

## Recipe for Industrial Policy: Blending Environmentalism and International Competitiveness

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**T**he answer to the question of whether the United States has an industrial policy is "Yes". It is formed by default by the sum total of the political decisions that affect the economy.<sup>1</sup> Environmentalism, I will argue, is a very substantial determinant of that industrial policy.

The issue before the house is not really whether we should have an industrial policy, but to what degree concerns about international competitiveness ought to play a role and be harmonized with our domestic policy goals and concerns. That is another way of saying that I see environmentalism and international competitiveness as two fundamentally different ways of looking at the world, which are, in a sense, in competition, perhaps in collision.<sup>2</sup> Both will shape the goals for our industrial policy in the next few years. The tension or collision between these two bodies of thought was first reflected by voices of opposition to the North American Free Trade Agreement ("NAFTA") coming in part from the environmental community in the United States. That was one of the first signs of what is really a deeper and more fundamental conflict.

I was recently in Ukraine, and heard a story that indicates to me a part of what the reaction of the environmentalists might be. The story is set during the Communist years. Apparently a farmer is walking down a road and several members of the Communist party come up to him and ask him how committed he is to the Party. He responds that he is very committed. They inquire as to whether he would give his tractor for the Party. He says, "Yes, of course." They ask him whether he would give up his wife for the Party. Again, he responds affirmatively. Then they ask about giving up an old cow. He says "No, not at all". They inquire as to why he is emphatic about not giving up the old cow. He responds, "Because I *have* the cow."

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The following text was compiled from the transcript of the remarks made by Professor Elliott at the Conference.

<sup>1</sup> One thinks of Camus's point that "No decision is also a decision," or Sheik Yammoni's remark, "The Americans think that no oil policy is an oil policy."

<sup>2</sup> The Danish Bottles case illustrates one such collision. In that case, the European court held that parts of Denmark's requirements that certain beverages be sold in returnable containers violated the principle that the restrictive effect on trade should not be disproportionate to the environmental objective. Case 302/86 EUR. COURT REP. 4607 (judgment of Sept. 20, 1988).

The same problem arises for the environmentalists. The environmentalists have had a very fundamental role in determining industrial policy in the United States in the last two decades. They perceive, perhaps properly, that their role and their values are increasingly being threatened by other competing forces which claim that their policy goals and objectives ought to play a more substantial role in defining our industrial policy.

I want to talk about the importance of environmental law in United States industrial policy and, also, what the effect of our current environmental policies are on international competitiveness. Then I want to turn to how in the future new legal relationships like those that will be created by NAFTA will change those policy relationships. Finally, I want to talk about how I see environmentalism and competitiveness as potentially harmonized in the future.

Let me turn quickly to the question of the importance of environmental regulation on industrial policy in the United States today. A year or so ago in the *Foreword* to the annual business issue of the *Wake Forest Law Review*, I observed that environmental policy had become like tax policy in the United States.<sup>1</sup> That is, no significant business transaction could be undertaken in the United States without thorough analysis of the potential environmental implications.

The fact environmental law has a substantial effect on business in the U.S. is also reflected by information about the aggregate effect of environmental law and business in the United States. We currently spend in the United States about a \$100 billion dollars a year in the public and private sector, combined, on environmental compliance. By the year 2000, based on the laws that have already been passed, that number will go up to \$150 billion.<sup>2</sup> That is currently about half the total cost of government regulation of the economy, just based on environmental compliance.<sup>3</sup> To put it in perspective it is right in the range of 2.5 percent of gross national product ("GNP").<sup>4</sup> Now, to put that number in perspective, 2.5 percent of GNP is almost exactly what we spent on the Marshall Plan to rebuild Europe following World War II.<sup>5</sup>

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<sup>1</sup> E. Donald Elliott, *Foreword: A New Style of Ecological Thinking in Environmental Law*, 26 WAKE FOREST L. REV. 1 (1991).

<sup>2</sup> E. Donald Elliott, *Environmental Law at a Crossroad*, 20 No. KY. L. REV. 1, 1 (1992) (Seibenthaler Lecture).

<sup>3</sup> Robert W. Hahn & John A. Hird, *The Costs and Benefits of Regulation: Review and Synthesis*, 8 YALE J. ON REG. 233 (1991); Kirk Victor, *Quayle's Quiet Coup*, NATIONAL JOURNAL, July 6, 1991 at 1676-77 (About half of the \$185 billion annual cost of government regulation stems from environmental rules; describing operations of the President's Council on Competitiveness).

<sup>4</sup> William K. Reilly, *Aiming Before We Shoot: The "Quiet Revolution" in Environmental Policy*, Address Before the National Press Club (Sept. 26, 1990).

<sup>5</sup> See CLARK CLIFFORD & RICHARD HOLBROOKE, COUNSEL TO THE PRESIDENT: A MEMOIR 195 (1991) (Marshall Plan equal to 2.5% of U.S. GNP).

Of course, the economy was much smaller then. So, one can think about environmental regulatory efforts as essentially the equivalent of an annual Marshall Plan at home to deal with the environment.

By remarking about how large this commitment of social resources is, I do not by any means want to be mistaken as implying that it is too large. It is almost exactly the same percent of GNP as Germany and Japan are spending.<sup>6</sup> I think the question is not the aggregate level of effort, but what are we getting for our money's worth? In that area we have some very good and also some very poor environmental expenditures.

I want to turn then to the aggregate effect of environmental regulation on U.S. competitiveness. One issue which has recently been raised in connection with NAFTA is whether differences in environmental compliance costs in various parts of North America will result in pollution havens. The concern is that an incentive will be created to move new enterprises and locate them in areas such as Mexico where environmental compliance is not as stringent as it is in other parts of North America.

The analysis of that issue by the Environmental Protection Agency and the Bush Administration was that the environmental compliance costs tend to be, for most industries, relatively small by comparison to other determinants as to where a factory would locate.<sup>7</sup> These include such things as labor costs, proximity, and transportation costs. While there might be some effect at the margins as a result of differences in environmental standard, I think that is not the primary way that environmental law may effect competitiveness.

Much more of a concern, I think, is the overall problem of the dead weight loss; that is, the type of regulation which imposes a burden on economic activity, but produces little or nothing in return. In order to evaluate environmental regulation from that perspective it requires that we change our traditional conception of looking at what environmental regulation is about.

Many economists have traditionally thought about environmental regulation as another kind of consumption good. People have a preference for a clean environment like they have a preference for broccoli or sax music. The amount of money that is going into environmental regulation is essentially consumption of a good that people desire.

Increasingly, economists are coming to rethink that way of looking at environmental protection and think of it much more in terms of public investment, just like building a road or some other activity. When one begins to think of environmental regulation as a public investment

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<sup>6</sup> See Elliott, *supra* note 1.

<sup>7</sup> Review of U.S.-Mexico Environmental Issues, Section III.D.2, Office of the U.S. Trade Representative, February, 1992.

it becomes clear that one cannot make a judgment in the aggregate as to whether or not it is a good or bad investment. It is just like building a road. If you build a road to nowhere and it produces very little, then it is not a particularly good public investment. Similarly with environmental protection. If you invest in a particular environmental regulatory matter that prevents more harm in terms of disease and expense than it costs, then it is a very good investment. On the other hand, if we spend a great deal of money on a particular program and it produces very little by way of benefit, then it is not a particularly good investment.

We have both of those kinds of activities in the environmental area. One difficulty in terms of applying the cost-benefit framework in the environmental area is often there are very substantial benefits that are extremely difficult to quantify. Measurement difficulties in the environmental area are really enormous. Nonetheless, there are many environmental expenditures that I believe are very clearly justified on a cost-benefit basis. One example is controlling lead in drinking water. For each expenditure to reduce the level of lead, one is preventing retardation in children which imposes large costs on society down the road.

Overall, from the standpoint of this perspective, environmental regulation shows up pretty well. In 1990 in an article in the *Yale Journal on Regulation*, Robert Hahn and John Hird synthesize and review the literature on the costs and benefits of government regulation. The article concludes that government regulation of the economy in the U.S. is costing about \$160 billion a year, of which about forty-five billion dollars is a dead weight loss on the economy.<sup>8</sup> That is, in total, government regulation produces benefits that are forty-five billion dollars a year less than its cost. However, in the environmental health and safety field, that is not the case. The aggregate, measurable benefits from environmental health and safety regulation are just about the same as the costs. It is very difficult for the authors to say there is a substantial net benefit or that there is a substantial dead weight loss on the economy. Most of our environmental programs, like the 1990 Clean Air Act, have estimated benefits from the program and estimated costs of the program that are just about the same. The comparison is within the range of uncertainty.

The real problem in the environmental area, as far as dead weight losses on our competitiveness is concerned, has to do with Superfund and related cleanup programs. Most of the other environmental programs are pretty close in terms of costs and benefits.

The University of Tennessee recently projected that if we continue on our current course with regard to the Superfund Program for clean-

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<sup>8</sup> Hahn & Hird, *supra*, note 3.

ing up hazardous waste sites over the next twenty years we will spend approximately \$1.2 trillion for virtually no benefit in terms of public health.<sup>9</sup> Now, just to put that in perspective, the annual output of the U.S. economy is on the order of five to six trillion dollars a year.

The problem with computing cost-effectiveness with Superfund is that there are really very few people who are exposed to the waste from a Superfund site. In addition, at a Superfund site, a very large percentage of the risk reduction is bought for a very small percentage of the costs at the front-end when EPA comes in and does what is called a "removal". That is where you get rid of the leaking drums and stabilize the situation. Typically, over ninety percent of the cost comes after that stage when you do the long-term cleanup, and of that, twenty to thirty percent is going into the hands of lawyers and consultants. The long-term, high-cost remediation of Superfund sites produces very little in terms of public benefit.

There is hope, I think, that this problem, which is really a major problem for the U.S. environmental effort, generally may receive some reconsideration in the Clinton Administration. After twelve years in which the Congress identified that there were no substantial problems in the Superfund Program and that the source of all problems was simply poor administration by the Republicans in office, there has suddenly been a change now that there is a Democrat in the White House. Recently, for example, Congressman Dingell announced that Superfund is a "waste of taxpayers' money".<sup>10</sup> We have a political opportunity as a country to really reexamine the question of how much of our limited natural resources ought to be deployed toward cleanup. The systems that we currently have for assuring there is some reasonable parity between costs and benefits in the environmental area do not work particularly well. From discussions with John Howard at this conference, it appears we have a more substantial effort in that area perhaps than in Canada, in the sense that we generally have judicial review of environmental decisions. However, judicial review has generally proved relatively ineffective at disciplining the political process in terms of costs and benefits in the environmental area. That was one reason that the Office of Management and Budget ("OMB") regulatory review process was created in the early 1980s; the ineffectiveness of the judicial review process to control the bureaucracy.<sup>11</sup>

Despite what you might read in the newspapers, academic studies of the OMB process which are reflected in a particularly fine book by

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<sup>9</sup> See Robert Hahn, *Reshaping Environmental Policy: The Test Case of Hazardous Waste*, 2 AMER. ENTERPRISE May/June 1991, at 72, 75.

<sup>10</sup> *Dingell Expects Drafting of RCRA, Superfund Legislation This Year*, Daily Rep. for Exec. (BNA) No. 75, at D-30 (Apr. 21, 1993).

<sup>11</sup> See E. Donald Elliott, *The Dis-Integration of Administrative Law: A Comment on Shapiro*, 92 YALE L.J. 1523 (1983).

Kip Viscusi, an economist at Duke, called *Fatal Tradeoffs*,<sup>12</sup> shows that the OMB regulatory review process has also been relatively ineffective at disciplining regulatory action in the environmental area. Viscusi recites that, on average, a regulatory measure in the environmental area spends about a \$145 million per statistical lives saved, which is about ten to fifteen times greater than the going rate for other expenditures in the economy. So OMB, too, has proved to be relatively ineffective at balancing a economic and environmental goals.<sup>13</sup>

There have been other political initiatives to try and ensure that environmental protection achieves a relatively good ratio of costs and benefits. There has been lots of emphasis in recent years on trying to develop a better process for ranking risks and comparing environmental expenditures in terms of the common metric of risk reduction. This goes back to EPA's *Unfinished Business Report* that was done in 1987 and which has been updated. Recently, there has been a lot of discussion about trying to focus our environmental expenditures where we will get the greatest benefits in terms of risk reduction. One of the great problems in this area is, essentially, that we are a democracy. Oftentimes, the public perceives the greatest risks far differently than where the so-called experts see the greatest risks as being. If you rank environmental risks according to the experts and according to the public, they are almost exactly reversed. The public sees the greatest environmental risks as being in the hazardous waste and the nuclear field. The so-called experts see the greatest benefit in terms of risk reduction, air pollution, water pollution, and perhaps global climate change where you have large numbers of people exposed.

The conflict between the public and the experts is where I think the effect of NAFTA really will be felt. Not only NAFTA, but also the GATT and the developing level of international regulation. In the volume last year, Michael Hart wrote that the purpose of trade agreements is to essentially regulate governments.<sup>14</sup> I think that Michael's statement was very insightful. And Robert Hudec, a professor in the international law area, has written in a forthcoming article even more pointedly that one of the purposes of international trade agreements is to change the results that would be reached by domestic legislation alone.<sup>15</sup> It is, according to Hudec, essentially an act of self-paternalism by a legislature to enter into an international trade agreement and reg-

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<sup>12</sup> W. Kip Viscusi, *FATAL TRADEOFFS: PUBLIC AND PRIVATE RESPONSIBILITIES FOR RISK* 1992.

<sup>13</sup> For the author's views on improving the OMB process, see Elliott, *TQMing OMB, LAW & CONTEMP. PROBS.* (forthcoming).

<sup>14</sup> Michael Hart & Sushma Gera, *Trade and the Environment: Dialogue of the Deaf or Scope for Cooperation?* 18 *CAN.-U.S. L.J.* 207, 1992.

<sup>15</sup> Robert Hudec, *"Circumventing" Democracy: The Political Morality of Trade Negotiations*, 25 *N.Y.U. J. OF INT'L L. & POL.* [] (1993).

ulatory regime. One of its purposes, again according to Hudec, is to provide an international forum that can question the extreme actions that are driven by domestic political forces. The domestic political considerations that require the subsidization of farmers in France is another one of those issues. It seems clear to me that NAFTA will essentially provide a series of procedural mechanisms by which some of our more extreme environmental actions can be questioned in an international forum.<sup>16</sup>

Article 712 of NAFTA provides a mechanism by which measures that arguably have an adverse effect on international trade within the North American free trade area can be challenged on the grounds that they adversely affect trade. The burden is on the party challenging the measure, and it can be challenged before expert dispute resolution panels. However, the measure can be upheld if it is found that it is scientifically necessary for protection of health or the environment. Consequently, the Article 712 process essentially provides a forum in which some of our environmental measures are very likely to be challenged on the grounds that they go well beyond what is really necessary from a scientific perspective.

There are a number of key procedural issues that will need to be sorted out before it can be ultimately determined how effective NAFTA will be at providing this additional check or international review of some of our environmental regulations. One key issue which is currently in the process of being decided is whether or not individual companies can actually participate and bring such challenges or whether or not challenges can only be brought on a government-by-government basis.

Increasingly in the negotiations concerning the procedure for the North American Commission on the Environment, we are moving in the direction of giving individual groups the right to participate.<sup>17</sup> It appears that a mechanism may be agreed upon whereby, for example,

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<sup>16</sup> Despite such challenges, Sandy Gaines, Deputy Assistant U.S. Trade Representative for the Environment, contends that "NAFTA itself assures that the United States and state and local governments can continue to adopt standard legislative and administrative procedures, and apply firmly and fairly their full arsenal of environmental laws, regulations, and policies." Sanford E. Gaines, *Environmental Laws and Regulations After NAFTA*, 1 U.S.-MEX. L.J. 199, 210 (1993).

<sup>17</sup> Subsequent to this speech, the final draft of the NAFTA supplemental agreement regarding the environment was issued. The final draft, among other things, provides that "[e]ach Party shall ensure that persons with a legally recognized interest under its law . . . have appropriate access to administrative, quasi-judicial or judicial proceedings for the enforcement of the Party's environmental laws and regulations." North American Agreement on Environmental Cooperation, Article 6.2., Sept. 13, 1993. Although the final draft does not provide a means for direct private party challenges to environmental laws and regulations, a private party may petition its government to bring such challenges. Whether denial of a petition to challenge a law or regulation would be subject to judicial review under the Federal Administrative Procedure Act remains an open question, although a denial would appear to constitute an unreviewable discretionary act. 5 U.S.C. § 701(a)(2).

an individual Canadian company that is exporting agricultural goods to the United States would have a right to challenge, for example, the Delaney Clause in U.S. legislation, that says any detectable amount of a carcinogen in food supplies is illegal, on the grounds that kind of a rule is overly stringent and, therefore, not necessary from a scientific perspective.<sup>18</sup>

I think these types of challenges are really terribly threatening to the environmental community in United States. And with good reason. The international standard which has been articulated both in the GATT and under NAFTA is one which imagines that environmental regulation can be justified or can easily be determined to be "scientifically necessary" or not "scientifically necessary." To an environmental lawyer, that appears to be a very simplistic perspective when applied in the environmental area.

One of the difficulties that we have in the environmental area is that the uncertainty term is usually larger than the data term when we are evaluating one of these standards. In other words, we also know very little and, therefore, we have to regulate on a precautionary basis.<sup>19</sup> When we regulate on a precautionary basis we usually deal with uncertainties by applying our cultural values. These values differ widely from one society to another. For example, the risks of cancer that appear quite acceptable to Europeans are risks that systematically appear unacceptable to Americans. Similarly, in the U.S.-Mexico context there has been ongoing debate between the U.S. and Mexico tuna fishers over the question of protecting the dolphins.<sup>20</sup> Undoubtedly to the Mexicans, the dolphin must appear to be the American sacred sea animal. They must find our attitude of protecting the dolphin as strange as we, for example, find the Hindu attitude of protecting cows.

One of the very difficult areas that will have to be sorted out over the next twenty years or so is what kind of deference to these various cultural judgments should be given by international bodies. The difficulties in this area suggest that if there are countries in the world that still pursue the mercantilist ideal — that is, they pursue the ideal that the optimum position for a country is to have everyone else pursue a free trade policy but for my particular country to pursue a protectionist policy — then environmental standards will provide an ideal area in which to try to set non-tariff trade barriers because it is very easy to

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<sup>18</sup> See generally *Les v. Reilly*, 968 F.2d 985 (9th Cir. 1992) (rejecting EPA attempt to read *de minimis* principal into Delaney clause).

<sup>19</sup> See, e.g., *Ethyl Corp. v. EPA*, 541 F.2d (D.C. Cir.) (en banc), cert. denied, 426 U.S. 941 (1976). On the role of uncertainty in environmental decisions generally, see E. Donald Elliott, *Global Climate and Regulatory Uncertainty*, 9 ARIZ. J. INT'L. & COMP. L. 259 (1992).

<sup>20</sup> For a summary, see Peter Lallas, Daniel Esty & David Van Toogstraten, *Environmental Protection and International Trade: Toward Mutually Supportive Rules & Policies*, 6 HARV. ENVIR. L. REV. 271 (1992).



try to justify environmental standards in terms of some of these cultural judgments.

Two other key procedural issues will need to be sorted out under NAFTA, in addition to whether or not individual companies can get involved in bringing the challenges. The second one may be a Canadian company challenge to a Canadian standard on the ground that it is too stringent, or does the NAFTA standard only apply where a company in one country is challenging a standard in another country. For example, can a U.S. company challenge regulations implementing the Clean Air Act on the grounds they go beyond what is scientifically necessary and, therefore, put the U.S. company at a disadvantage vis-a-vis its Canadian and Mexico competitors?

A third issue is whether or not this is a one-way street — whether or not regulations can only be challenged on the grounds they are too stringent, or could they also be challenged on the grounds that they are too *weak*. Can a U.S. company, for example, go in and challenge the lack of enforcement in Mexico arguing that lack of enforcement is giving its Mexican competitors an undue advantage? These are, I think, ultimately some of the kinds of problems that will be confronted as the issue of environmental regulation ultimately moves from the national level to a much more international regulatory system.

I am somewhat optimistic that the challenge can be met in a positive way which harmonizes the goals of environmentalism and competitiveness, and I think that to do that we will have to go to a much more cooperative and less adversarial approach.

There are some positive trends in that direction which I will review very briefly. One is moving to a much more market-based and incentive-based approach to regulation which I think is happening worldwide. My colleague Dick Stewart once wrote that U.S. environmental protection is the one example in our economy of Soviet-style central planning.<sup>21</sup> It is the case that we allocate use of the environment, which is a resource, in a bureaucratic way, which is typical of the way many resources are allocated in a central planning system. Increasingly, we are getting away from that kind of command and control approach to regulation and trying to deal much more in incentive-based approaches.

A second trend, which I think is necessary, is greater integration at the level of government policy. I winced when Deborah Wince-Smith said this morning that regulatory policy was boring. That really cut me to the quick. But the fact of the matter is that the competitive policy of the Department of Commerce is very rarely coordinated at an early stage in the process with what EPA is doing, and there are many, many examples of government policy where activity essentially suffers from

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<sup>21</sup> Richard B. Stewart, *Economics, Environment and the Limits of Legal Control*, 9 HARV. ENV'T L. REV. 1, 6 (1985).

the pursuit of a single objective without really taking into account other values and the kind of integration and total quality management she was talking about.<sup>22</sup> I think it is something we can do much better within the governmental area.

Let me give one example. A typical way that we have set environmental standards in the U.S. is on the basis of so-called "best available control technology," taking into account the economic resources of the companies that are regulated. I recently realized if you look at that policy from the standpoint of the competitiveness of particular sectors on the international stage, this approach is absolutely perverse. What it says is that we will impose a greater burden of environmental protection on those sectors that are best able to pay. For example, the chemical industry, which is one of our few manufacturing industries that is still competitive on the international scale, as a matter of policy, a greater proportion of environmental compliance costs are allocated to that industry as opposed to an industry like the steel industry which is having a hard time competing. So in a systematic manner, our environmental policies tend to dampen down the success of particular sectors on the international scale.

Let me just finish with one idea, and that is that, ultimately, I think environmental protection and competitiveness can be made much more compatible. This is an idea that goes back to Gifford Pinchot, the great real inventor of the conservation movement in the United States and Theodore Roosevelt's Secretary of Interior. Pinchot wrote eighty years ago, "in the great commercial struggle between nations, which will eventually determine the welfare of all, national efficiency will be the deciding factor."<sup>23</sup>

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<sup>22</sup> See generally Lloyd Cutler & Robert Johnson, *Regulation and the Political Process*, 84 *YALE L.J.* 1395 (1975).

<sup>23</sup> GIFFORD PINCHOT, *THE FIGHT FOR CONSERVATION* 50 (1910).