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Trade and the environment

How are trade and environmental sustainability compatible?

The expansion of global trade and the increasing integration of global value chains raise questions about how trade and the environment interact with each other. What are the effects of trade on the environment? And inversely, how can a changing natural environment (e.g. climate change impact) modify trade patterns? Is trade liberalisation good or bad for the environment? What are the short term and long term consequences and can an optimal combination of trade and environment policies harness the benefits of trade while minimizing environmental costs?

Trade can have both positive and negative effects on the environment

Economic growth resulting from trade expansion can have an obvious direct impact on the environment by increasing pollution or degrading natural resources. In addition, trade liberalisation may lead to specialisation in pollution-intensive activities in some countries if environmental policy stringency differs across countries – the so-called pollution haven hypothesis.

However, increased trade can in turn, by supporting economic growth, development, and social welfare, contribute to a greater capacity to manage the environment more effectively. More importantly, open markets can improve access to new technologies that make local production processes more efficient by diminishing the use of inputs such as energy, water, and other environmentally harmful substances.

Similarly, trade and investment liberalisation can provide firms with incentives to adopt more stringent environmental standards. As a country becomes more integrated within the world economy, its export sector becomes more exposed to environmental requirements imposed by the leading importers. Changes needed to meet these requirements, in turn, flow backwards along the supply chain, stimulating the use of cleaner production processes and technologies.

Consequences from climate change can disrupt trade

Direct consequences of climate change on trade could come from more frequent extreme weather events and rising sea levels. Supply, transport and distribution chains infrastructure are likely to become more vulnerable to disruptions due to climate change. Maritime shipping, which accounts for around 80% of global trade by volume, could experience negative consequences, for instance from more frequent port closures due to extreme events. More importantly, climate change is expected to decrease the productivity of all production factors (i.e. labor, capital and land), which will ultimately result in output losses and a decrease in the volume of global trade.

At the same time, there could also be positive economic impacts on maritime shipping through the potential further opening of Arctic shipping routes, albeit at the cost of environmental degradation.

How can policymakers optimally combine trade and the environment policies?

Effective environmental policies and institutional frameworks are needed at the local, regional, national, and international levels. The impact of trade liberalisation on a country's welfare depends on whether appropriate environmental policies are in place within the country in question (e.g. correctly pricing exhaustible environmental resources). Stringent environmental policies are compatible with an open trade regime as they create markets for environmental goods that can subsequently be exported to countries that follow suit on environmental strandards – the so-called first-mover advantage. This is especially true for complex technologies such as renewable energies.

Countries have undertaken a number of environment-related efforts under the World Trade Organization (WTO) framework including negotiating tariff reductions in environmental goods and services, seeking more clarity on the relationship between existing WTO rules and specific trade obligations in multilateral environmental agreements, and seeking disciplines on fisheries subsidies. In this way, the WTO is building a multilateral framework for international trade that also discourages any misguided temptation to engage in a "race to the bottom".

The inclusion of environmental provisions in bilateral and regional trade agreements has also helped harmonise environmental regulations between developed and developing countries. More advanced economies can provide resources and institutions for capacity building, and can encourage lessdeveloped partners to strengthen environmental regulations. The OECD has addressed many issues on trade and environment such as environment and regional trade agreements (RTAs) the drivers of environmental provisions in RTAs, as well as the stringency of environmental policies as a driver for trade in goods in environmental goods and services. We are also currently developing a set of policy indicators on trade and environment to help monitor progress towards more policy coherence, and to identify policy priorities at the intersection of trade and environment.

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