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Global Competition and EU Environmental Policy

Global Competition  
and EU Environmental Policy:  
An Overview

JONATHAN GOLUB

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**ROBERT SCHUMAN CENTRE**

**Global Competition and EU Environmental Policy**

**Global Competition and  
EU Environmental Policy: An Overview**

**JONATHAN GOLUB**

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Born in 1973 of dual Community objectives--providing public goods while simultaneously completing the common market--there is widespread agreement that the subsequent development of EC environmental policy represents one of the most successful areas of European integration. Throughout the past twenty-five years the European Community has developed an impressive array of environmental regulations, and established itself as a main player in international environmental negotiations (Vogel 1993, Sbragia 1996a, 1996b). Community commitment to environmental policy has periodically been reaffirmed and strengthened in five Environmental Action Programmes, blueprints for the over 300 directives and regulations now in force. A similar expansion of activity has taken place in the international arena, with the Community now a party to several dozen environmental agreements.

Despite its steady expansion, however, the future of EC (now EU) environmental policy remains very much in question (Collier and Golub 1997). As in other parts of the world, an increasing sensitivity to global economic competition and budgetary constraints has made European governments wary of any form of regulation which might threaten economic growth, foreign investment, export markets, and employment creation. These pressures have been evident even in Germany, the member state most responsible since 1973 for driving up EU air, water and vehicle standards. The enormous financial costs of reunification and the emergence of the "location Germany" debate have scuttled a number of ambitious national environmental proposals and eroded previous German environmental leadership at the EU level (Cremer and Fisahn 1997). National officials from other member states have expressed similar malaise--the much publicised 1995 Molitor report of independent experts, dominated by industrial representatives and ministers, complained of environmental over regulation and cautioned against EU environmental policy which might jeopardise Europe's economic competitiveness (EC 1995a). Although full-scale retrenchment of environmental regulation is currently an option under discussion rather than an inevitable outcome or a *fait accompli*, the number of proposals for new EU environmental policies has slackened considerably since 1992.

Rather than a sudden obsession, however, the issue of economic competitiveness represents a perennial feature within EC environmental policymaking. On one hand, a desire to curb pollution both at home and abroad has guided Community action, catalysed in many cases by the ambitious environmental efforts of a few member states (Hildebrand 1993, Haigh 1984). On the other hand, the transmission of policy from the national to the EC level was justified in part by considerations of economic competitiveness: harmonisation of standards reflected the need to avoid green trade barriers

within the Community and the perception that unregulated environmental externalities constituted an unfair source of competitive advantage for polluting states (Rehbinder and Stewart 1995). In many cases EC regulation levelled the economic playing field while simultaneously reducing pollution. But the sensitivity of regulated industries and their national governments to the high cost of pollution abatement, with its attendant effects on competitiveness, has often tempered the ability of the EC to pursue an aggressive response to environmental problems (Golub 1996b, 1996c).

A substantial literature addresses the tension between environmental improvement and economic competitiveness within the context of EC internal environmental policy, including two volumes in this series (Collier 1997, Golub 1997a, see also H eritier et al 1996). By contrast, relatively little sustained attention has been paid to the global competitiveness dimension of EC environmental policymaking, a topic which this volume seeks to address.<sup>1</sup> This paper provides an introduction to the central issues and questions which guided this project and which are explored in the subsequent contributions. In so doing it also offers an overview of their findings and recommendations, and attempts to lay the groundwork for additional research.

The first section establishes the relevance of the global competitiveness issue within EC environmental policymaking, and suggests a framework for analysing the variety of ways in which the objectives of maintaining competitiveness and improving environmental protection conflict. It draws attention to the conflict's political salience as well as its contested empirical validity. Section two explores whether or not, and the various means by which, the global competitiveness dimension played an important role in each of the case studies. The third section then identifies a menu of possible options available for reconciling environmental and economic goals, and draws upon the case material to ascertain which approaches have predominated in EC policy. The fourth section discusses the Commission's increasing reliance upon a new approach--the pursuit of "strategic" or "win-win" solutions--which portrays stringent environmental policy as a means to enhance rather than undermine economic competitiveness. The serious practical and theoretical limitations of this approach are then discussed. A concluding section outlines a potential mixture of new and traditional responses to the competitiveness issue which might serve as a viable foundation for constructing and legitimating the next generation of environmental policy.

## Competitiveness as an issue in EU environmental policy

### *Conceptualising economic competitiveness*

At the most basic and commonsense level, a firm is competitive when it has the capacity to produce at costs which enable its goods to be sold at profit. But how does one conceptualise the economic performance of a single firm in relation to its competitors, or the competitiveness of entire countries or regions, or the factors which improve competitiveness or precipitate its decline? For these questions there is no single measure or definition of competitiveness. Rather, the term has come to embody a composite of a firm's production costs, productivity, export performance, capacity for technological innovation, and ability to serve and create market openings (EC 1982). Some of these factors are internal to the firm and under its control, while others, particularly the opportunity for market access, are at least partially external and affected by national as well as foreign regulations (OECD 1996). Thus it is common to think of national governments defending and promoting the competitiveness of industries within their borders, upon whose prosperity they depend for job creation, growth and revenue.<sup>2</sup>

The analysis of competitiveness therefore necessarily involves exploring the interdependence of government policy, individual firm performance, and national economic prosperity. In other words competitiveness depends as much on the context in which firms operate as it does on the internal design of the enterprise. The Commission has adopted an equally inclusive conception of this controversial term. According to a reflection report on the progress of the single market programme, competitiveness within the Community is generally understood to be "the ability of firms to stand up to their competitors on domestic and world markets" (EC 1987: iii). The proper role of government and EC policy was, therefore, to help firms do this. That the famous Commission White Paper on Growth, Competitiveness and Employment failed to offer a more specific definition of individual firm, country or Community competitiveness indicates just how well established this broad and in many ways imprecise view of the concept has become (EC 1993a). In light of this, contributors to this volume were given wide latitude to explore various aspects of competitiveness, but they focus particular attention on questions of production cost, global market opportunities and international trade rules as they relate to the development of various EU environmental policies.

## *Competitiveness and the environment*

In recent years attention has increasingly focused upon the connection between environmental policy and economic competitiveness, but the precise relationship between stringent standards and economic performance remains a matter of intense debate. Theoretically, environmental policy has the potential to function as a two-edged sword: ambitious pollution control measures may limit the ability of EU firms to compete globally, but may also be used to protect EU firms from foreign competition. Distinguishing between environmental improvements to production methods and environmental trade barriers related to product standards clarifies these opposite effects.

Conventional wisdom suggests a negative relationship between economic competitiveness and efforts to green the production process (Leonard 1988:ch 1, Jaffe et al 1995). Regulations which require firms to reduce emissions, increase recycling, pay more for energy, or switch to more expensive fuels and ingredients all raise the final price of their products or services, with the result that green states lose markets to "dirty" states who lack similar environmental standards. EU firms can be confronted with lower standards and thus production prices in foreign states, or can enjoy lower domestic standards than their foreign competition. Thus we would expect EU producers and service providers to oppose environmental regulation at the EU or international level which placed them at a competitive disadvantage to neighbouring producers or those based in non-EU states. The fact that national differences in production costs translate into differences in competitive position not only engenders resistance against new efforts at controlling pollution, but also creates the potential for a "race to the bottom" or "ecological dumping", whereby governments strategically lower their environmental standards in order to expand exports and attract foreign industrial investment.

Foreign environmental aid also has a potential competitiveness component as it raises the question whether EU states should shoulder the costs of environmental improvement abroad. In addition to a general reluctance on the part of states to provide substantial direct financial assistance in times of fiscal restraint, a more immediate economic concern for EU firms specialising in advanced pollution control relates to the conditions under which this technology is transferred to developing states as part of aid packages.

The link between environmental protection and economic competition is most salient when national measures threaten to disrupt international free trade by directly excluding foreign products. Market access might be denied in cases where imported goods violate domestic product standards, such as maximum

emission and noise levels, prohibition of certain ingredients or requirements for a minimum amount of recycled material. Market access might also be denied to foreign goods manufactured through production processes deemed environmentally unacceptable by the importing state.

Under certain conditions, however, environmental and economic goals can be mutually reinforcing. Where penetration of cheap and “dirty” products or services threatens to erode the market share of EU firms, whether at home or abroad, efforts by EU governments to ratchet up process standards in foreign states through international treaties and conventions can restore European competitiveness while simultaneously improving the overall commitment to global environmental protection. Negotiating international environmental agreements allows EU members to level the economic playing field and to undermine the effects of pollution havens. One would expect to find the EU advocating stringent international environmental standards and mechanisms to improve compliance in cases where it has already adopted ambitious internal policies, or where it implements current international rules more rigorously than other states. Similarly, one might expect incremental advances in EU internal environmental policy to be contingent upon reciprocity abroad.

Stringent domestic environmental regulations also reinforce the economic competitiveness of EU firms when they function as trade barriers against non-EU states, prohibiting access to EU markets by foreign products which fail to satisfy certain environmental conditions. Unilateral green trade barriers not only prevent competitive disadvantages from foreign states actively engaged in environmental dumping, but insulate EU producers against foreign goods which become comparatively less expensive as the EU raises its own standards. Because competitiveness relies so heavily on export and import penetration rates, the great risk is that nations will artificially defend their competitiveness by adopting such protectionist measures (Krugman 1994).

Herein lies the double-edged nature of the competitiveness issue: ambitious EU environmental standards might jeopardise EU firms by raising their production and compliance costs, but green EU trade barriers can insulate firms from foreign competition. In selecting a range of cases for this volume capable of illustrating both sides of the issue, attention was paid to the fact that global competition concerns enter EU environmental discourse through two routes: during direct negotiation and implementation of international agreements between EU and non-EU states, and during the formation of EU environmental legislation which significantly impacts upon economic relations between EU and non-EU states. The Working Papers therefore focus not only on the conclusion of international agreements but also the adoption of EU

internal environmental regulations which might exceed standards set by such agreements, EU environmental regulation in sectors with substantial export markets, and provision of EU environmental aid to developing countries.

States with high environmental standards often disagree with each other when seeking to coordinate environmental laws which might raise production costs, and when determining whether national environmental policies constitute trade barriers. Within the context of strictly internal EU policymaking, disputes have erupted over the competitive effects of requiring installation of best available technology, and of pursuing environmental quality objectives rather than emission standards (Haigh 1989, Golub 1997b, Héritier et al 1996, Sbragia 1996b). Intense political and legal battles have also been waged over the trade-distorting effects of Danish bottle recycling programmes, stringent German car emission standards, and most recently the proliferation of national ecolabels and other new types of environmental instrument such as ecotaxes. As mentioned above, harmonisation of environmental standards at the Community level serves to avoid or eliminate the competitive effects of these and other diverging national policies.

Disagreements over what constitutes a “dirty” product or production method, and the competitive implications of prohibiting them, also arise between the EU and other states with highly developed environmental policies, particularly in the context of global free trade. In a statement identifying the frequent point of tension, US ambassador to the EU Stuart Eizenstat noted that “Just because the US process is different does not mean that it is environmentally unsound”. The famous US tuna embargo and many other examples in this volume illustrate the difficulty of reconciling conflicting national environmental policies when well established harmonisation or coordination procedures analogous to EU internal policymaking do not exist at the international level. Redressing the variation of environmental standards between EU and non-EU states raises even more difficult questions of economic competition because it involves potentially enormous disparities in production costs in addition to the legality of green trade barriers.

### *The ambiguous empirical record*

A substantial literature has developed questioning the empirical validity of the presumed trade-off between competitiveness and environmental protection. If such a trade-off existed, one would expect to find signs of economic decline in countries with the most stringent environmental standards, particularly the United States, Germany, and Japan. Predictable shifts in trade, growth and investment patterns should also appear within the US as environmental

investment patterns should also appear within the US as environmental standards and their enforcement vary amongst individual states. In fact, many studies suggest that such effects are minimal or entirely absent, finding that for most industries the expenditure required to meet environmental regulations constitutes an insignificant proportion of overall production costs, often only one percent; labour costs by contrast often comprise twenty-five percent or more. These studies further suggest that green countries do not incur economic losses from decreased trade or industrial flight, nor do dirty countries gain competitive trade advantages and attract foreign investment by acting as pollution havens (Jaffe et al 1995 provide a comprehensive literature review, see also Pearson 1987, Leonard 1988, Dean 1992). The supposedly negative relationship between environmental protection and economic competitiveness has also not been found by specific analysis of US-Mexican relations (Grossman and Kreuger 1993), US inter-state trade and investment flows (Jaffe et al 1995:148-50, Bartik 1988, McConnell and Schwab 1990), and Japanese economic performance (Nishijima 1993:104).

Furthermore, some studies, in particular those focusing on Eastern Europe and the former Soviet Union, suggest that low environmental standards actually deter foreign direct investment rather than attract foreign industry, as environmental neglect often reflects deeper social problems and instability, and is frequently associated with a lack of important factors such as infrastructure and communication which contribute much more to overall production costs (Zamparutti and Klavens 1993:125).

However, the literature on the environment-competitiveness issue is anything but conclusive. A number of studies, even some of the ones mentioned above when read closely, note that for some industries the proportion of total production or investment costs stemming from environmental regulation is actually much higher than suggested by aggregates of national economic trends. In the energy, paper, oil, steel, copper and chemical sectors, for example, anywhere from 5-20% of overall costs, and an even higher proportion of investment costs, are devoted to environmental protection. Such figures have been found for both European and American firms (Blazejcack 1993:110, Jaffe et al 1995:142, Stewart 1993:2063-5, French 1993:30). In these cases the negative effects of stringent regulation on product price and exports appear more significant. Studies also raise important questions about even small additions to production cost, noting the potential implications for economic competitiveness where profit margins are very tight; three percent at the margin can be crucial in some industries, as even a WWF representative has conceded (Jaffe et al 1995:143, Arden-Clarke 1993:152).

To take one example where marginal costs might have been decisive, Heerings found that EC environmental regulation accelerated the demise of the phosphate fertiliser industry in Western Europe since 1988. As the EC adopted ever stricter discharging standards which raised domestic production costs, imports of cheap fertilisers from Northern Africa soared and EC industry relocated to developing countries (Heerings 1993:114-18).<sup>3</sup>

A careful examination of the empirical record, including the material often relegated to footnotes in sanguine literature reviews (Jaffe et al 1995:152), also reveals evidence that rising environmental standards have adversely affected American and European productivity growth in the 1970s and 1980s respectively (Conrad and Wastl 1995, Stewart 1993:2073). In the US case, the percentage of overall decline attributable to environmental regulation varied by sector but remained considerable in several important areas: 10% for chemicals, 30% for paper, 44% for electric utilities (Barbera and McConnell 1990).

Regardless of whether the available evidence proves or disproves a conclusive relationship between economic performance and environmental regulation, the important point from the perspective of this volume is that the possible or perceived loss of competitiveness constitutes as much a political as an empirical matter, and figures prominently in industry's resistance to environmental regulation (Zamparutti and Klavens 1993:120, Morris 1993:168). Examples from the US and Canada attest the salience of a perceived negative relationship for policymaking. Canadian food and chemical industries have protested that domestic environmental laws disadvantage them against US farmers and firms, while the Canadian paper industry has complained that US and German environmental laws regarding newsprint paper recycling and paper production constitute disguised trade barriers which have damaged Canadian exports and forced Canadian plants to relocate to the US (St.-Pierre 1993:98-9). Similar fears in the US over the adverse economic effects of stringent domestic environmental policies prompted the Bush administration to establish the so-called "Competitiveness Council" under the direction of Vice President Dan Quayle, which immediately set about scrapping existing legislation. Besides pruning its own environmental policies, US negotiators sought to level the playing field by raising standards abroad. In an effort to "eliminate or reduce competitive disadvantages resulting from differential national environmental standards and controls," the US secured provisions against pollution havens in the NAFTA agreement and sought to introduce similar language during the GATT Uruguay round (Barrett 1993, Charnovitz 1993:131-132).

The link between environmental protection and competitiveness has also dominated recent discussions in Europe, with calls for deregulation, scaling

back expensive international environmental commitments, and improving foreign compliance with existing rules. Even as the Maastricht treaty was proclaiming Europe's renewed commitment to environmental protection, its tight convergence criteria for countries joining the single currency were squeezing governments to reduce their deficits—spending on pollution abatement and foreign environmental development aid presented attractive targets for cuts.

Moreover, the need to reduce production costs in order to survive in increasingly global markets has played as much of a role in Europe as it has in the US. Much like their North American counterparts, German and British companies have railed against the adverse effects on international competitiveness of domestic regulation in the chemical sector (Rudnick 1992). More recently, the influential but controversial Molitor Report, produced for the Commission in 1995 by a “group of independent experts,” stressed that “Over-regulation stifles growth, reduces competitiveness and costs Europe jobs...[it] hampers innovation and deters both domestic and inward investment” (EC 1995a:1). Having singled out environmental policy as one of the areas requiring “legislative and administrative simplifications,” the Report advocated a range of deregulatory measures not unlike those of Quayle's Competitiveness Council. High on the list of proposals was the search for cheaper and more flexible regulation, and a greater reliance on new types of environmental instrument such as market based mechanisms and voluntary measures, tools which have already gained prominence at both national and EU level, and which are discussed at length in the other volumes of this series (Golub 1997a, Collier 1997).

### **The pervasive competitiveness dimension**

The perception by major actors of a significant negative relationship between economic competitiveness and stringent environmental policy constitutes a recurring theme in each of the cases analysed in these working papers.

Ian Rowlands suggests in the opening paper that EU policy for ozone layer protection has been shaped to a large extent by a perceived negative relationship between economic competitiveness and environmental regulations which restrict the use and sale of CFCs. Because EC industries accounted for one-third of total global production of CFCs in the 1970s, and certain countries such as Britain depended upon CFCs for £70 million/yr in exports and 50,000 jobs, the Community was extremely sensitive to US proposals for international restrictions on CFCs. Even after the discovery of the “ozone crater” over

Antarctica in 1985 sparked renewed efforts to control CFCs and methyl bromide, both the extent and manner of their reduction were guided by concern for economic competitiveness of EC firms vis-à-vis the US, as well as by intra-EC economic battles where substantial local adjustment costs (14,000 jobs in the case of Spain), product development costs, competing CFC substitutes and export markets were at stake.

Much like the case of CFCs, the development of EU restrictions on the export of hazardous chemicals, explored by Marc Pallemmaerts, posed enormous consequences for the competitiveness of EU firms. In the late 1970s, EC-based companies accounted for over one-third of world pesticide sales, and had a particular stake in export markets outside Europe where two-thirds of all their sales were concentrated. As a result, for many years EC internal regulations governing pesticides were not extended to cover exports, a position supported until 1983 by the Commission. In the mid-1980s, intra-EC economic competitiveness became a central issue in policy development, as a number of member states adopted their own restrictions on chemical exports and sought similar action at the EC and international level. Amidst intense debate within the Council, a fully-blown prior informed consent procedure which would limit EC export of chemicals was proposed in 1990, but only took meaningful effect in 1994. During this time attention was constantly focused on negotiations within the context of GATT, UNEP and the FAO, in order for the EC to avoid or compensate for expensive unilateral restrictions by imposing a legally binding PIC regime on Japan, the US, Canada, Australia and other states competing for the lucrative chemical export market.

Economic competitiveness has emerged as an increasingly important issue in the field of marine environmental protection, as Andre Nollkaemper demonstrates. Whether transporting waste or oil, the operation of substandard vessels with poorly trained crews and operators increases the risk of environmental disasters. While the EC and some individual member states have steadily tightened up their own shipping laws and domestic implementation of international rules, discrepancies remain throughout the community and equivalent measures have not been applied with similar force in many non-EC states, resulting in a substantial compliance gap which damages the environment and poses considerable economic problems for the greener member states. Up to 13% of a vessel's total annual running costs derive from meeting international standards, including environmental standards, with more ambitious national environmental laws imposing an additional 1-2%. Flagging out, port shopping and avoidance of expensive environmental technology results, as ship owners, port operators and flag states compete for business and competitive advantages in a sector renowned for tight profit margins. The

substantial decline in the number of ships flying EC flags, particularly Dutch flags, has been blamed in part on competitive disadvantages incurred by ports and flag states who enforce EU and international environmental laws. Within the EU, although no studies of the matter have been conducted, national officials have expressed concern that business might have shifted towards those member states where compliance with standards is relatively lax, most notably Greece.

Issues of economic competition have also dominated the development of an EU carbon energy tax. As Thomas Heller discusses, the fate of the Commission's 1992 proposal to reduce carbon dioxide emissions through an incremental levy on fuel hinged primarily on whether or not member states could agree on how to minimise or distribute the predicted impacts on economic growth, employment and inflation levels throughout the Community (see also Verbruggen 1993:57). Negotiations over a possible burden sharing solution were deadlocked as no state proved willing to shoulder a disproportionate responsibility for achieving the Community's overall emission stabilisation target originally agreed at Rio, whether through fuel switching, investment in more efficient generation of energy, dramatic reductions in energy consumption, or substantial expenditure on environmentally friendly modes of transportation. Economic competition between the EU and its major trading partners also played a considerable role in the negotiations, as member states conditioned adoption of an EU tax on the US, Canada and Japan undertaking similar expensive measures.

The range of cases assessed five by David Vogel illustrates the direct and substantial effect on economic competitiveness of green trade restrictions in the US and EC. Penalties imposed for failing to meet US car emissions standards cost European car exporters \$500 million in 1991, while the 1990 and 1992 US bans on tuna caught with nets which endangered dolphins cut off exports from a variety of trading partners, including France, Italy, and Spain. Similarly, the proposed EU ban on furs caught with "inhumane" traps would foreclose a \$30 million export market, and threaten 80,000 Canadian trappers with potential economic ruin. Ecolabelling schemes do not directly exclude products, and thus are not usually classified as traditional trade barriers, but raise equally important issues of economic competition. The EU ecolabel has come under attack from the US and developing states as a disguised barrier to trade which establishes a variety of capricious criteria designed specifically to reward EU products which are not necessarily "greener" than foreign goods.

In contrast to the other cases, Andrea Lenschow's analysis of the Common Agricultural Policy demonstrates an area, where, until recently, the

perceived negative effects of environmental regulation upon economic competitiveness have played only a marginal role. By providing EU farmers with guaranteed prices--import levies, export subsidies and direct intervention purchasing--the CAP sheltered its domestic producers from the pressure of international competition and alleviated some of the potential economic consequences of imposing stringent environmental controls. The lack of a green political agenda and the extreme insulation of powerful agricultural interests within the EU decisionmaking process--domestic rather than international factors--prevented the introduction of anything beyond modest environmental regulations. However, the relationship between environmental standards and the economic competitiveness of EU farmers has become an increasingly relevant issue in the debate over how to structure the CAP in such a way as to accommodate international trade liberalisation, EU enlargement, and the subsidiarity principle.

Economic competitiveness has also emerged as an important consideration in the area of EC aid to developing countries. As Nick Robins shows in the final working paper, throughout the history of EC aid efforts the Community has periodically reviewed its own aid programmes in light of their environmental effectiveness, incorporating sustainable development goals, environmental impact assessments and project cycle management provisions into the Lome Convention and other aid programmes. The financial value of EC aid devoted to environmental projects has also been substantial, reaching 1 billion ECU in 1994, and constituting approximately ten percent of all EC development aid in the first half of the 1990s. But government efforts to foster sustainable development abroad through green financial aid and technology transfer face mounting pressure from competing economic priorities--general fiscal constraints and competition for market share amongst producers in the rapidly growing multibillion dollar market for high technology pollution abatement equipment. To take the most striking example, four years after the UN Earth Summit in Rio de Janeiro the EU has failed to deliver on its \$4 billion aid commitment towards implementing global sustainable development.

### **Reconciling environmental protection and economic competitiveness**

When faced with the threat of economic disadvantages produced by stringent environmental policies, the EU and its member states have traditionally relied upon four policy options which might be analogised to "carrots" and "sticks" (Charnovitz 1993:143-4). When choosing to use "carrots", governments alleviate perceived competitive disadvantages either by simply relaxing their domestic environmental standards, or by compensating for the effects of high

standards through the use of domestic subsidies, exemptions for affected industries and other offsetting measures. In contrast, when opting for “sticks”, the EU and individual member state governments attempt to overcome competitive disadvantages by forcing other countries (including reluctant EU states) to raise their environmental standards. This can be done by pursuing more stringent international agreements and harmonised EU standards, as well as by seeking to improve compliance with existing international rules and EU legislation. When placed at a competitive disadvantage against non-EU states, the Community can also consider the possibility of offsetting the costs of its internal environmental policies with countervailing duties (CVDs), a particular type of “stick” which places green taxes on imports (Charnovitz 1993:142-3).

### *Relaxing environmental standards*

Contrary to expectations that competitiveness might ignite a “race to the bottom” and provoke widespread use of the “carrot” approach, evidence from the case studies suggests that EU governments do not strategically repeal existing environmental legislation in order to attract investment or maintain market share for their domestic industries. Nor has the EU systematically sought to withdraw from international environmental agreements to which it is a party. In only two cases did EU governments actually lower their environmental standards and commitments. To bolster their declining shipping industries, the governments of Germany, Denmark and Finland created ‘second registers’ with lower standards similar to those found in ‘open registers’, including less demanding requirements for crew training and equipment which helps prevent marine pollution. In this same sector, the Dutch government is considering whether to relax some of its own environmental standards in order to cut costs. The second instance involved concern for the general economic competitiveness of EU states and the perceived opportunity costs of providing large sums of foreign environmental aid. In recent years, pressures to reduce public spending have hit aid programmes hard, and in 1994 the EU reneged on its \$4 billion aid pledge made at Rio. Most EU states also reduced their total levels of environmental development assistance. Nick Robins has suggested that Rio was the “death knell of international welfarism,” including green aid (Robins 1996:10). In addition, conscious of the need to gain economic advantage from the spending that remains, foreign aid is increasingly aimed at improving investment and trade links for donor states, rather than fostering sustainable development in the recipient countries.

## *Domestic offsets*

While an outright race to the bottom has not occurred, governments have consistently deployed a range of domestic “carrots” to offset the perceived effects of environmental policies on economic competitiveness. Measures which alleviate the costs of current and proposed environmental regulation include: government subsidies for pollution control, financial aid for research and development, lax enforcement, and postponement or avoidance of costly new legislation which would disadvantage domestic industry. In some cases, which are discussed later, reliance upon offsets has led to an extreme version of the “carrot” approach, sometimes referred to as a “no regrets” policy. This involves adopting regulation only when environmental improvements can be achieved without incurring any additional economic costs—in short, the possibility of getting a free lunch. While not entirely free, the solution advocated by the Molitor report, and one already apparent in both national and EU level legislation, involves searching for a “cheap lunch”—minimising regulatory costs by shifting from the traditional command and control approach towards an arsenal of new policy tools such as ecotaxes, ecolabels and voluntary agreements (Golub 1997a, Collier 1997).

In the case of marine pollution, government offsets in both flag states and port states occur through lax implementation of EU and international rules, producing a situation much like a race to the bottom. While states in the Middle East and North Africa top the list of environmental laggards, ships flying the flag of Portugal, Greece and Denmark have the highest rates of failure within the EU, a dubious honour which Nollkaemper attributes in part to the pressures of economic competitiveness. The “carrot” approach has also been tried, for example in Rotterdam, where the government subsidised the reduction of port costs for tankers using segregated ballast tanks (SBTs), an environmentally beneficial feature which owners are disinclined to invest in because it adds to a ship’s size and increases its tonnage dues in port. The IMO has encouraged all states to follow similar offset policies aimed at reducing marine pollution. At a more general level, the shipping sector has received widespread state aid throughout the EU, assistance which can be used to cover the costs of meeting international and EU environmental regulations.

Pallemaerts identifies several cases in the field of pesticide exports where EC laws included attempts to offset competitive disadvantages. The Commission’s 1986 proposal for an “informed choice” system, which would have restricted EC exports more tightly than existing international guidelines suggested, was rejected by the Council, and the 1988 regulation eventually adopted, according to Pallemaerts, had only a minimal effect on EU trade. The

prior informed consent procedure adopted in 1992 also contained provisions designed to limit its economic impact on EU producers, as enforcement was left to the discretion of the member states and chemicals actually subject to restriction were only identified in 1994.

Perhaps more than any other area covered in this volume, EU policy on climate change exemplifies governmental recourse to offsets and no regrets policies as a means of ameliorating competitive disadvantages from environmental regulation. The four member states which have enacted carbon taxes have all exempted energy intensive industry and set tax rates at extremely low levels. Similar exemptions, as well as general tax refunds, were made an integral part of the ill fated EU carbon-energy tax, negotiations over which nevertheless remain deadlocked mostly because of sensitivity to issues of competitiveness. It was hoped that a burden sharing approach coupled with an unspecified form of intra-EU transfer payments would facilitate political agreement by offsetting the costs in the hardest hit member states. The EU strategy also contained research subsidies under the ALTENER programme. Finally, as was the case with individual national policies, EU proposals also took a carrot approach through “fiscal neutrality”--offsetting energy taxes with lower employer contributions for social security and other expenses, and by earmarking the collected tax revenue and returning it to industry in the form of subsidies.

Heller suggests that joint implementation, an innovative form of offset which minimises EU expenditure by targeting emissions abatement in developing states where the marginal costs of CO<sub>2</sub> reduction are much lower, provides the only realistic means of preventing global warming which reconciles the EU's dual concern for competitiveness and environmental protection. The impending exponential increase in emissions from Asian states over the next fifty years could well trigger global warming regardless of whether Europe were to dramatically reduce its own use of fossil fuels (the so-called “China Trap”). And compared to what additional sharp cuts in CO<sub>2</sub> would cost the already highly regulated member states, the potential emissions reductions made by altering the trajectory of Asian transportation and energy developments constitute relatively inexpensive “low hanging fruit”, offering cost savings of 70-85%. But to avoid the “China Trap”, the EU and other developed countries must act quickly to help reduce Asian emissions, lest these fruits rot on the vine as Asian states commit themselves to inefficient and polluting growth paths.<sup>4</sup>

Domestic offsets have also been used to prevent farmers from facing the full cost of remedying environmental damage attributable to the CAP. Although

a longstanding goal of EC environmental policy, and an explicit provision of the 1987 Single European Act, the Polluter Pays Principle has never been applied to agricultural production, and the farm lobby has successfully resisted the few proposals which would have introduced ambitious measures to combat diffuse non-point source pollution from fertiliser. In addition to the lucrative price supports mentioned above, the handful of environmental measures adopted by 1992 provided subsidies for land set-aside and direct payments to farmers who undertook environmentally friendly projects.

Under pressure during the Uruguay GATT round to liberalise international trade and reduce traditional forms of agricultural subsidies, EU officials actively embraced offsets which effectively greened the CAP because such measures were some of the few remaining GATT-legal means of supporting EU farmers. Deprived of the ability to maintain price supports at the same level, the EU sought to compensate farmers for their losses through two measures acceptable under GATT rules--direct income support decoupled from production, and environmental payments. Capitalising on the "selling points" of environmental measures, the EU supported creation of the "green box" which exempted these two sources of support from GATT scrutiny, thereby offsetting a mandatory 20% drop in domestic subsidies.

Evidence suggests that the partial decoupling of financial assistance from production has produced a notable drop in the use of chemical fertilisers and pesticides. However, liberalisation pressures will never adequately green the CAP, as a range of traditional as well as new considerations exert powerful constraints. Moreover, the widespread reliance on environmental offsets from Brussels as a source of aid, income and guaranteed market share risks the possibility of an intra-EU regional subsidy war if the CAP is renationalised in accordance with the subsidiarity principle, as southern farmers struggle to secure local subsidies and maintain competitiveness against better financed northern producers.

One of the most important lessons which emerges from the cases is that, while it certainly plays an important role in reconciling competitiveness and environmental protection, the absence of a "carrot" approach has not precluded the EU or some of its respective member states from pursuing ambitious environmental objectives. One obvious reason for this is that scientific and technological advances, as well as highly publicised environmental disasters, have generated a rising baseline of environmental policy within European countries. Major political parties have also incorporated environmental themes in order to capture voters and neutralise the attractions of Green parties (Collier and Golub 1997, Richardson and Rootes 1995). However, while most states

have embraced environmental rhetoric, this does not suggest a convergence in national environmental perspectives--important national differences have remained and in some cases intensified.

The primary source of green leadership has come from states with strong traditions of environmental protection, most frequently Germany and the Netherlands, often working together with the Commission. Pallemmaerts draws attention to the fact that Germany, the Netherlands and the UK each pursued unilateral restrictions on chemical exports in 1985-86. Rowlands notes that during the same period, contrary to what one might have expected based on industrial interests, Germany pushed for aggressive restrictions on CFCs. Heller describes how individual member states moved to reduce CO<sub>2</sub> emissions in 1990, prior to the Rio conference, and how in the same year the Council adopted an emissions stabilisation target. And Vogel discusses EU environmental trade initiatives designed to promote international protection of animals and forests. In each of these cases economic competitiveness did not prevent policy development, nor were domestic firms fully compensated through government offsets.

This certainly does not imply that competitiveness issues placed no constraints on environmental upgrading in these leader states. On the contrary, an equally important lesson from the cases is that when greening does occur in a progressive state, this is often foreshadowed by, and certainly followed by, efforts to compensate for its costs through EU-wide and then international regulation. The remainder of this section concentrates on this phenomenon.

### *Forcing standards up*

By far the most common response within the EU when facing the environmental-competitiveness dilemma, including in the cases of environmental leadership mentioned above, has been recourse to "sticks" rather than "carrots". States have advocated EU harmonisation and supported international conventions which coincide with their existing or planned domestic measures.

EU policy to combat climate change exemplified this approach when application of the carbon-energy tax was made contingent on other OECD states adopting similar measures in accordance with a "conditionality clause". In the case of shipping, a few EU efforts to reduce discharges at sea and to improve domestic compliance with environmental rules were made after the famous Amoco Cadiz, Aragon and Khark-V accidents in 1978-1979, but the 1992 disaster off the Shetland Islands was the real watershed which prompted the

aggressive new plans contained in the “Common Policy on Safe Seas.” The Common Policy will greatly improve compliance within the EU, but threatens to exacerbate the competitiveness gap with non-member states. The Commission contends that greater reliance on its external competence and a united EU negotiating position in the IMO would allow it to project similar improvements abroad, thus closing the gap.

Since 1983, the Commission has tried to achieve environmental protection in the field of pesticide exports while minimising competitive losses by pegging its innovations as much as possible to international developments, for example by developing internal PIC procedures then pushing for similar legally binding international rules. Here again we see competitiveness issues arising between the EU and its trading partners as well as amongst EU member states. The 1986 Commission PIC proposal was shaped by discussions within international arenas such as the FAO, OECD and UNEP, but it also reflected the interests of the three member states who had already adopted stringent unilateral domestic standards. Although originally blocked by the majority in the Council, when the EC eventually adopted a legally binding PIC procedure in 1990 the Commission immediately abandoned its previous reservations and sought to impose similar measures abroad through GATT, UNEP and FAO rules. In stark contrast to its 1988 position on the Tuna Dolphin case, where the EC accused the US of violating GATT rules by pursuing environmental protection beyond its own borders, when facing competitive disadvantages from its own unilateral PIC regulations for exportation of pesticides, the EU explicitly endorsed the need for governments to incorporate extraterritorial environmental considerations into their trade policies.<sup>5</sup>

As Rowlands shows, the “stick” approach has been used consistently by governments when devising policy to protect the ozone layer, with the US seeking to raise EC standards and green member states seeking to raise and harmonise EC standards. In 1977, the US banned CFCs in aerosol cans, and then pushed for similar international action. Sensitive to the interests of its CFC producers, the EC limited its own legislation to a production cap that safeguarded domestic CFC usage as well as lucrative export markets. In the mid-1980s, several member states adopted unilateral CFC restrictions and then attempted to share the economic burden by raising EC standards.

A similar pattern emerged in the late 1980s and 1990s after scientific consensus had generated widespread pressure for an aggressive CFC phase-out: the race for CFC substitutes and export markets conditioned national negotiating positions. The UK and Germany, along with US, supported sharp HCFC reductions because they were already exploring the next generation of

substitutes, whereas France resisted such reductions because it has invested heavily in HCFCs as the preferred substitute. For methyl bromide, the US again was the first to restrict its use and sought similar international measures in part because US farmers perceived a threat from Mexico and Southern Europe where economic competitiveness depended on using this crop-enhancing chemical. Of course southern EU states resisted out of fear for their competitive position, while many northern states who do not produce any methyl bromide, and had already taken or planned unilateral reductions in its use for environmental reasons, supported the US.

As noted at the start of this paper, resolving the tension between economic competitiveness and environmental protection by forcing other states to adjust their standards upwards can take the form of green protectionism. As Vogel shows, each of the EU positions taken in relation to environmental trade has served to defend EU firms against foreign environmental measures, or to shelter EU producers from foreign products. Thus the EC opposed US car emissions (CAFE) standards which disproportionately harmed European exporters. In decrying the extraterritorial effect of the US tuna bans, the EC remained sensitive to how depressed prices from a glutted market would harm its own tuna industry.

But, as mentioned above, in several areas the EU has supported extraterritorial environmental concern when this has coincided with the economic interests of its producers. The US, Canada and several developing states have attacked the EU ecolabel and various national labels for their improper use of life-cycle-analysis, their unjustified emphasis on using recycled materials and their lack of transparency, features which place the EU's trading partners at a competitive disadvantage for product markets. The Commission has retained the stick approach, attempting to ensure the legitimacy of the EU ecolabel as part of ongoing WTO reform (EC 1996a) while avoiding equivalence with less demanding ISO standards (Taschner 1997). Two more examples are the 1983 EC ban on imports of seal skins, and the 1991 ban on importation of furs caught using leg-hold traps, each of which supported the EC pelt industry. Similarly, the EU is considering restrictions on exported Malaysian wood, which would protect its own timber industry, after having strongly criticised an Indonesian timber export restriction which would have protected the Indonesian wood processing industry. In none of these cases has the EC supported or taken action which improves the environment at the expense of its own economic competitiveness.

## *Countervailing duties*

The cases in this volume suggest that, amongst the many “carrots” and “sticks” available to neutralise the perceived competitive disadvantages stemming from stringent domestic environmental policies, governments only occasionally seek to impose countervailing duties. Two instances stand out as exceptions to this general finding. Under Spanish leadership, the 1995 Vienna Conference agreed to phase out methyl bromide by 2010 but included the possibility of trade measures against non-parties (Spain was particularly concerned about Morocco) to level the playing field. The possibility of incorporating CVDs as a means of safeguarding economic competitiveness was also considered during the protracted negotiations over the EU carbon-energy tax .

While CVDs have traditionally played a minor role in EU environmental policy, they have recently emerged as an important agenda item in the ongoing debates over “greening” the GATT/WTO (Esty 1995). The EU supports greening the GATT for a variety of factors, one of which is undoubtedly a sincere commitment to improving international environmental protection. But economic considerations, including the desire to preserve competitiveness in light of high EC standards and the fear of being swamped by cheap imports from relatively unregulated former East Block countries, have also played a major role. The debate centres more on how, not whether, to green international trade rules, and the EU position on unilateral efforts to force up foreign environmental standards remains finely balanced, if not openly hypocritical. In fact, no country is immune to charges of hypocrisy--the EC, Canada, the US and other OECD states all struggle to shape international trade rules which legitimate their own policies.

As Vogel discuss, officially the EU opposes levies and other forms of environmental trade barriers (EC 1992, 1996a), although the European Parliament has advocated reforms which allow “non-tariff trade barriers to protect the environment” (EP 1993b). The Commission has moved between these two positions depending on the issue at hand. For example, originally EC opposition to the US unilateral tuna embargo was “a convenient stick with which to beat the Americans in the margins of the Uruguay Round,” (EP 1993a:4) but the threat of one million tonnes of tuna being dumped on EC markets generated sudden interest in saving dolphins and support for unilateral measures having extraterritorial effect. The ecolabel controversy between the EU and its trading partners exemplifies the potential for green protectionism, and the pressure for WTO reform created by a new generation of environmental policy tools which blur the product/process dichotomy underpinning traditional environmental trade law (EC 1996a).

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Signs of green protectionism have also appeared in the EU's handling of CAP reform. Lenschow notes that EU ministers have expressed alarm over additional moves towards agricultural trade liberalisation which would expose them to competition from non-EU states with lower environmental standards. Unless offset by domestic subsidies, CVDs, or direct trade barriers, the EU's relatively stringent environmental policies may eventually disadvantage its farm sector when entering bilateral agricultural trade agreements (for example with South Africa). And if EU environmental standards are not maintained uniformly across the Union after its enlargement, similar competitive divisions may emerge between the present agricultural community and farmers in candidate countries.

### **Strategic EU environmental policy**

In contrast to the traditional sticks and carrots approach which acknowledged and sought to neutralise the negative economic effects of environmental regulation, recent debates have centred around the new paradigm of "strategic environmental policy" which questions the inherent tension between economic and environmental goals. Rather than envisaging a race to the bottom, this theory suggests that unilateral action actually improves economic competitiveness, thereby igniting a race to the top (Barrett 1993). Part of this new approach is to recast environmental costs as investments in long-term competitiveness and self-interest. The argument, increasingly heard in Europe, that environmental protection provides long term economic advantages, echoes similar claims made by American scholars struggling to reconcile US environmental regulation with competitiveness (Porter 1990, Porter and van der Linde 1995).

The Commission has espoused this new perspective in a series of recent publications, and has grounded the legitimacy of ambitious EU supranational regulations on their ability to promote "win-win" solutions--instances where rising environmental standards not only diminish pollution, but reduce production costs and improve competitiveness (EC 1992, 1993b, 1994, 1996a). The strategic environmental policy view argues that firms do not automatically operate at maximum efficiency and profitability because market failures, including operational and transaction costs, prevent them from automatically pursuing innovation and savings. Thus the environmental regulation so adamantly resisted by industry actually generates a range of net financial gains:

by guaranteeing clean inputs for manufacturing, spurring more efficient modes of production, preventing disruptions to production caused by environmental accidents, improving workers' health and productivity, guaranteeing EU products access to foreign markets, meeting green demands from foreign consumers, and positioning EU firms with first mover advantage to capture the lucrative \$200 billion global market for green technology and services.<sup>6</sup> Not only do regulated industries actually stand to gain financially, so the argument goes, but by reducing pollution governments can improve the business environment, thereby encouraging foreign investment and preventing capital flight.

Studies of how environmental regulation has affected the performance of firms in the US, Germany, Japan and Australia provide numerous examples of missed investment opportunities and after-the-fact savings which support Commission claims that win-win solutions abound (Blazejczak 1993:110, Porter and van der Linde 1995). Rather than arising spontaneously from market forces, these savings have occurred through regulation, as inertia, risk and uncertainty are overcome by levelling the playing field with tough standards (van der Linde 1993:74-76).

The papers suggest that the strategic approach has played a minor role compared with reliance upon traditional sticks and carrots, but that in a few instances the Commission and individual member states have built win-win provisions into their environmental policies.

On EU climate change policy, Heller discusses how the Commission has based its strategy for selling a carbon-energy tax to reluctant member states on the promise that environmental protection yields a "double dividend" of increased growth and employment, the clearest example to date of a win-win philosophy. The Commission contends that restructuring national tax bases, deriving revenue not primarily from the usage of labour by firms as is currently done, but by taxing their consumption of environmental resources, will stimulate technological development and enhance EU competitiveness while also averting the consequences of global warming (see DRI 1994).

Robins explores how the "second generation" of green development assistance has involved a search for win-win solutions through the use of tied aid—improving environmental conditions abroad while simultaneously increasing exports of EU services and high technology pollution abatement equipment. Officially, EU aid policy is designed in part to promote use of environmentally friendly technology by developing states (Robins 1996). However, the Community recovers 48% of this money through purchases from

European companies by recipient states. And 80% of Lome contracts go to EU firms. A similar win-win strategy has been adopted at the national level: Denmark and France each offer substantial amounts of aid, but in both cases 35-50% is tied to purchases in the donor state and national officials extol the domestic economic objectives of green development assistance. Unfortunately, the intra-EU competition issue re-emerges here, as states are reluctant to screen or in any way hinder export promotion activities. Although eventually halted, British funding for the Pergau hydro-electric scheme in Malaysia highlights the potential environmental consequences of tied green aid.<sup>7</sup>

Besides reliance on tied aid, the emergence of an EU “environmental security” dimension may offer a novel form of legitimating international environmental assistance as part of a win-win strategy. Instead of focusing on the cost of providing aid, this new approach would emphasise how sustainable development promotes the EU’s economic and political security by guaranteeing a steady long-term supply of materials, improving stability in developing states, and preventing flows of environmental refugees.

In contrast to the climate change and green aid examples, Nollkaemper finds that neither the Commission nor individual EU member states have followed a win-win approach towards controlling marine pollution from the shipping sector. The Commission’s reluctance to adopt a strategic perspective appears somewhat surprising in light of a 1993 analysis which predicted that stringent environmental rules and improved enforcement would undoubtedly damage competitiveness in the short run but would yield win-win results over the long run by inducing innovation. On the other hand, the steady decline of EU shipping and continued flagging out make aggressive unilateral measures appear less attractive.

Nor did a win-win philosophy underpin national or EU policies to protect the ozone layer although some authors, including Rowlands suggest that *ex post* analysis has revealed that international restrictions might have actually yielded net savings where substitutes cost less than the CFCs they replaced. According to these accounts, while for many years producers had knowledge of these potential substitutes and in some cases were investing in their development, government regulation was a necessary prerequisite for their actual introduction and the attendant cost savings. Nevertheless, Rowlands notes that once international regulation became inevitable, EU companies pursued win-win strategies by seeking first mover advantages. In this case industry did not receive substantial direct aid from national governments or the EU, but as part of a long-term strategic approach such measures might feature more prominently in future episodes.

## *Risks of this approach*

Does the strategic environmental policy approach really provide an adequate foundation upon which to overcome the competitiveness problem and construct the next generation of environmental policies? Or does reliance on win-win solutions offer more of a false panacea than a source of legitimation?<sup>8</sup> Unfortunately, a combination of economic considerations, legal impediments and moral uncertainties make it unfeasible for the Commission or ambitious member states to justify tougher environmental standards solely on the grounds of positive competitive gains.

As discussed above, the fact that studies of how environmental regulation affects competitiveness are inconclusive, and that negative economic impacts on certain sectors are hard to deny, highlight the unlikelihood of obtaining win-win solutions in each and every case (Jaffe et al 1995:157, Palmer et al 1995 Stewart 1993:2082-84, EEA 1996:33). Evidence suggests that, if they occur at all, the economic gains from stringent environmental regulation often fail to offset the costs completely. Moreover, the negative relationship may intensify as global infrastructure improves and competitive advantage depends more on small factors such as the marginal costs of environmental protection (Medhurst 1993:43).

And even if one assumes that in many cases a strategic environmental approach could produce competitive advantages, important economic problems of distribution arise because win-win offsets do not always involve gains by the industry being regulated. Rather, the winners and losers under a win-win approach are often different groups (EEA 1996:33-34). For example, the Commission might be correct that tough unilateral environmental standards will induce first mover advantages and help the EU environmental protection industry capture the lucrative market for green technology and services, but this "win" will be accompanied by losses imposed on dirty and often declining industries which must purchase this technology and pay higher costs for energy, waste disposal or emissions reductions, which could force them to relocate or close. Devising and coordinating a system of "strategic" environmental regulation which balances winners and losers therefore involves much larger questions about the extent to which governments should involve themselves in market intervention and industrial policy.

Of course capturing green technology markets is only one element of win-win solutions--ideally, stringent environmental standards encourage efficient production and induce innovative management, the savings from which accrue to the regulated industry itself. Moreover, a firm's capacity for

distribution and industrial policy remain because these offsets are often contingent upon targeted government tax rebates and subsidies, as shown particularly clearly in the case of carbon-energy taxes (see Golub 1997a, EC 1996b).

Coordinated packages of direct offsets might increase the frequency of win-win solutions, but strategic environmental policies which incorporate these features encounter several legal impediments. The Polluter Pays Principle (PPP), supported by the OECD and enshrined in Article 130 of the Maastricht Treaty, militates against government, as opposed to industry, investment in pollution abatement. GATT rules on subsidies and countervailing measures allow a certain amount of "assistance to promote adaptation of existing facilities to new environmental requirements imposed by law," but "cannot cover investments that result in manufacturing cost savings" and generally discourage any green subsidies which are open to abuse and threaten to undermine the PPP (EC 1996a:15, Esty 1994:170, Charnovitz 1993:2041). GATT rules also take a dim view of achieving win-win solutions through green protectionism, and EU actions to develop ecolables, and to protect animals and forests have received international criticism precisely because they privilege EU industry. In sharp contrast to these cases, it should be noted, changes to GATT rules as part of ongoing trade liberalisation actually facilitated the greening of the CAP.

Direct government intervention, whether in the form of industrial policy, recycled tax revenue or targeted subsidies, also runs a high risk of violating EU treaty provisions on competition and state aids (EC 1996a, 1996b, Delbeke and Bergman 1997).<sup>9</sup> Even if used to facilitate win-win solutions, the Commission recognises that "state aid is liable to give certain firms an advantage over their competitors in other Member States not receiving such aid" (EC 1995b:156). EC rules, while highly complex and open to various interpretations, generally allow governments to cover only 15-25% of a firm's investment towards meeting new environmental standards.

Ironically, even if the strategic approach were economically feasible and permissible under international trade law, its premise actually undermines at least part of its legal legitimacy under EU treaty provisions (Golub 1996a). One of the traditional justifications for harmonising EU environmental laws, and under the subsidiarity principle one necessary to establish that EU action is "better" than national action, has been that diverging national regulations convey illegitimate competitive advantages to laggard states (often in Southern Europe) by creating room for environmental dumping and pollution havens. This argument from economic considerations is no longer tenable if, as the Commission now contends, stringent unilateral standards by progressive

member states actually provide them with competitive advantages. The only remaining economic rationale for regulation at the EU level would be to prevent green protectionism amongst member states--the leaders rather than the laggards would constitute the threat to competition. While this could legitimate EU product standards, it would not extend legitimation to EU regulation of industrial processes.

Moreover, with limited internal competence for certain types of environmental regulation, the Commission will have a more difficult time establishing the legal legitimacy of an international EU voice (Nollkaemper 1987). The Commission's dilemma is only made worse by the fact that several aspects of EU win-win solutions do not require any international action. Continued growth in the market for green technology requires that other states eventually adopt tough environmental laws similar to those in the EU, which would justify a strong Commission role in international negotiations, but the economic efficiency and other cost savings associated with win-win solutions can be captured simply with national or possibly EU rules.

Finally, and perhaps most significantly, the strategic, "free lunch", approach poses a moral question: does the Commission really want to stake the legitimacy of future EU environmental policy primarily on the availability of win-win solutions? To do so would significantly curtail the range of permissible measures, and would surrender the classic source of legitimation for regulation designed to safeguard public goods--that it provides net social benefits. This is not a win-win approach, but rather a "win > loss" perspective, which would justify stringent regulation when the social welfare it provides through a clean environment outweighs the social cost, including a possible loss of economic competitiveness (compare Palmer et al 1995 with Porter and van der Linde 1995, see EC 1996b, Golub 1997a).<sup>10</sup>

### **EU competitiveness and the environment: the difficult road ahead**

Twenty-five years of internal EC regulation and international agreements have done much to improve environmental protection. How has this been accomplished given the inherent tension with economic objectives? Green leadership from northern European states, often in alliance with parts of the Commission and usually with the persistent support of the European Parliament's environment committee, helps explain many such policy advances (Héritier et al 1995, Sbragia 1996b, Judge 1993).

However, the working papers highlight two recurring themes which environmental groups often lament, and which provide perspective on the achievements made to date as well as the path ahead: that competitiveness objectives have delayed and in some cases prevented environmental regulation at the national level, and that reconciling these conflicting objectives through collective international action has proven both politically and legally difficult. Judging from the seven cases here, as well as those considered in the other two volumes of this series, this task will only become more difficult in the coming years.

Constructing the next stage of EU environmental policy appears daunting in the face of pressures to maintain and improve economic competitiveness, but atrophy of supranational authority is not necessarily inevitable, nor environmental decline unavoidable. Continuation of a strong EU role in this field depends on convincing a majority of states that supranational action remains the most rational means of combating environmental degradation, and that economic competitiveness can in fact be reconciled with environmental protection. To rebuild confidence in the European project, the Commission has embraced two strategies.

The first is to minimise regulatory costs by replacing the traditional EU command and control approach with a greater emphasis on new flexible and efficient policy tools such as ecotaxes, ecolabels and voluntary agreements with industry (Collier 1997, Golub 1997a, 1997b). The second has been to transform the competitiveness debate in favour of EU environmental action by seeking new sources of legitimacy for environmental regulation. In the cases where they can be found, and legally achieved, win-win solutions should be seized as a means of reconciling competitiveness and environmental protection. But free lunches may constitute a minority of cases, particularly if EU and GATT rules prevent the possibility of wedding environmental and industrial policy. Tough unilateral EU environmental standards therefore run the very real risk of damaging EU economic competitiveness. One possible way forward, then, would be for the Commission to strengthen its commitment to multilateral solutions, not only because they “offer the most effective way to tackle global and transboundary environmental problems” (EC 1996a:10-11), but also because, as examples of the “stick” approach, they offer an attractive means of saving the global commons without sacrificing competitiveness.

Even the multilateral approach has its limits, however, some of which are identified by the authors in this volume. First, the Commission will continue to encounter resistance over the issue of its external competence. In shipping, member states have traditionally resisted empowering the Commission as an

external voice in the IMO, preferring wide latitude for their individual negotiating efforts, although Nollkaemper identifies some recent moves towards greater Commission involvement. Pallemmaerts finds similar instances in the early stages of pesticide regulation where the Council denied the Commission's request to play a leading role in international negotiations. Similarly, Member states are not convinced of the value-added from EU environmental development assistance, and outside of a few exceptional cases jealously preserve traditional bilateral aid arrangements, with their attendant advantages for pursuing national security interests and promoting national exports. Second, multilateral solutions also pose sometimes insurmountable collective action problems, which is why Heller advocates a "minilateral" solution to CO<sub>2</sub> reduction through the use of JI.

A third problem is that while international harmonisation and other multilateral arrangements are often a solution to avoid competitive disadvantages, they are sometimes a second-best option because they undermine the stringency of EU laws. In essence, rather than wielding a "stick" at the international level, the EU is forced to capitulate on environmental standards. For instance, international adoption of the ISO standard for ecolabels has been suggested as a way to avoid a proliferation of EU rules which constitute trade barriers, but its environmental merits have been seriously questioned in comparison to the EU's preferred labelling criteria (Taschner 1997, Europe Environment 1995). Creating ISO "humane standards" which when met by hunters would guarantee the export of their furs might obviate recourse to trade restrictions from an outright EU ban on the use of leg-hold traps, but might not adequately prevent the use of these traps in North America. Finally, the Commission's sanguine view that multinational agreements will be deemed trade-friendly under GATT/WTO rules (EC 1996a:17) may not materialise in practice, in which case resolving competitiveness issues will require a different solution. This raises interesting questions about what the EU should do in such situations, whether it can maintain its own high standards, whether it must adjust downwards in order to continue trade relations with its partners, and whether at some point it should abandon trade for environmental reasons.

In light of all these concerns, must proponents of a cleaner environment therefore concede defeat? Not necessarily. As mentioned earlier, the win-win and "stick" approaches do not exhaust the possible grounds upon which to legitimate aggressive national and EU environmental regulation. Despite its zealous commitment to free lunches as a means of reconciling economic and environmental objectives, the Commission has been careful not to abandon entirely the possibility of justifying pollution reduction in the absence of similar foreign measures, even without positive effects on competition. The fifth EAP

includes a section on costing environmental pollution (and the social costs of “non-environment”) which espouses a more traditional philosophy: the only condition that is really required to legitimate environmental protection is that “the ultimate benefits should outweigh the so-called costs over time” (EC 1993b:141). This demands consideration for the welfare of future generations as well as the Treaty’s precautionary principle. Meeting the ‘ultimate benefits’ test should not prove difficult given the enormous social costs of foregoing environmental action (EP 1994).<sup>11</sup>

Pursuing environmental protection for its intrinsic value has long been the primary motivation of leader states in the EU as well as the Commission, and finds clear expression in both the Single European Act and the Maastricht Treaty on European Union. It has underpinned previous policy developments, and it might offer the best rationale for combating a wide range of polluting activities in the future. And, as Nick Robins argues, the adoption of a traditional rather than a strategic approach to policymaking is also crucial for the continuation of environmental and humanitarian aid. Justifying member state and EU assistance strictly on the grounds of potential win-win solutions not only abdicates moral leadership and abandons aid efforts whose primary objective is poverty relief, it also commits donor states to a system which yields perverse results such as those evident in the Pergau dam incident. This perspective diverges radically from Heller’s plea to substitute a “culture of business for a culture of aid”.

But before deciding to pursue a unilateral approach, regardless of possible adverse effects on competitiveness, the Commission and individual member states must also consider which course of action will actually maximise environmental protection. If firms respond to declining competitiveness by relocating or reinvesting outside the EU, the important question becomes whether such industrial “flight” degrades or improves the global environment. The former suggests that strict regulation within the EU will simply result in greater damage abroad as pollution shifts location (for several examples, including the US-Mexico case, see French 1993). Alternatively, flight might not be a bad thing for the environment, as multinational companies fleeing proposed legislation in one country often take their state-of-the-art methods and technology with them. Some studies have found this “environmental technology transfer” effect whether examining investment in Latin America, East Asia, Eastern Europe or the former Soviet Union (Zamparutti and Klavens 1993:124, Palmer et al 1995:130, Stewart 1993:2070, Jaffe et al 1995). Additional research is required to illuminate this facet of the environment-competitiveness issue.

The path forward is most certainly paved with obstacles. Inevitably, despite the fact that excessive attention to competitiveness may be myopic and misguided, appeals to general social welfare will be more difficult, even impossible, in a political climate sensitised to any legislation which might undermine comparative advantage. At the same time, however, neither a strategic nor a multilateral approach by itself offers a satisfactory solution. Those devising the next generation of environmental policies in the EU therefore face the difficult challenge of securing political viability for a regulatory package which strikes an appropriate balance between competitiveness and environmental protection.

## Notes

- <sup>1</sup> The literature devoted to international environmental policy, when it addresses the role of the EU, its member states, and competitiveness, does so as a means to explore regime building, interest group involvement and the environmental implications of individual international conventions (Haas, Keohane and Levy 1993, Hurrell and Kingsbury 1992, Young 1989). Moreover, the leading texts on the determinants and future of European economic competitiveness pay little or no attention to the issue of environmental policy (Francis and Tharakan 1989, Hughes 1993). For analyses which do discuss competitiveness issues as they relate to both internal and external EC environmental policy, see Klepper (1992) and Freeman et al (1991).
- <sup>2</sup> Precisely how one should conceptualise competitiveness, particularly its relationship with productivity, remains a matter of intense debate, as does the notion that a country's economic competitiveness depends on the performance of firms within its boundaries (Francis 1989, Hughes 1993, Krugman 1994).
- <sup>3</sup> Heerings attributes the decline of the EC fertiliser industry in part to mounting pressure, particularly in Belgium and the Netherlands, to reduce cadmium and phosphorus discharges. The example highlights the role of national regulation, as the 1983 EC Directive on cadmium emissions explicitly exempted the phosphate fertiliser industry.
- <sup>4</sup> Heller's 'window of opportunity' prognosis sharply contradicts scholars who suggest that action can be postponed another decade or more without risking environmental catastrophe (see Beckerman 1991).
- <sup>5</sup> In its 1992 "Communication on Industrial Competitiveness and Environmental Protection," the Commission claimed that it "fully support[ed] the basic rule according to which a country should not unilaterally restrict imports on the basis of environmental damage which does not impact on a country's territory" (EC 1992:8).
- <sup>6</sup> To cite just one of the many examples from Commission documents, the Fifth EAP contains a section on international competitiveness which portrays stringent environmental requirements as sources of competitive advantage (EC 1995:64). In 1990 the world market for pollution control was \$200 billion. The EC market has been estimated at \$50 billion, and enormous growth is forecast through year 2000. Commission figures also show that 600,000 European jobs are linked to the eco-industry (EC 1992).
- <sup>7</sup> Robins also identifies conditions under which development aid promotes rather than harms recipient states, such as where national governments have used aid finance to raise the competitiveness of developing country producers, assisting them improve production standards and achieve certification so as to gain access to the environmentally conscious markets of the North.
- <sup>8</sup> This charge has been levelled against Martin Porter and other American proponents of this approach (Palmer et al 1996, Oates et al 1993).

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<sup>9</sup> Articles 92-94 of the Treaty prohibit state aid which distorts competition within the common market.

<sup>10</sup> The distinction between this approach and the win-win strategy is crucial: “the suggestion of proponents of the Porter hypothesis is not that the benefits of environmental regulation (in terms of reduced health and ecological damages) exceed the costs of environmental protection...Rather, the notion of a “free lunch” is that—putting aside the benefits of environmental protection—the costs of regulatory action can be zero or even negative (a “paid lunch”) (Jaffe et al 1995:155).

<sup>11</sup> For a quantitative study of US air and water laws which finds that social gains from environmental regulation have outweighed the costs, see Burtraw and Portney (1991).

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