Handbook on Trade and the Environment

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*Steve Charnovitz**

Introduction

This chapter offers an introduction to the trade and environment debate. Readers of this *Handbook* will encounter many different approaches to these complex issues. What I seek to do here is to provide historical, political and legal context for analysts who try to understand and, ultimately, to solve trade and environment problems. Following this introduction, the chapter has two sections. The first puts the contemporary debate in historical context and explains how the trading system got to the point where it is today. The second section provides a legal guide to the provisions of World Trade Organization (WTO) agreements that relate directly to the environment.

History and context

International policies on trade and on environment have always intersected. The earliest multilateral environmental agreement (MEA), the Convention for the Protection of Birds Useful to Agriculture, signed in 1902, utilized an import ban as an environmental instrument.[1] The earliest multilateral trade agreement to pursue trade liberalization, the Convention for the Abolition of Import and Export Prohibitions and Restrictions, signed in 1927, contained an exception for trade restrictions imposed for the protection of public health and the protection of animals and plants against diseases and against 'extinction'.[2]

As environmental regimes evolved over the twentieth century, trade instruments continued to be used by governments seeking workable environmental protection. When the postwar multilateral trading system was designed in 1947–48, governments recognized the need for some policy space to accommodate the use of trade measures as instruments to safeguard the environment and health. The General Agreement on Tariffs and Trade (GATT) of 1947 contained provisions in Article XX (General Exceptions) to accommodate governmental measures necessary for the protection of life and health, and measures relating to the conservation of exhaustible natural resources. Although it never came into force, the Charter of the International Trade Organization provided an exception for measures taken 'in pursuance of any inter-governmental agreement which relates solely to the conservation of fisheries resources, migratory birds or wild animals . . .'.[3]

In these first-generational 'trade and environment' policies, the two regimes recognized some linkage to the other, but did not actively look for ways to enhance each other's goals. For example, the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES), signed in 1973, uses trade bans as a central instrument for the management and enforcement of wildlife policies. For many years, however, CITES was not fully attentive to how controlled trade could enhance sustainable management. Similarly, the GATT system was often not attentive to how its normative activities to

address non-tariff barriers were being perceived in the environmental community as a challenge to the legitimacy of environmental measures.

With few exceptions, until the early 1990s, there was very little communication between trade officials and environment officials operating at the international level and not much more at the national level. As a result, the trade effects of environmental laws and regulations were often not considered by the governments imposing them. Similarly, the environmental effects of trade and investment liberalization, and the impact of trade law disciplines were often not considered.

As a result of the new 'trade and environment' debate beginning in the early 1990s, there is now much greater understanding of these linkages. Trade officials at the WTO and in national capitals are much more aware of the linkages between trade and environment, and say that they are committed to avoiding conflicts. Similarly, there is greater recognition by environmental officials as to how trade restrictions can be overused or misused in the pursuit of environmental goals. Considerable credit should be given to many foundations, non-governmental organizations (NGOs), institutes and business groups that devoted attention to these issues from the early 1990s onward.

Of course, the fact that international policy on the 'trade and environment' is more coherent and constructive now than it was in the 1980s and 1990s does not mean that this level of progress is sufficient or that the underlying problems have been solved. Environmental problems will always be a challenge on a planet where governmental units do not exactly match ecosystems. Another way of saying this is that so long as the policies in one country can impose externalities on others, and so long as prices in the market are not fully reflective of environmental costs, there will be a need for international governance to manage the transborder conflicts that will inevitably ensue. In a recent speech, WTO Director-General Pascal Lamy explained that governance 'is a decision-making process that through consultation, dialogue, exchange and mutual respect, seeks to ensure coexistence and in some cases coherence between different and sometimes divergent points of view' (Lamy, 2006). That will be a key challenge for global governance in the twenty-first century.

Because all major ecological problems affect the world economy – for example, climate change, biodiversity, forestry, fisheries and pollution – linkages between the world trading system and environmental policies are inevitable. In Lamy's paradigm, there is a need for governance because individual governments acting alone will not, as a practical matter, adopt policies that are efficient on a global scale. Although individuals can act in a self-interested way in the market knowing that an invisible hand exists to help generate efficient outcomes, the same overall pro-efficiency dynamic does not automatically ensue in global politics if governments act only in a self-interested way toward other countries.

One of the contributions of environmentalist Konrad von Moltke, about 20 years ago, was the dictum that 'unmanaged environmental problems become trade problems'. There are two insights in this dictum. The first is that major environmental problems can never be definitively solved; new developments will always spawn new problems that require new solutions and better management. The second insight is that governments need to cooperate to solve environmental problems, and when such cooperation is not forthcoming, a government stymied in getting the cooperation it seeks may resort to a trade measure. This dynamic of environmental problems spilling out into the trading system can be seen in many of the major trade–environment conflicts to date.

Recently, this danger has become apparent in the proposals being made for a climate tax or tariff to be imposed on imports from countries that have not ratified the Kyoto Protocol to the UN Climate Change Convention or are not controlling their greenhouse gas emissions (Bennhold, 2007, p. 10). Because many governments are not cooperating on addressing greenhouse gas emissions and other energy conservation challenges, frustration is spilling out into the trade arena. In the case of climate change, trade measures are being suggested as a way either to level the playing field between countries with different levels of energy tax or to induce free-riding countries to cooperate gainfully.

Because the WTO is a functional international organization with a mandate for trade, WTO law does not generally address government policies beyond trade, but rather leaves those issues to environmental institutions. This approach has clear advantages and disadvantages. The advantage is that the WTO sticks to its technical competence and leaves environmental decisions to organizations with that technical competence. The disadvantage is that in trade and environment, the WTO looks only at one side of a problem. For example, in the *United States–Shrimp* case, the WTO considered the appropriateness of the US import ban directed at countries that the US government believed were not adequately protecting sea turtles. But the WTO did not consider whether the complaining governments were adequately protecting sea turtles. Because it is partial rather than holistic, WTO dispute settlement may not be able to achieve a satisfactory solution to complex disputes regarding the 'ecolonomy', that is, the overlay of the world ecology and economy.

This legal point has an analogue in the economic critiques of international trade law and WTO negotiations that point to the uncertainty as to whether trade liberalization will always benefit the participating countries. For example, the impact of services regulation on an economy will depend to some extent on whether the liberalizing government has an adequate regulatory regime in place. In other words, an adequate regulatory regime can be viewed as a precondition of fully benefiting from trade liberalization. The same point can be made regarding whether a government has in place an adequate legal system, adequate competition policy, adequate openness to investment, adequate adjustment assistance for workers and farmers, and adequate environmental controls. All of these policy preconditions have in common the fact that the WTO generally does not have rules assuring that non-trade policies are adequate for trade liberalization.

Beginning with Agenda 21 (1992), governments have affirmed that trade and environment policies should be 'mutually supportive in favour of sustainable development'.[4] This mantra is inscribed in the Doha Ministerial Declaration where the WTO members state: 'We are convinced that the aims of upholding and safeguarding an open and non-discriminatory multilateral trading system, and acting for the protection of the environment and the promotion of sustainable development can and must be mutually supportive.'[5] This phraseology has been adoptable because there is something in it for all sides of the debate. Those who view the trading system as already supportive of the environment can point to the way that trade can positively contribute to environmental goals. On the other hand, those who are skeptical of the benefits of trade for the environment see the mutual supportiveness as a commitment by the WTO to carry out the Doha agenda in a way that actually does deliver some environmental benefits. My guess is that if there is a Doha Round agreement, it will contain significant environmental language (Lamy, 2007).

Guide to WTO treaty provisions addressing the environment

This section examines the various provisions of WTO law that address the environment. The Marrakech Agreement Establishing the World Trade Organization (WTO Agreement) mentions the environment and sustainable development in its Preamble. The Appellate Body has stated that the WTO Preamble informs the interpretation of the WTO covered agreements, and the jurists used the language above in the *US–Shrimp* case to help interpret the WTO provisions at issue (Cameron and Campbell, 2002, p. 30).

The foundational WTO Agreement on trade in goods, the GATT, contains General Exceptions to all rules in that Agreement, including the disciplines governing import bans, domestic taxes and border tax adjustments. Although most environmental measures can be carried out without infringing WTO rules, a trade-related environmental measure (TREM) may come into conflict with trade rules.[6] With respect to the environment, Article XX (General Exceptions) states:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:
> . . . (b) necessary to protect human, animal or plant life or health;
> . . . (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption. The introductory paragraph to Article XX, known as the 'chapeau' has been interpreted by the Appellate Body as a condition for the use of any of the Article XX exceptions. The chapeau is examined after a disputed measure is found to qualify provisionally under one of the specific exceptions. Both the (b) and (g) exceptions would be usable for an environmental measure. A panel adjudicating Article XX should first consider the threshold question to see if the governmental measure being litigated fits within the range of policies covered by the exception. If so, then the specific discipline in that exception would be examined. The Appellate Body has allocated the burden of proof to the defendant government for all steps of the Article XX analysis.
>
> For measures regarding human, animal, or plant life or health, the (b) exception requires that the measure be 'necessary', and that term has been applied strictly. In *EC–Asbestos*, the Appellate Body found that the XX(b) exception could justify the contested measure. According to the Appellate Body in that case, the term 'necessary' in Article XX(b) requires that there be no reasonably available and WTO-consistent alternative measure that the regulating government could reasonably be expected to employ to achieve its policy objectives. To determine whether a potential alternative is reasonably available, a panel will engage in a 'weighing and balancing process' that considers: (1) the extent to which the alternative measure 'contributes to the realization of the end pursued', (2) whether the alternative measure would achieve the same end, and (3) whether the alternative is less restrictive of trade.[7]

The Article XX(d) exception could also be relevant to environmental measures. That exception is for measures necessary to secure compliance with certain laws or regulations that are not GATT-inconsistent. In the *Mexico–Taxes on Soft Drinks* case, the Appellate Body held that this exception is designed only to secure compliance with a WTO member's own laws and regulations. This holding would seem to preclude the use of the XX(d) exception to justify laws, such as the US Lacey Act,[8] that prohibits importation of fish taken in violation of any foreign law.

For measures regarding the conservation of exhaustible natural resources, the (g) exception requires that the disputed measure be 'relating to' such conservation. In *US–Shrimp*, the Appellate Body ended the controversy as to whether 'exhaustible' natural resources

were distinguishable from renewable resources (such as turtles) by holding that exhaustible natural resources includes both living and non-living resources. The issue of whether there is an implied jurisdictional limit to Article XX(g), that is, whether the natural resources being protected by the contested measure must be within the territory of the defendant country, remains unresolved. In the *US–Shrimp* case, the Appellate Body seemed to suggest that there had to be a 'sufficient nexus' to the defendant country.[9] The term 'relating to' has been interpreted by the Appellate Body to require an examination of whether the general structure and design of the measure is reasonably related to the ends sought and are not disproportionately wide in scope. In addition, the (g) exception further requires that a measure applying to imports be made effective in conjunction with restrictions on domestic production or consumption. In *US–Gasoline*, the Appellate Body held that this clause requires 'even-handedness' in the imposition of restrictions, in the name of conservation, upon the production or consumption of exhaustible natural resources.[10]

The applicability of GATT Article XX to process-related measures (PPMs) is controversial. In the *US–Shrimp* case, the Appellate Body ultimately ruled that a US import ban on shrimp from Malaysia was WTO-consistent even though it was linked to Malaysia's conservation practices.[11] On the other hand, the WTO Secretariat continues to declare that 'trade restrictions cannot be imposed on a product purely because of the way it has been produced'.[12] The issue of process-related taxes can also raise questions regarding the exceptions in Article XX as well as the underlying GATT rules on the imposition of taxes on imported products and border tax adjustments on imported or exported products. If taxes get used more widely as an instrument to address climate change and to promote the use of clean energy, some tax disputes may be brought to the WTO. The availability of Article XX to justify measures against so-called eco-dumping or against MEA violations has not been litigated.

As for all WTO rules, the WTO dispute settlement system prescribes trade sanctions as an instrument to induce compliance when trade rules are being violated. Ironically, the WTO is the only international organization (other than the UN Security Council) to use trade sanctions in that manner. The implementation system for MEAs relies more on the soft powers of persuasion and capacity-building. When MEAs use trade controls, the only trade blocked is the natural resource being regulated by the MEA.

Violations of GATT obligations were found in the *US–Gasoline* and *US–Shrimp* cases, and in both instances the US government corrected the violation without sacrificing its environmental policies. The experience in both cases demonstrates the focus of panels on the means used to achieve an environmental aim, not a second-guessing of the ends sought to be achieved. Of course, one should note that both of these cases involved an Appellate Body decision that reversed the lower-level panel on key points. The original panel decisions, if carried to their logical conclusion, had seemed to undermine the right of a government to carry out environmental regulation that affected trade.

The only pending environmental case is *Brazil–Measures Affecting Imports of Retreaded Tyres*. This is a complaint filed by the European Communities about Brazil's import ban on retreaded tires. In June 2007, the panel issued a report rejecting Brazil's invocation of the GATT Article XX(b) exception. As of this writing, that panel report has not been adopted.

Besides the GATT, several other WTO agreements supervising trade in goods also include provisions pertaining to the environment. For example, the Agreement on

Agriculture declared that fundamental reform is an ongoing process and committed parties to begin new negotiations in 2000. These negotiations are to take into account the so-called 'non-trade concerns, including food security and the need to protect the environment'.[13] The Agreement on Agriculture contains a so-called 'green box' list of subsidies that have an exemption from reduction commitments, so long as they have at most minimal trade-distorting effects or effects on production.[14] The WTO Secretariat has opined that this green box enables governments to 'capture positive environmental externalities'.[15] Yet I am unaware of any research on the true value for the environment of green box subsidies.

The Agreement on Technical Barriers to Trade (TBT) contains a complex set of rules regarding government and private regulatory systems. A central rule is that technical regulations not be more trade restrictive than necessary to fulfill a legitimate objective. The TBT Agreement includes, among an illustrative list of objectives, the 'protection of human health or safety, animal or plant life or health, or the environment'.[16] Furthermore, TBT requires governments to use international standards as 'a basis for' technical regulations except when such standards would be an ineffective or inappropriate means for the fulfillment of the legitimate objectives pursued.[17] The applicability of this requirement to international environmental standards has not been well defined or litigated.

Despite the mention of processes and production methods (PPMs), the extent to which these come within the scope of the TBT Agreement remains unclear. For example, would the sustainable fisheries label devised by the Marine Stewardship Council be a TBT measure? Another ambiguity in the TBT Agreement is whether the rules for conformity assessment by non-governmental bodies would apply to organizations such as the Forest Stewardship Council and Green Seal.

The Agreement on the Application of Sanitary and Phytosanitary (SPS) measures governs trade and domestic measures imposed to prevent risks to life or health from pests, diseases, additives, contaminants, toxins and disease-causing organisms. The governmental responses to epidemics, in so far as the ensuing policies involve trade in goods, are also governed by the SPS Agreement.[18] The SPS Agreement was written with a focus on food safety and veterinary concerns, and, at one time, trade law commentators thought that environmental regulations would be governed by the TBT Agreement rather than the SPS Agreement. Yet in 2006, the WTO panel in *EC–Approval and Marketing of Biotech Products* gave a broad interpretation to the scope of the SPS Agreement and emphasized that the Agreement could cover 'certain damage to the environment other than damage to the life or health or animals or plants'.[19] This precedent may mean that the disciplines of the SPS Agreement, which are among the strictest in the WTO, will collide more with TREMs in the future.

When a measure is covered by the SPS Agreement, it is subject to numerous rules. For example, SPS measures affecting trade have to be based on a risk assessment and cannot be maintained without sufficient scientific evidence.[20] SPS Article 3 directs governments to base their SPS measures on international standards, but allows governments to set a higher level of protection than exists in the international standard. The Appellate Body has taken note of 'the delicate and carefully negotiated balance in the SPS Agreement between the shared, but sometimes competing, interests of promoting international trade and of protecting the life and health of human beings'.[21] In that holding, the Appellate

Body seems to view the SPS Agreement as embodying a choice between trade and life/health. Another rule in the SPS Agreement is that regulatory measures (for example, a maximum residue limit on pesticides) not be more trade restrictive than required to meet the importing government's appropriate level of protection.

The Agreement on Subsidies and Countervailing Measures (SCM) supervises the use of domestic and export subsidies by governments, and the imposition of countervailing duties against subsidies. The SCM Agreement does not contain disciplines exclusively for environmental subsidies. Nor does it incorporate the polluter-pays principle. As negotiated in the Uruguay Round, the SCM Agreement contained an article (Article 8) making certain subsidies non-actionable. Listed among the non-actionable subsidies were financial contributions by governments for adapting existing facilities to new environmental requirement (subject to specified conditions). In so far as these subsidies are used to address market failure, the SCM Agreement manifested some sensitivity to the fact that some subsidies may be justifiable for economic reasons even if they distort trade. At the end of 1999, however, SCM Article 8 expired. With the expiration of this provision, an environmental subsidy can be 'actionable', which means that if a subsidy is 'specific' and causes 'adverse effects' to the interests of other WTO members, then that subsidy would violate the SCM Agreement.[22] The remedy for such a violation would be for the subsidizing government to withdraw the subsidy or remove the adverse effects.

The foundational agreement on trade in services, the General Agreement on Trade in Services (GATS), contains General Exceptions to all rules in the Agreement. The structure of the GATS General Exceptions, found in GATS Article XIV, is similar to the structure of GATT Article XX in having a chapeau like the one in Article XX and a list of specific exceptions. The GATS includes an exception for measures necessary for the protection of life and health, but does not include an exception regarding conservation or the environment. So far, this omission has not proved significant because no environment-related service measure has been challenged in WTO dispute settlement. The Preamble to the GATS recognizes 'the right of [WTO] members to regulate, and to introduce new regulations, on the supply of services within their territories . . .'[23] Nevertheless, that language did not impede the finding of a violation in the *US–Gambling* case, which involves a US ban on internet gambling without regard to whether the gambling services originate domestically or in other countries. In that dispute, the Appellate Body held that the challenged measure came within the scope of the GATS General Exception, but further held that the US measure did not qualify for an exception because the US government had not demonstrated that, with respect to horseracing, the regulations on remote gambling were not less favorable to foreign suppliers than to domestic suppliers.[24] If this decision means that government consistency is a precondition for a right to regulate, then that principle could work against the integrity of environmental regulations.

The foundational WTO agreement on intellectual property rights, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), does not contain an overall environmental exception. Article 8 of TRIPS states that WTO members 'may' adopt measures necessary to protect public health and nutrition, provided that such measures are consistent with TRIPS. Thus this provision is merely circular and lacks any content. The rules in TRIPS that would seem most likely to be in interface with environmental regulation are the requirements in Part II, Section 5 regarding the granting of patent rights to nationals of other WTO member countries. Section 5 provides that WTO

members may exclude from patentability inventions if 'necessary' to 'protect human, animal or plant life or health or to avoid serious prejudice to the environment', and further provides that members may exclude from patentability plants and animals other than microorganisms provided that plant varieties receive protection either through a patent or an effective *sui generis* system.[25] The meaning of these optional exclusions from patentability has not yet been explicated in WTO dispute settlement.

Conclusion

So much for the legal details; I conclude this chapter with a thought for the future. What can environmental policy-makers learn from the trading system? For some, the answer is the importance of the principles of non-discrimination and free trade. In my view, that misses the point because the WTO rejects these principles as much as it embraces them.[26] The real lesson from the WTO is the success of an international regime that uses higher law to enable governments to enact and lock in optimal policy changes that would otherwise be hard to adopt because of vested interests. As Daniel Esty noted many years ago, importing that approach can be beneficial for environmental law (Esty, 1994, p. 230).

Notes

* Parts of this chapter draw from a study prepared for the World Bank Institute in 2007.

1. Convention for the Protection of Birds Useful to Agriculture, 19 March 1902, 102 BFSP 969, art. 2 (no longer in force).
2. Convention for the Abolition of Import and Export Prohibitions and Restrictions, 8 November 1927, 97 LNTS 391, art. 4, ad art. 4 (not in force).
3. Havana Charter for an International Trade Organization, 24 March 1948, art. 45.1(a)(x) (not in force), available at http://www.wto.org/english/docs_e/legal_e/prewto_legal_e.htm.
4. UN Conference on Environment and Development, Agenda 21, para. 2.21(b).
5. Doha Ministerial Declaration, WT/MIN(01)DEC/1, 14 November 2001, para. 6.
6. A TREMs is a measure in an environmental treaty, law or regulation that affects trade. Disputes about TREM can be lodged in the WTO. For example, the *EC–Asbestos* case involved a complaint by the Government of Canada about a French decree that banned the manufacture, sale, or importation of asbestos fibers and any product containing such fibers. The purpose of the decree was to prevent harm to human health. TREMs that inhibit trade are regularly used for environmental purposes. Of course, most measures that inhibit trade are trade measures, not environmental measures. For example, tariffs, quotas and countervailing duties are trade-related trade measures.
7. Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, paras 162–72.
8. 16 USCS §3372(a)(2)(A).
9. Appellate Body Report, *United States–Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998, para. 133.
10. Appellate Body Report, *United States–Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, pp. 20–21.
11. Appellate Body Report, *United States–Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/AB/RW, adopted 21 November 2001.
12. WTO, 'The environment: a specific concern', available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey2_e.htm. The Secretariat does not cite any legal authority for this assertion.
13. Agreement on Agriculture, Preamble recital 6, art. 20 (c); Doha Declaration, para. 13.
14. Ibid. Agreement on Agriculture, art. 6.1, Annex 2, paras 2(a), 12. Among the listed subsidies are infrastructure works associated with environmental programs and payments under environmental programs. Eligibility for such payments has to be determined as part of a clearly defined government environmental or conservation program and be dependent on the fulfillment of specific conditions. Moreover, the amount of payment has to be limited to the extra costs or loss of income involved in complying with the government program.
15. WTO, 'Relevant WTO provisions: descriptions', available at http://www.wto.org/english/tratop_e/envir_e/issu3_e.htm.
16. TBT, art. 2.2. See also ibid., art. 5.4. This requirement also applies to voluntary international standards.

17. Ibid., para. 2.4.
18. Measures to control cross-border travel of natural persons supplying or consuming services would be governed by the WTO Services Agreement. It is interesting to note that the World Bank counsels that trade and travel restrictions could be appropriate instruments to address an avian flu epidemic (World Bank, 2007, p. 146).
19. Panel Report, *EC – Measures Affecting the Marketing and Approval of Biotech Products*, WT/DS291/R, para. 7.209, adopted 21 November 2006.
20. SPS arts 2.2, 5.1. In instances where scientific evidence is insufficient, a government may provisionally impose SPS measures based on pertinent information. See SPS art. 5.7.
21. Appellate Body Report, *EC–Asbestos*, ibid. para. 177.
22. SCM Agreement, arts 1.2, 2, 5.
23. GATS Preamble.
24. Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS286/AB/R, paras 371–2, adopted 20 April 2005.
25. TRIPS arts 27.2, 27.2(b).
26. For example, the WTO permits preferential trade agreements and antidumping duties against low-price imports.

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