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Redesigning Canadian
Trade Policies for
New Global Realities



Edited by Stephen Tapp, Ari Van Assche and Robert Wolfe

About this chapter

Scott Vaughan is president and CEO of the International Institute for Sustainable Development (IISD), a global sustainability think tank headquartered in Canada. He has worked for Canada's Commissioner of the Environment and Sustainable Development, and he was a counsellor with the World Trade Organization, head of economics at the NAFTA Environment Commission and a visiting scholar at the Carnegie Endowment for International Peace.

Redesigning Canadian Trade Policies for New Global Realities, edited by Stephen Tapp, Ari Van Assche and Robert Wolfe, will be the sixth volume of *The Art of the State*. Thirty leading academics, government researchers, practitioners and stakeholders, from Canada and abroad, analyze how changes in global commerce, technology, and economic and geopolitical power are affecting Canada and its policy.

Chapter summary

Sustainable development is one of the most difficult policy challenges of our time. It is also closely linked to the global trading system. In this commentary, Scott Vaughan (President of the International Institute for Sustainable Development) describes how environmental concerns have become part of international trade policy over the past two decades, and discusses some of the implications for Canada.

Vaughan says that properly crafted trade and environmental policies can work together to promote better outcomes and encourage sustainable development. As a trader of environmental goods and services, Canada has much to gain from concluding trade deals such as the Environmental Goods Agreement. This is an ongoing negotiation among several World Trade Organization members that seeks to liberalize trade in a broad range of environmental goods (for example, renewable energy).

More generally, Vaughan argues that strengthening the multilateral trading system is in Canada's long term interest and will contribute to achieving the new United Nations sustainable development goals. It will not be easy, but Canada has the bureaucratic capacity and diplomatic skills to make a difference.

Résumé de chapitre

Le développement durable est l'un des plus grands enjeux de notre temps. Et il est indissociable du système de commerce mondial. Scott Vaughan, président de l'Institut international du développement durable, décrit dans ce commentaire comment les préoccupations environnementales sont devenues en 20 ans partie intégrante des politiques commerciales internationales, et examine l'incidence de cette évolution sur le Canada.

Des politiques commerciales et environnementales bien conçues peuvent favoriser conjointement l'obtention de meilleurs résultats en matière de développement durable, soutient-il. Pays marchand de produits et services environnementaux, le Canada a ainsi tout à gagner d'ententes comme l'Accord sur les biens environnementaux. Cet accord de libéralisation des échanges est en cours de négociation entre plusieurs États membres de l'Organisation mondiale du commerce et cible un vaste éventail de biens (entre autres ceux liés à la production d'énergie renouvelable).

Plus généralement, le renforcement du système de commerce multilatéral sert les intérêts à long terme du pays et contribuera à la réalisation des nouveaux objectifs de développement durable des Nations unies. Le défi est de taille, mais le Canada possède les capacités administratives et les atouts diplomatiques pour jouer un rôle clé dans ce processus.

Trade and Sustainable Development

Scott Vaughan

SUSTAINABILITY IS THE DOMINANT POLICY CHALLENGE OF OUR TIME, FROM THE imperative of reducing the rate of climate change through ensuring that people everywhere have enough to eat.¹ Sustainable development has three dimensions — economic, social and environmental — and trade policy is intimately involved in each one. Trade can be part of the problem, if it encourages pollution havens and heedless damage to the environment; and it can be part of the solution, if it allows optimal use of resources while enhancing access to the most efficient technologies. Trade can also be the vector through which one country's environmental policy preferences affect others, as is the case with the European Fuel Quality Directive (which would establish a “default carbon intensity” value for fuels derived from conventional crude oil) and US resistance to the Keystone XL pipeline (which would transport crude oil from western Canada to the southern United States), both of which put pressure on Canadian energy policy. Moreover, barriers to trade, such as limits on foreign market access, can reduce Canadian exports of clean technologies, thereby undermining the productivity of the sector.

In this commentary I review how “sustainable development” was introduced into the trading system and how it has affected the recent trend to bilateral and regional negotiations. I then assess the likely agenda going forward, and draw implications for Canadian trade policy.

Sustainable Development and Trade Agreements

IN 1987, THE BRUNDTLAND COMMISSION REPORT DEFINED SUSTAINABLE DEVELOPMENT as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs” (Asafu-Adjaye 2004, 417).

Although some view stronger world trade rules as an essential component of sustainable development, others see international trade as having a negative impact (George and Kirkpatrick 2004). Trade agreements first included sustainable development objectives over two decades ago, when the North American Agreement on Environmental Cooperation became the essential piece of the political puzzle that allowed ratification of the North American Free Trade Agreement (NAFTA) by Canada, the United States and Mexico. Around the same time, the preamble of the 1994 agreement that created the World Trade Organization (WTO) stated that trade in goods and services should take into account “the optimal use of the world’s resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of development” (WTO 1994).

These critical agreements emerged at a time of fierce debate about the relationship between trade and the environment. Environmentalists worried that trade liberalization would increase the scale and specialization of production and weaken domestic environmental regulations in a race to the bottom that would create pollution havens. This view assumed that higher standards could lead either to demands for lower standards, in order to become more competitive with standards elsewhere, or to decisions by companies to move from higher-cost to lower-cost countries.

Just as trade issues have a wide reach, the environment is an aspect of virtually everything that the trade regime touches, including agriculture, industrial policy, subsidies and dispute settlement. Neither the environment nor trade stands alone. Properly crafted, trade and environmental policies can be mutually supportive, leading to better outcomes and encouraging sustainable development. In reality, however, it is difficult to work out how best to marry trade and environment aspirations (Halle 2014). Trade policy practitioners tend to focus on increasing the flow of traded goods and services, and they can be impatient with factors, such as the environment, that they consider extraneous to trade concerns. Likewise, environmental policy practitioners sometimes underestimate the impact of environmental measures on trade. In both cases, this occurs less out of ill will than because the two policy communities largely speak two different languages with only limited crossover, and are thus insufficiently aware of each other’s goals.

When the WTO was created, the environmental community worried that disputes would be settled according to the perspectives of past negotiators, disregarding contemporary concerns, and that formally binding rulings would force countries to change their environmental policies in accordance with WTO rules (Neumayer 2004). Contrary to these early fears, it turns out that both the WTO's dispute settlement system and regular WTO committees have been sympathetic to environmental issues in the trade context. The Appellate Body in particular (the powerful apex of the WTO dispute settlement mechanism) has taken a broad view of the international law applicable to trade disputes.

Although sustainable development covers many more aspects than the environment, the WTO system has allowed space for members to pursue environmental goals, including through carefully defined trade measures. For example, by the end of 2012, there had been 353 notifications of technical barriers to trade in environmental and sustainability standards (WTO 2014). Scope for domestic action around environmental measures also exists in numerous WTO agreements, such as on government procurement, subsidies and even services.

Regional and Bilateral Trade Agreements

WITH BROADER WTO NEGOTIATIONS EFFECTIVELY STYMIED, MUCH OF THE ACTION on trade and sustainable development has moved to bilateral and regional negotiations. Such preferential negotiations have proliferated in recent years, often with an ambitious behind-the-border agenda that includes environmental issues.

In 1994, NAFTA broke new ground by including several environmental provisions in the main text. The side agreement on environmental cooperation was intended to assess and respond to trade-related environmental stressors; it included trade-related environmental impact assessments and introduced an independent public complaints process by which citizens could initiate investigations into negative impacts of trade liberalization. More than 20 years later, many analysts are disappointed that NAFTA and its side agreements have done little to alter linkages between trade and the environment and forge more integrated approaches to advance sustainable development.

But even if criticism is warranted, the early principles of NAFTA and its parallel environmental agreement have largely shaped the subsequent generation of preferential trade agreements, several of which emphasize strong domestic environmental

standards and effective enforcement. A core objective of these agreements is, broadly, to constrain policy actions that trigger environmental damage.

There has been a recurring emphasis within post-NAFTA regional and bilateral trade agreements on adhering to strong domestic environmental standards, including through effective enforcement. For example, standard language in US bilateral agreements (such as that between the United States and Colombia) now requires each party to ensure that its environmental laws provide for high levels of protection and have sufficient enforcement provisions, such as sanctions for violations. Unfortunately, the question of effective compliance has been progressively diluted since NAFTA. In the United States-Peru agreement, for example, noncompliance as a means to attain a trade advantage was recognized as unacceptable, but the parties agreed to respect country differences regarding their “right to exercise prosecutorial discretion and to make decisions regarding the allocation of environmental enforcement resources with respect to other environmental laws determined to have higher priorities” (United States 2009, chap. 18).

In addition, the investor-state dispute settlement mechanism (ISDS) within NAFTA has called into question NAFTA’s effectiveness in protecting environmental standards. Since 1994, ISDS mechanisms have proliferated in trade and investment agreements (see Newcombe, in this volume), and many analysts and civil society organizations worry about their effect on the state’s capacity to enforce environmental regulation rigorously.

Although NAFTA was innovative for its time, the treaty did not have the clear governance structures necessary to implement an ambitious environmental agenda. The provisions in the sustainable development and environment draft chapters of the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) seem more ambitious, at first glance (DFATD 2014, chaps. 23 and 25). There is to be a point of contact that would address matters of common interest in the interface between economic development, social development and environmental protection, and a Civil Society Forum comprising representatives of employers, unions, labour, business organizations and environmental groups. The parties are to exchange information regarding their implementation of Multilateral Environmental Agreements. The environment chapter even provides for a panel of experts to examine issues that cannot be resolved in consultations between the parties. But note that nothing in these chapters would be subject to CETA’s dispute settlement provisions.

The Future Agenda for the Environment in Trade Negotiations

COMMITMENTS ON TRADE ARE AN IMPORTANT PART OF “TRANSFORMING OUR WORLD,” the new agenda for sustainable development adopted by the United Nations in September 2015, although they are not very demanding. What else might be on the agenda?

Regulatory cooperation, a central feature of contemporary trade negotiations (see Hoekman, in this volume), is closely connected to environmental objectives. Although not new, regulatory cooperation has become much more salient in the context of climate change. In addition to standards, whether mandatory or voluntary, specified by government, international trade has seen a major increase in the use of private standards. Many of these standards embody social concerns, including those relating to the environment and labour. For example, there has been an emphasis on social standards in funding provided by international development banks, and nascent efforts by financial institutions to monitor implementation of social standards throughout supply chains.

The post-2015 environmental agenda also might be shaped by the growing prominence of so-called green industrial policy. There are clear signs that governments will resort to industrial policies to meet accepted environmental priorities such as avoiding catastrophic climate change. Because these policies involve government intervention in markets, they will need to be carefully designed so that they do not unnecessarily affect trade. Thus far, finding the balance has proved to be a challenge (Halle 2014).

The 2013 dispute in the WTO about Ontario’s Feed-in Tariff (FIT) program illustrates the WTO’s struggle to address the relationship between green industrial policy and trade effectively. Ontario’s program encouraged the development of renewable generation capacity with a highly attractive rate for the electricity produced (the FIT), and the program required the projects to use technology manufactured in the province. Although the Appellate Body ruled that the local-content requirements in the FIT program were unacceptable, the status of renewable energy support measures remains unclear, because the Appellate Body refused to establish whether the FIT was a subsidy (Casier and Moerenhout 2013). Further disputes regarding governments’ renewable energy programs seem bound to occur in the future, unless WTO members clarify the rules on subsidies for projects with environmental objectives. Of course, some subsidies with an

environmental dimension are bad, as shown in the work of the Global Subsidies Initiative (2015). In this regard, the WTO could do a better job of disciplining fossil fuel subsidies. Enhancing the transparency of such subsidies could be a crucial first step to demonstrating their negative impact on the market as well as on the environment, and thereby reducing their use (Casier et al. 2014).

One area that remains deadlocked in the WTO's lengthy Doha Round is the negotiations on environmental goods and services. In July 2014, as part of efforts to find new ways to negotiate in the WTO, a subset of WTO members launched plurilateral negotiations (see Wolfe, in this volume) on an Environmental Goods Agreement (EGA) intended to liberalize trade in environmental goods such as renewable energy (United States 2015). Together, the participants in the EGA negotiations account for a substantial share (86 percent) of global environmental goods trade — and the hope is that others eventually will join the process. Since clean energy technologies fall within the scope of these discussions, the WTO has a chance to reduce greenhouse gas emissions by differentiating tariff treatment between clean and nonclean energy technologies. Meanwhile, environmental services are also being discussed plurilaterally as part of the ambitious Trade in Services Agreement (TISA), which would cover all services sectors and go beyond market opening to establish new trade rules (Ghibutiu 2014).

Policy Implications for Canada

LINKING TRADE AND SUSTAINABLE DEVELOPMENT HAS BEEN UNDER WAY FOR MORE than two decades, since the early debates around NAFTA and early references in the WTO. Those agreements originally were contested by both trade and environmental interests as being intrusive, unnecessary, weak or beside the point. Since then, however, including environmental and sustainable development references within trade agreements has become standard. These linkages are here to stay, particularly as the economic and trade effects of climate mitigation efforts become more pronounced. But much ambiguity remains on how to approach the environment and sustainable development aspects of the global trading system. Canada has a great deal to gain from initiatives such as the EGA, given its strength as a trader of environmental goods and services, with approximately 2 percent of the global market in 2013. Moreover, Foreign

Affairs, Trade and Development Canada estimates that Canada's environmental goods exports were worth 1.3 percent of GDP in 2013 (DFATD 2015).

Collective responsibility for the planet cuts across both unrestricted international markets and respect for the sovereign right of governments to manage their own affairs. Least-developed countries, in particular, have legitimate concerns about the capacity of billions of people to adjust flexibly to greater engagement in the global economy. But if we are all to be accountable for the planet, we need to think of new ways to resolve this tension. The challenge at the nexus of commercial interests, climate change imperatives that affect trade openness and development cooperation is where trade policy fully becomes foreign policy. Here is where a stronger multilateral trading system is in Canada's long-term interests. Playing such a systemic role will not be easy, but Canadians have the bureaucratic capacity and diplomatic skills to make a difference.

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