Chapter 27
Environmental Regulation, International Trade, and Informal Sector:
Theory, Policy, and Indian Experience

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ABSTRACT

This chapter deals with some contemporary issues related to trade and environment, which are mainly faced by the developing nations of the world. In this context, the present study has considered some facts and figures of Indian tannery industry for realization of the above-mentioned objective. In this chapter, an attempt has been made to analyze theoretically the effect of both environmental regulation and trade liberalization on the output of different sectors and also on the national welfare in a small open economy. To categorize this, the authors have presented a theoretical model based on the general equilibrium framework that mainly highlights a paradoxical result. Apart from this, the present research shows that the capital used specifically in advanced export sector is likely to affect the welfare positively, and the capital used by the rest of the economy is likely to affect the welfare adversely when usual export sector of the economy vanishes, and the opposite will occur when the pollution-intensive informal sector of the economy vanishes.

INTRODUCTION

The relationship between trade and environment is a complex and highly debated issue. Addressing this relationship is fundamental in order to achieve sustainable development. As a result of increasing global economic interdependence and further trade liberalization as well as growing pressure on the environment and the use of natural resources, there is an ever growing interface between trade and environment. It is widely recognized that trade and environment can be mutually supportive, but, differences remain on effective implementation. The Commission Communication on Trade and Environment, adopted in

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1996, underlined that a mutually supportive relationship between trade and environment can occur but is in no way automatic. In fact, trade liberalization and trade policy have positive and negative impacts on the environment (Mukhopadhyay, 2004; Chatterjee, Gupta & Chatterjee, 2017). However, a number of conditions should be met to ensure that the net gains deriving from trade liberalization will support and reinforce the protection of the environment.

One essential condition for making sure that trade and environment are mutually supportive is to ensure that the trade liberalization process is paralleled with the development and strengthening of effective and non-protectionist environmental legislation, at national, regional and international levels. Environmental policies could, in turn, provide an incentive for technological innovations, promote economic efficiency and, consequently, improve productivity. Having recognized the need for such policies, one should also ensure that trade rules do not unnecessarily constrain but rather support and promote the ability of countries to develop and implement adequate and non-protectionist environmental measures, at both national and international levels.

Trade policy has also a role to play in actively supporting sustainable trade flows and, in particular, environmentally friendly trade. Trade policy and trade related instruments should be further encouraged to act as a sustainable driver by providing incentives for more sustainable trade flows. This is valid at the multilateral level but even more so at the regional and bilateral levels where the identification of positive synergies among trading partners as well as convergence and co-operation should be easier than is the case at the international level. Trade tools could, for instance, be instrumental in making tangible progress towards more sustainable consumption and production patterns. Economic instruments also need to be more actively developed, notably with a view to allow for the necessary internalization of external environmental costs. In addition, positive synergies between trade, environment and development should be further considered, particularly regarding the elimination of environmentally damaging subsidies and the promotion of environmentally friendly goods and services, with a special focus on those originating in Developing Countries (DCs).

International trade contributes to economic growth, benefits all participating countries, while growth, in turn, increases the demand for environmental quality and provides the financial resource for environmental protection. It is commonly assumed by economists and environmentalists alike that greater economic openness will lead to increase pollution in developing countries, as free trade will increase environmental degradation in developing countries. Thus there are points at which trade and environmental objectives are in potential conflict. If left unattended, these conflicts can weaken the trade system and become an obstacle to sustainable development (Wright, 1974; Hayami & Nakamura, 2002; Mukhopadhyay & Chakraborty, 2004; Jha & Rabindran, 2004).

But what is the impact of trade liberalization on the environment is a matter of debate. Two conflicting hypotheses have emerged from the debate. First one is pollution haven hypothesis (hereafter PHH). This hypothesis suggests that the developed countries impose tougher environmental policies than do the developing countries, which results in distortion of existing patterns of comparative advantage. So the polluting industries shift operations from the developed to the developing countries; developing countries thus become "pollution havens." The second hypothesis, the factor endowment hypothesis (hereafter FEH), states that trade liberalization will result in trade patterns consistent with the Heckscher-Ohlin-Samuelson-Vanek (hereafter HOSV) theory of comparative advantage based on factor endowment differentials. Rich countries are typically well endowed with capital. Since capital-intensive goods are often also pollution-intensive, factor-endowment theories of international trade predict that rich countries specialize in polluting goods. Thus the manifestation of the PHH is in direct conflict with the FEH.

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