trade
policy brief

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Trade and the environment

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- The environmental benefits of trade are manifold: diffusion of environmental goods and services, alleviation of materials scarcities, sending waste to high standards processing facilities.
- Challenges arise as cross-country differences in environmental policy stringency can induce pollution and waste leakages, and unsustainable level of materials extractions.
- Trade-related environmental benefits are best maximised and risks minimised through international co-operation, as reflected by the emergence of environmental provisions in more recent trade agreements.

What's the issue?

The rapid expansion of goods and services trade over the last several decades has created complex patterns of interdependencies between production, consumption and job creation across economies. At the same time, a range of environmental issues –declining biodiversity, water scarcity and water pollution, climate change, growing pressures from raw materials consumption, and the heath impacts of air pollution – are becoming more acute, and call for a strong, immediate, and co-ordinated international action. In this context, addressing the nexus between international trade policies and domestic environmental regulations is now more urgent than ever, in particular related to: (i) their complementarity and; (ii) the potential adverse consequences that intervention in one area can have on the other.

Trade can be a driver of environmental sustainability

When new environmental regulations are introduced, one way that companies, governments, and consumers react is by demanding goods and services that alleviate associated compliance costs – for instance, goods and services that rely on cleaner technologies, reduce environmental risks, and minimise pollution and resource use. Even without a regulatory push, there is a greater public awareness and consumer demand for products that better protect the environment. In this context, firms that produce environmental goods and services in countries where environmental standards are already high could be very competitive on international markets. Recent evidence suggests that countries with stringent environmental regulations have larger domestic markets for, and are net exporters of, environmental goods and services.

In addition, opening markets to environmental goods and services allows for the diffusion of new resource-efficient technologies and provides firms with incentives to adopt more stringent environmental standards. As a country becomes more integrated within the world economy, its export sector becomes more exposed to environmental requirements imposed by the leading importers. Innovations needed to meet these requirements, in turn, flow backwards along the supply chain, stimulating the use of cleaner production processes and technologies.

Trade can also enable waste to be sent to countries that have the most-efficient sorting and processing capabilities, including facilities with higher environmental standards for material and energy recovery. This can reduce the cost of waste treatment and recycling, which is beneficial to trading partners and leads to better environmental outcomes. Similarly, the substitution of primary raw materials with secondary raw materials (i.e. scrap) can help decouple raw material extraction from economic growth. International trade in secondary materials and waste helps enable a transition towards a more resource efficient and circular economy.

An interconnected world also carries environmental risks

By contrast, because of the increasingly fragmented nature of production processes across countries, domestic CO2 emissions are sometimes generated to produce goods consumed in other countries. Global interconnectedness therefore carries the risk that uneven domestic policies can lead to pollution havens, whereby countries with lower environmental regulations and enforcement progressively specialise in pollution-intensive goods that are exported to other countries with more stringent environmental policies. Recent analyses suggest that a subset of countries specialise in economic activities that are consistent with the existence of pollution havens. Similarly, concerns regarding trade in waste and scrap arise if exports destinations lack regulatory frameworks for environmentally sound waste management and the associated infrastructure capacities. Trade flows of waste destined to informal and non-compliant waste-recovery facilities, uncontrolled landfills, or even open dumping will have an adverse effect on the environment.

What should policy makers do?

Ensuring that environmental benefits associated with trade are maximised while the risks are minimised will require international co-operation. Countries have undertaken a number of important environment-related efforts under the World Trade Organization (WTO) multilateral framework, including negotiating tariff reductions in environmental goods, seeking more clarity on the relationship between existing WTO rules and specific trade obligations in multilateral environmental agreements, and seeking disciplines on environmentally related subsidies (e.g. fisheries).

Co-operation on issues at the intersection of trade and environment can also be achieved by including environmental provisions in Regional Trade Agreements (RTAs). In recent years, the number of RTAs has increased, and many of them contain environmental provisions setting ambitious environmental objectives. Between 1959 and 2016, of the 691 RTAs signed, 596 included environmental provisions, 494 of which included broader and deeper commitments. While the multilateral trading system under the WTO should be the preferred approach to establish trade and environment disciplines, RTAs offer a pragmatic approach to explore the possibilities in better addressing environmental objectives in trade agreements.

Policy alignment and co-operation for environmentally sustainable trade will make meaningful contributions to address concerns against trade and globalisation and raise the public acceptability of trade agreements more broadly. These efforts will also help achieve the ambitious goals of multilateral systems such as the UN 2030 Agenda and Sustainable Development Goals (SDGs) and the COP21 Paris Agreement.

Further reading

- Garsous, G. (2019, *Forthcoming*), "A report on a set of policy indicators on trade and environment," *OECD Trade Policy Papers*.
- Kozluk, T. and C. Timiliotis (2016), "Do environmental policies affect global value chains?: A new perspective on the pollution haven hypothesis", *OECD Economics Department Working Papers*, No. 1282, OECD Publishing, Paris, http://dx.doi.org/10.1787/5jm2hh7nf3wd-en.
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- Yamaguchi, S. (2018), "International Trade and the Transition to a More Resource Efficient and Circular Economy: A Concept Paper", *OECD Trade and Environment Working Papers*, No. 2018/03, OECD Publishing, Paris, https://doi.org/10.1787/847feb24-en.