out a report on this in 1995 after three years of very rigorous analysis. The Swedish Institute has come out against an AOX standard. Even the Federal Government of Canada has come out against a general AOX standard.

What is the preference of the community? I would like to have thought that in British Columbia they would do some analysis and, for example, consider some of the air pollution problems that are of a higher priority and have us put our 350 million dollars, or at least part of it, into solving that problem instead of jumping into what was an area of great topicality at the time because the Green Movement was pressing it rather than doing what needs to be done.

COMMENT, *Mr. Elliott*: The legal standard under NAFTA is very similar to the legal standard for judicial review under U.S. law. It is a reasonable or necessary justification necessary under the GATT and has been interpreted as being essentially the same as the due process standard of reasonable support.

The judicial standard in the U.S. has been actually applied in a way that is highly deferential. I have done some empirical study of this and between eighty and ninety percent of judicial review of agency decisions results in affirmance, and that is on all issues.² You really have

² Peter Schuck & E. Donald Elliott, *To the Chevron Station: An Empirical Study of Fed-*

a situation in which judicial review is largely a rubber stamp.

The element of the NAFTA procedural design that holds out some prospect of a somewhat more searching review is that these are not reviews that are conducted by lay judges with general jurisdiction. There is at least the possibility that these will be expert panels of people who have greater expertise in the field, perhaps even scientists. A lot remains to be seen about the actual composition of the panels that would be applying the standard. I think that is going to make a difference. The kind of scientific justification that will pass muster for a judge who is not scientifically trained may be very different than the type of justification that will suffice for someone who has a stronger scientific background.

QUESTION, *Professor King*: I had a question in connection with environmental regulation. Professor Elliott mentioned Superfund and the extra costs that are involved in Superfund. Can the U.S. continue to be far out in front of the rest of the world? Are we in danger of pricing ourselves out of range against countries that do not enforce their environmental regulations or do not have the statutes on the book? Is there a concern about competitiveness?

ANSWER, *Mr. Elliott*: I spent a lot of time looking at the available information on competitiveness. If one looks at the environmental issue in isolation it probably is the case that the U.S. is still rich enough that we could continue to do a lot of not very sensible things and still survive. It has, I think, a cumulative effect, and this is the other side of what John Howard was saying that I agree with very much. When you look at the studies, and this has been studied rather thoroughly, the burden of environmental regulation in almost all industries is so small compared to other cost factors that it is very rarely going to drive the location decision.

Environmental regulatory decisions typically are in the range of about four percent of total cost factors. Environmental regulatory considerations are going to be dominated by proximity to raw materials, transportation costs and labor costs. The environmental regulatory costs cannot be large enough, even on something like Superfund, that their aggregate effect on the economy is likely to cause someone to locate in one country as opposed to another country. That has been rather thoroughly studied in connection with the effect between the United States and Mexico as a consequence with NAFTA.

Having said that, though, any additional cost affects some people at the margins. That is the whole notion of marginalism. Some of the hostile regulatory climate that we see in the environmental area is only one element of a larger regulatory climate which I think is much less facilitative on international competition in the U.S. political culture

than in many of our competitors around the world.

I know more about Germany than I do about Japan, but certainly when they define their environmental regulatory strategies in Germany, they give a good deal more thought than we do to attempting to use environmental regulation in a positive way, to facilitate international competitiveness rather than to retard it. In the U.S., environmental regulation, like other forms of regulation, at a minimum is not used in a positive way, and often times the effects of environmental regulation actually turn out to be perverse from the standpoint of international competitiveness. Not because environmentalists, I think, are consciously motivated to be hostile to industrial development, but more that the international competitiveness factors are simply not taken into account as a part of the design of the regulatory system.

So, therefore, I believe that in the long run we do not have the choice of not having an industrial policy. The types of social regulation in the environmental area and other areas are so pervasive that they are going to have a significant effect on industrial environment; therefore, the question becomes: To what degree are we going to take into account policies other than protecting the environment in designing those regulatory systems?

COMMENT, *Professor King*: It affects not only the existence of the rules, but also the enforcement.

QUESTION, *Mr. Barrett*: For Professor Elliott. You gave some specific ideas of cost and benefits in environmental regulation in the U.S. How do you quantify the benefits of environmental regulations?

ANSWER, *Mr. Elliott*: It is very difficult to quantify the benefits. Although, the benefits of environmental regulation are systematically understated, there are certain benefits you can quantify. You can identify other benefits in addition to those that you are able to quantify, but you are not in a position to quantify. There is a very large body of theory that is developed about how you go about doing that. Most of it has developed in the last ten or fifteen years under the regulatory impact analysis that we do under Executive Order 12291. Basically what you attempt to do is to quantify the damage. For example, you should attempt to sum up the health costs, the loss of employment, the additional deterioration of materials, and so on, that results as a result of, say, air pollution. When you have got that all summed up, you recognize that you only captured a portion of the benefits that are actually out there.

The danger, in terms of cost-benefit analysis, is what Larry Tribe once called "the tyranny of false precision." If you think you have got all the benefits, you are wrong. My view is that any environmental regulation that is in the same order of magnitude of cost and benefits is probably a pretty good idea, because we systematically understated what the benefits are. So, for example, the Clean Air Act of 1990 prob-

ably has calculated benefits on the order of, say, twenty billion dollars a year. The cost estimates are in the range of thirty to fifty billion dollars a year. That does not bother me too much, because I think we probably understated the benefits that we are able to quantify. On the other hand, one regulation at the EPA had a calculated cost in excess of sixty billion dollars and they were predicting that it would save three lives over a hundred-year period. At that point, where you have that kind of disconnect between the calculated benefits and the costs, in a real gross order of magnitude sense, then I think one needs to begin to ask some hard questions. Cost-benefit analysis is a very imprecise tool, but it is very useful if it is used with sensitivity analysis, because it is going to systematically understate the benefits because you can quantify costs much more easily than you can quantify benefits.

Having said that, I still think it is a usable technique because we can essentially know the direction of the error and its approximate magnitude.

QUESTION, *Mr. Couzin*: One thing that was not mentioned by either speaker, which surprises me a bit, is the issue of taxes. A very popular subject of conversation is becoming the use of tax instruments in environmental policy for all different reasons.

It allows people to claim they are using market mechanisms for trade determinants and things like that. It allows you to tax evil people like those who keep their homes and drive cars and things. It allows you at the same time to raise money. It has this dual benefit. Certainly the province I live in is fine. It is very attractive. I wonder what you think about the future use of tax instruments instead of regulatory instruments. I am specifically referring to things like carbon taxes and permits for pollution.

ANSWER, *Mr. Howard*: We are into those in a big way, virtually every place they are used. British Columbia is a classic example. There are totally regressive property or wealth taxes on existing operations. If they had any relationship at all, either to the risk caused by the industrial facility or some threat to human health, I think we could all understand it.

Let me put it in perspective. In the City of Vancouver eighty percent of the pollution is imputable to automobiles, but eighty percent of the air pollution tax is paid by the few industries left in the city. That is how governments work.

What we are all optimistic about is coming up with some kind of trading permits that will get it out of the political system altogether, including out of the tax system. We have great difficulties in determining who is going to get what tradeable credits with respect to old mills, new mills and so on, but the whole purpose of that policy is to try to get it out of that regulatory system and into the marketplace.

ANSWER, *Mr. Elliott*: I am a great believer in market-based or

incentives systems. However, I do not think they can completely replace command and control.

As a purely theoretical level, the most beautiful system is to set a tax, as John indicated, based on the level of damage, and then the market allocates it as most efficiently how it can be done. The difficulty is that people who talk about market failure often do not have a comparable theory of government failure. One of the difficulties that we have found in terms of experience is, at least in our system, tax proposals seem to be much more subject to rent seeking and political manipulation. The notion that assumes you can set a perfect tax based on the damage function in some way assumes away the problem. One of the reasons that, as a practical matter, we have gone in the U.S. increasingly to tradeable permit systems as opposed to tax systems is that our experience is they are much less susceptible to the types of political manipulation than are taxes.

In principle, I am quite favorable to the use of tax incentives as a purely professorial theoretical matter. However, I think as a practical matter, tax mechanisms tend to be much more subject to political distortion and manipulation at least in our system. That has caused them to be less useful than they might have been.

QUESTION, *Mr. Fay*: President Clinton has said he wants to do something about Mexico and redraft NAFTA. I got the impression that he is still up in the air about where he stands and what Congress is going to do. Do you have a crystal ball as to what can happen?

ANSWER, *Mr. Elliott*: As I have read his statements, he has very carefully avoided saying he wanted to redraft NAFTA. In fact, what I think he has said and what they appear to be doing is not attempting to renegotiate the text of NAFTA, but to have a parallel process for the implementation of NAFTA in which they are negotiating a series of additional side agreements that will attempt, to some extent, to assuage the concerns by some of the constituency groups. Then I think they will declare NAFTA to have been fixed, at least to some degree, by these side agreements. That is currently going on in terms of defining, for example, the procedures to be followed by the North American Commission on Environment.

One of the great concerns that the environmental groups had is, as originally drafted, NAFTA was silent as to whether or not they had a seat at the table, whether or not they had a role, whether they could participate, and what the composition of these groups would be. I suspect that what will happen is that there will be no renegotiation of the basic text of NAFTA, but there will be a number of things that are being done and will continue to be done in sort of a parallel track of how NAFTA is going to be implemented.

ANSWER, *Mr. Howard*: What I was going to do in a more formal presentation was try to suggest some of the things that I think

should be done. This is derived from a very good article by Richard Stewart in the current Washington and Lee Law Review. If there is anything we need, it is some more particularization of not the standards but the factors that are to be considered when people are making these decisions. NAFTA itself already puts the onus on the person blocking trade to justify the environmental grounds for putting up the block. In addition, you want to look at the entire context in which this is done, the relative resources, the source of the resources, and the production and the dependence of the supplier on them. You want to look at the trade relationships, you want to look very closely at the motives of the people raising the block to try to determine what the adverse impact is on trade, look for trade neutral ways to solve the problem and, finally, again, consider whether the remedy is totally disproportionate to the threat. This is another way of saying is it a trade blocking pretext or is it truly an environmental ground?

ANSWER, *Mr. Elliott*: I do not agree with all of that. The question really is how far are the environmental and labor groups going to be able to move the Clinton Administration in getting assurances that NAFTA will be interpreted in a "pro-environmental way" as a price for getting the Clinton Administration's support for NAFTA. That is, in fact, the process that is currently going on.

COMMENT, *Professor King*: I did want to indicate before we close that the proceedings of our last conference which dealt with environmental regulation are being used by some of the negotiators in Mexico City who are meeting there now.

