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# Trade Policy Analyses

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One of the first meetings of the Cordell Hull Institute's Trade Policy Roundtable was on the debate over labor and environmental standards, social issues, and human rights in international trade agreements.

Discussion was based on a paper by Richard Eglin, of the WTO Secretariat, Geneva. The meeting on July 21, 1999, was held at Wilmer Cutler & Pickering, one of the law firms that sponsors the Institute's Trade Policy Roundtable (see the note below).



Reproduced here is the paper by **Richard Eglin** (above).

#### About the Author

Richard Eglin has been the director of the Trade and

#### NON-TRADE CONCERNS...

## Labor Standards, Human Rights and Other Issues in the WTO

Richard Eglin

SINCE it came into being in 1995, the World Trade Organization (WTO) has been at the centre of a debate among government officials, politicians and public-interest groups about the broad, non-commercial effects and implications of trade liberalization.<sup>1</sup> The debate has focused on the links that exist naturally – or that some feel should be forged artificially – between, on the one hand, the rules of the multilateral trading system and, on the other, efforts at national and international levels to promote better protection of the environment, improved social conditions, respect for human rights and higher labor standards.

Critics of the WTO system have made three main claims with respect to these complex interrelationships. They say:

1. Trade is a root cause of much of the problem. It encourages, for example, more intensive use of environmentally sensitive natural resources. It creates markets for the products of child labor. Trade should not be liberalized in the absence of guarantees that its effects will be benign.
2. The rules of the trading system do not provide enough room for, or in some cases are at direct odds with, important pieces of national environmental and social legislation. The rules should be changed.
3. The WTO should allow trade sanctions to be used to enforce international agreements and standards. It already does so in the field of peace and security (under the GATT's Article XXI). This facility should be extended to the environmental, social and human-rights fields.

The first of these claims is based on the "magnifier" effect of trade liberalization in expanding commercial activities that create environmental pollution, abuse of child labor and so on. The

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Earlier, he headed the Development Division; and earlier still, the Trade and Environment Division (1991-96) when the Committee on Trade and Environment was first established.

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#### Trade Policy Roundtable

The Cordell Hull Institute's Trade Policy Roundtable is sponsored by seven international law firms with offices in Washington, DC: Akin Gump Strauss Hauer & Feld, Arnold & Porter, Hogan & Hartson, O'Melveny & Myers, Sidley Austin Brown & Wood, Steptoe & Johnson and Wilmer Cutler & Pickering.

problem identified is real enough, but the proposed policy response is incorrect, so it has been rejected. The proper response is to put in place policies to control environmental pollution, prevent abuse of child-labor and so on. In their absence, even closing an economy to trade completely would have no predictable effect in improving environmental conditions or labor standards.

The second claim cannot be dismissed so easily. The rules of the multilateral trading system increasingly extend beyond border measures to encompass domestic regulations that affect conditions of competition for imported goods and services. Inevitably, frictions arise over the extent to which disciplining regulations for trade purposes interferes with their effectiveness in achieving other policy objectives.

By and large,<sup>2</sup> WTO rules can cope with this where regulations are product-based because, subject to meeting the core disciplines of non-discrimination and transparency, a WTO member country can do anything it wants to regulate imported goods that it also does to regulate domestically produced goods. The core of the complaint here is that WTO rules do not permit members to restrict imports of goods and services on the basis of unincorporated "process and production methods" (PPMs). The classic example has been dolphin mortality caused by tuna fishing. More recent versions of the same thing are (i) banning trade with Myanmar (Burma) on the grounds of human-rights abuse and (ii) demanding that foreign farm exports meet animal-welfare norms. But there are good economic reasons for continuing to believe that the WTO rules are properly formulated in this respect.

The third claim of linkage casts the WTO in the roles of enforcing the foreign policy objectives of member countries through its dispute-settlement mechanism and of allowing trade restrictions to be used to punish renegade governments that do not conform to international norms. Here politics has more to do with the argument than economics. But the economics cannot be ignored if the politics is to yield its desired result and before taking political decisions careful thought has to be given to what damage might be done to the WTO's capacity to meet its core trade responsibilities.

In preparations for a first WTO round of multilateral trade negotiations, the WTO has to concentrate attention on the one area in which it can claim competence (trade) and not dilute its primary message (reduce trade protectionism). This requires considerable single-mindedness of purpose.

It is important, however, that single-mindedness is not mistaken for narrow-mindedness or for a belief that improving the functioning of the multilateral trading system stands well above other important public-policy objectives. The success of the WTO in

advancing the multilateral trade agenda is bound up today – in ways that it never was before – with the progress governments make in dealing effectively with non-commercial issues, nationally and multilaterally. If they are to maintain popular support for open trade, they cannot fail to respond to broader concerns about the effects of trade liberalization and economic globalization.

That speaks in favor of adopting a new WTO work program to complement the one in place already on trade and environment and to consider ways in which the concerns in question can be addressed. Whether the conclusion, in the end, is that something can be done about them through trade policies and the trading system or that they are best addressed, instead, through other specialized inter-governmental organizations and through policy measures other than trade, the main protagonists need to be heard and their facts and arguments examined objectively.

This paper reviews the main aspects of the WTO work program on trade and the environment that got underway in 1992 – during the Uruguay Round negotiations. It draws conclusions on where the main elements of linkage seem to lie and how further work should proceed. Having the trade and environment work program in place has allowed a great deal of the heat that originally surrounded this subject to be replaced by (a certain amount of) light. The paper goes on to extend the analysis to labor standards. It concludes that the WTO should not become involved in enforcing core labor standards. That was decided at the first WTO Ministerial Conference in 1996, but the argument has continued – at least in the United States.

## **TRADE AND THE ENVIRONMENT**

In 1991 a GATT dispute-settlement panel ruled against an embargo by the United States on imports of tuna fish from Mexico imposed on the grounds that Mexico's tuna-fishing fleet was drowning dolphins in its nets.<sup>3</sup> The core of the panel's argument was that GATT Article III did not permit the United States to differentiate and restrict products at the border on the basis of process and production methods that were not incorporated (and detectable) in the final product. The United States could not invoke the "exceptions" (to GATT rules) in Article XX(b) because the "human, animal or plant life or health" it was seeking to protect through the trade embargo did not lie within its national jurisdiction.

The GATT ruling was condemned by environmentalists as evidence that Mexico's commercial interests counted for more in the eyes of the multilateral trading system than the lives of dolphins. In the fall of 1991, "GATTzilla" posters hung stuck on lampposts around Washington depicting the GATT as a monstrous lizard with a dying dolphin in one hand and a drum of DDT under its arm, towering just one step away from flattening the U.S. Capitol Building. The

symbolism was crude, but it played effectively to other political concerns in the United States at the time, that the GATT and the Uruguay Round negotiations then in progress meant compromise and surrender of national sovereignty.<sup>4</sup>

"GATT kills dolphins" was quickly followed by claims from environmental groups that GATT rules were undermining environmental policies and standards on a broad front. The environmentalists demanded that governments "green the GATT".<sup>5</sup> It was claimed

- that trade liberalization necessarily brought about increased environmental degradation;
- that GATT rules were exercising a chilling effect on the development of new environmental legislation and were forcing countries (i) to lower their environmental standards for fear of them being challenged on commercial grounds as trade restrictions or (ii) to engage in a "race to the bottom" to safeguard the competitive position of their domestic producers;
- that such serious competitiveness problems would result from differences in environmental standards between rich and poor countries;
- that "green" trade restrictions (eco-dumping duties) would be needed to deal with them; and
- that the GATT would be swamped by environment-related trade disputes, which it would be incapable of dealing with sensitively and effectively.

Meanwhile, many GATT member countries, particularly among the developing ones, were hostile to any notion of acknowledging that a legitimate linkage existed between trade and the environment. They were suspicious of the motives of those making this claim. Some felt that the governments of OECD countries were over-reacting to pressure from vocal green lobbies to pursue environmental goals at every opportunity and at any cost and were seeking to weaken the rules of the multilateral trading system to allow trade restrictions to be used more easily for environmental purposes. Others feared that a new "green conditionality" would be attached to their access to developed-country markets. Still others saw the issue as a dangerous new manifestation of trade protectionism at a time when several OECD countries were having difficulty in agreeing to reduce trade barriers in traditional areas such as textiles and clothing and agriculture.

Since the early 1990s, the GATT/WTO has analyzed and examined a wide range of issues falling under the rubric of trade and the environment. The more extreme claims (and some of the less extreme ones, too) from both sides of the argument have been found to lack substance in fact. At the same time, three issues have remained on the table as the core of the debate: (i) trade liberalization and the environment; (ii) enforcing international environmental agreements through trade sanctions; and (iii) the

unincorporated PPM issue on which the *Tuna-Dolphin* panel ruled. These three issues are reviewed below. The conclusions drawn can be summarized in the following points that should form the basis for further work in the WTO on this subject:

1. *Keep markets open and competitive.* Trade liberalization complements effective environmental policies, not only at a general level but also, even more importantly, through removing trade restrictions and distortions that themselves cause direct environmental harm.
2. *Feed into markets proper price signals.* The key to managing environmental resources properly in a market economy is to ensure that their prices reflect as accurately as possible their real scarcity and true social value. A wide range of market-based instruments and regulatory measures are available to serve that purpose. Trade restrictions may have a supporting role to play in certain well-defined circumstances but, usually, they are not useful or effective policy tools for meeting environmental objectives.
3. *Resolve international environmental problems cooperatively through multilateral negotiation and agreement.* Allowing disagreements in the negotiation of international environmental agreements to degenerate into trade disputes, or pressing unilaterally for the resolution of trans-boundary environmental problems, will not produce the kind of stable solutions to environmental problems that are needed if economic growth and the protection of the environment are to be sustained over the long term.
4. *Respect the fact that different countries do not and will not all have the same environmental standards.* The values they assign to environmental resources will not necessarily, or even probably, be the same. There is nothing inherently wrong in finding that the price of a good consequently varies from one country to another, any more than that it varies because of differences in wage levels or corporate tax rates.

At all costs, avoid the use of environmental measures, purposely or otherwise, for trade protectionist purposes. Slippage there will poison not only the trading system but also national and international environmental agendas.

### **Trade Liberalization and the Environment**

One of the most influential factors that has helped forge the basis for a common approach to the subject of trade and the environment in the WTO, particularly between developed and developing countries, has been elaboration of the concept of "sustainable development". This replaced the "limits to growth" paradigm that was popularized in the 1970s, through which economic growth was viewed as being a part of the problem of environmental degradation, not part of the solution.<sup>6</sup>

Making development sustainable means ensuring that economic growth goes hand in hand with better environmental protection. Growing market economies are best equipped to take care of their environments properly and effective protection of the environment is needed if economic growth is to be sustained over the long term. Trade can help governments deliver the greatest increase in the quality of the environment at the least cost by allocating scarce resources, particularly environmental resources, as efficiently as possible and by stimulating technological progress and productivity growth. Trade also generates wealth, which can help finance the expensive task of cleaning up and protecting the environment. Creating the conditions for international trade and investment to prosper by opening markets, particularly to exports from developing countries, and by keeping markets open through clear and enforceable rules, is therefore very much part of a comprehensive approach towards the protection of the environment.

The results of the Uruguay Round negotiations provide a ready source of inspiration:

- reducing barriers to trade in environmentally friendly goods and services;
- providing developing countries with improved market access for higher value-added production to relieve the pressure they face to specialize in natural-resource exploitation or low value-added, environmentally sensitive activities;
- eliminating environmentally damaging trade restrictions and subsidies; and
- encouraging the spread of environmentally sound technology by enforcing intellectual property rights.

By implementing these policy reforms, WTO member countries have already made an important contribution to sustainable development and better environmental protection worldwide.

The challenge is to agree on how those advances can be taken further. Two areas that stand out for particular attention are energy and agriculture. Liberalization of these two sectors generates a good deal of resistance on the part of a number of WTO member countries, yet they are cited more often than any other areas of trade as having the potential of yielding clear "win-win" situations in terms of gains for both the trading system and the environment.

Several countries continue to protect domestic energy production (notably coal), through border restrictions and domestic support measures, when alternative sources of more environmentally friendly energy are available from overseas suppliers.<sup>7</sup> Removing the trade restrictions and market distortions yields both trade and environmental benefits. The energy sector is sensitive for many WTO member countries and achieving significant liberalization



there will no doubt be difficult. All the more reason, then, for the environmental community to lend its considerable political weight to the task at an early stage and join the trade community in pressing for more rational energy policies in WTO member countries.

The agricultural sector contains many examples of the failure of markets to incorporate environmental externalities and the task of designing proper environmental policies to deal with them is not easy. What has made this sector a matter of such environmental concern, however, is that market failures have been compounded by trade restricting and distorting policies with negative environmental consequences of their own. Studies paint a largely unambiguous picture of direct and often significant environmental harm stemming from market access restrictions, domestic support policies and export subsidies on the one hand, and from high taxation of agricultural production relative to other economic activities on the other (not only directly but also indirectly through exchange rate over-valuation and import protection of other sectors of activity).<sup>8</sup>

New agriculture negotiations were launched in Geneva in early 2000. The difficulties involved cannot be over-estimated, and the case for enlisting the support of the environmental community so as to pursue environmental objectives in tandem with trade objectives is a strong one. Ford Runge, of the University of Minnesota, has summed up the point very well:

“One of the most potentially constructive effects of the interdependence of trade and environmental issues is that in developed countries, accompanying environmental interventions can help to 'sell' trade reform in agriculture to a broader public. In developing countries, on the other hand, the benefits of trade reform including market access, higher prices and expanded exports can help these nations 'buy' needed environmental improvements.”<sup>9</sup>

Beyond traditional sectors such as these, there is considerable scope for the WTO to engage in creative thinking about where new markets for environmental goods and services can be developed and liberalized to the benefit of both the trading system and the environment. One promising line of examination is environmental services which, although already traded, are not for the time being assigned any market value, nor paid for. The most pressing case is the export of greenhouse gas absorption services by countries with large forest resources; these countries are receiving no payment for the environmental services their forests provide to the rest of the world, and for many of them there is consequently little commercial incentive to protect the forests from destruction. A system of tradable permits for greenhouse gas emission, negotiated and administered through the WTO, would provide an effective, market-friendly way of correcting this problem. Bringing it under

WTO rules could provide it with a binding quality that would make its implementation all the more effective.

### **Coordinating Trade and Environmental Agendas**

Developing constructive linkages between the multilateral trade and environmental agendas is a logical step for governments to take in an era of economic "globalization" and of more trans-boundary environmental problems. The fact that over 200 international environmental agreements (IEAs) co-exist with the WTO gives clear cause for believing that multilateral cooperation on the environment is a practical option. Its appeal is quite evident from the point of view of the WTO, which is dedicated to finding cooperative, multilateral solutions to problems in the area of trade. Yet there has been little evidence until recently of an attempt by trade and environmental negotiators to coordinate their policy proposals and forge a common approach towards trade-related, global environmental problems.

One result is that a number of the most important IEAs contain trade measures whose consistency with the WTO trade rules is at best questionable.<sup>10</sup> If any of these measures were put to the test through the WTO's dispute-settlement procedures and found inconsistent with WTO obligations, a WTO member country could be faced with the politically unacceptable choice of having either to remove a trade measure it is obliged to apply to meet its IEA commitments or to defy the WTO ruling and be retaliated against.

It is disruptive to both the multilateral trade and environmental agendas for governments to continue to be placed in the position of undertaking binding policy obligations that may be found to be mutually inconsistent under different international legal instruments. Clarification is required either by changing IEAs or by changing WTO rules.

More ink has probably been spilled on this than on any other issue at the interface between trade and environment questions. The discussion has ranged across legal analysis of how IEAs and the WTO are related under international law, what interpretation should be given to various WTO rules (particularly GATT Article XX), economic analysis of the efficiency and effectiveness of using trade restrictions in IEAs, analysis of the relative institutional strengths and weaknesses of international environmental organizations (particularly the United National Environmental Program [UNEP]) and the WTO, and cruder debates about the respective political importance of the objectives of trade and environmental polices.<sup>11</sup>

In 1996, in the context of negotiating the WTO's *Report on Trade and Environment* to Ministers in Singapore, a number of OECD countries proposed changing WTO rules (or at least interpreting them differently) so as to accommodate trade measures in IEAs



that are currently WTO-inconsistent, infringing WTO rights, but which are claimed to be essential to the environmental effectiveness of the IEAs. Similar proposals are being tabled ahead of the third WTO Ministerial Conference. The proposals met stiff opposition in 1996, particularly but not exclusively from developing countries, and they are doing so again in 1999.

The trade measures that the OECD countries have in mind are those applied by IEA parties to discriminate against imports from countries that have not joined the IEA and are not engaged in tackling the environmental problem the IEA seeks to resolve. The *cause célèbre* is the Montreal Protocol on protecting the earth's ozone layer under which parties are required to ban trade with non-parties in ozone-depleting substances and in products containing those substances (refrigerators *et cetera*).

Several reasons have been put forward as to why this trade provision in the Montreal Protocol was considered necessary. The most convincing has been the need to reassure private companies holding patents on the new generation of (far less ozone-depleting) refrigeration chemicals that their market-shares would not be undermined by continued production of the old generation of chemicals from locations in non-parties to the Montreal Protocol. However convincing this might seem, in terms of the political economy of consensus building in support of the Protocol, the economics behind it make little sense. Trade restrictions can make no dent in continued production for the domestic market using the old generation of chemicals, which in the case of countries such as India and China posed far more of a threat to the earth's ozone layer than did their production for export.

The most deep-seated concern about changing WTO rules to accommodate this sort of provision in IEAs relates to the importance of not abusing the WTO as a powerful tool of enforcement in areas outside its specific competence. The obligations in question are those of non-discrimination, which, as the cornerstone of the WTO legal system, is the principal means of protecting the rights of weaker members of the multilateral trading system.

The use of trade sanctions for breaches of international environmental norms, or to try to change the environmental practices of other countries, is very divisive. It largely contradicts efforts to find cooperative solutions to environmental problems that are regarded as having an international dimension. Trade restriction is a blunt instrument that may appear to offer a seductively easy means of action in the short-term to those who can wield it most readily. Over the longer term, however, it destroys the basis of international relations and cooperative action – and in the case of the environment it is the long term that matters most.

As long as the WTO continues to operate on the basis of consensus decision-making (and there are strong arguments in favor of it

doing so), it is hard to see how agreement will be reached to weaken its non-discrimination provisions and allow discriminatory trade measures to be used for non-trade purposes. A country that has not been persuaded to join a consensus to resolve an environmental problem through an IEA can hardly be expected to join a consensus in the WTO to change the trade rules in ways that would allow it to be punished.

If trade is the cause of an environmental problem, then trade measures are the appropriate tool for policy intervention and it would follow that the WTO should accommodate them; and in at least one important respect it will, since in such circumstances it would seem unnecessary to apply the trade measures in a discriminatory fashion. If, however, the trade measures are intended to serve some other purpose, for example to penalize countries that do not sign an IEA (as was the case with the Montreal Protocol), it is far more difficult for the WTO to provide the necessary accommodation without undermining its multilateral purpose.

It is surely more constructive for environmental agreements to be backed up by financial compensation arrangements and technology transfers, where these are necessary to encourage full participation in an IEA, rather than using trade-policy weapons to try to force countries into a course of action that is not of their own choosing.

### **WTO Rules, Standards and Competitiveness**

The demand for a cleaner environment and for environmentally friendly goods and services is increasing worldwide. It has generated a range of new policy measures, both price-based and regulatory, that are designed to value environmental resources properly in the marketplace, an exercise sometimes referred to as "internalizing" environmental costs. This has been most evident so far in OECD countries, but new environmental legislation and environmental standard-setting is increasing in developing countries, a trend that appears likely to continue.

Environmental policies can have complex and potentially significant trade effects. It would be naive to ignore the danger that trade protectionists may pursue their commercial interests behind a facade of environmental concern. The WTO has a permanent responsibility towards member countries to remain vigilant in that regard. Its role is all the more important because there are serious dangers involved, for the environment as well as for the trading system, in misusing trade restrictions. Important questions arise, therefore, about the adequacy of WTO rules and disciplines to ensure that unnecessary obstacles to trade are avoided.

At the same time it would be cynical to suggest that environmental policy-makers faced with pressing environmental problems cannot

find an accommodation for efficient and effective policy measures within the WTO framework of rules. Inevitably, these measures will affect imported as well as domestic products, but the WTO need not get in their way. The WTO does not stand for free trade at any cost.

The key requirement, from the WTO's point of view, is that environmental measures that incorporate trade provisions or that affect trade significantly do not discriminate between home-produced goods and imported goods, or between different trading partners. Non-discrimination is the foundation of secure and predictable market access and undistorted competition.

Subject to the requirement of non-discrimination being met, WTO rules place little constraint on the policy choices available to a country to protect its environment against damage, either from domestic production or from the consumption of domestically produced or imported products. By and large, a country can do anything to imports or exports that it does to domestically produced goods; and it can do anything it feels necessary to regulate its own production processes. What a country cannot do under WTO rules, however, is apply trade restrictions to try to change the production methods of other countries or to limit their access to world markets in the event their production methods remain unaltered.

For environmental policy-makers, this constraint is one of their principal bones of contention with the WTO rules, which they believe are insensitive to environmental issues and need changing. From their point of view, life-cycle analysis of a product, including the way it is produced and ultimately disposed of as waste, is important to ensure the full environmental impact of both production and consumption activities is taken fully into account. The way a product is produced cannot be divorced, they believe, from the product's physical characteristics. Is there, in that regard, any legitimate case to be made for using trade restrictions to differentiate among traded goods and services according to how they have been produced?

To answer that question, it is useful first to distinguish measures that address environmental problems and pollution caused by the consumption of a product (e.g., measures favoring the use of unleaded gasoline in cars) from those that address environmental problems and pollution caused by the production process (e.g., measures to reduce air emissions from factories). This distinction underlies the concept of "like product", which is of considerable practical and systemic importance in all of the core GATT articles and related WTO agreements. Defining whether or not products are "like" depends to a very large extent upon case-by-case analysis. Broadly speaking, however, products are "like" if they have the same or similar physical characteristics or if they can be used more or less interchangeably for the same purpose.

It is inconsistent with WTO rules to discriminate between like products by, for example, applying different tariff rates to them or an internal tax to an imported product but not to its domestically produced equivalent. Products can be differentiated on the basis of differences in their product characteristics or on the basis of differences in their production methods if these affect the characteristics of the product (e.g. pesticide residues on fruit). They cannot be differentiated though on the basis of their production methods if these leave behind no trace in the product (e.g. tuna caught in a way that causes the death of dolphins).

The rationale behind this style lies in the efficient assignment of economic policies to amend market distortions. It is most efficient to use the policy instrument that addresses a distortion as close to its source as possible. Policy instruments that are applied further away from the source of the distortion are likely to have less predictable beneficial effects and higher secondary costs with their continued use. In the case of a market distortion that relates to an environmentally damaging process, the best solution is assured through the equalization at the margin of the costs of pollution abatement and control and the benefits of improved environmental quality.

Generally speaking that implies acting directly on the source of pollution by changing the production method. Even in theory, the equalization will rarely be achieved by restricting trade at some distant market in the products that are being manufactured in a polluting way. In practice, it is unlikely that it will ever be achieved, given the difficulty policy-makers have in designing an optimal policy intervention.

By way of a practical example, consider the problem of tropical deforestation. There appears to be a large degree of agreement that the cause of the problem is the under-valuation of tropical forests as international environmental resources, both in timber exporting countries and in import markets where the timber is consumed. Policies need to correct that under-valuation at source if they are to succeed. What role might trade restrictions play?

The position of a number of European countries has been to restrict, or even ban, imports of tropical timber from countries that are not felt to be managing their forest resources and harvesting the timber "sustainably". In all probability, any such restrictions would run foul of WTO rules, since they would be based on an unincorporated production method (unsustainable forest management) that is not detectable in the final product.

That is not a happy finding from the point of view of the environmental community, yet the economics involved suggests strongly that the WTO rules are correctly formulated. Trade restrictions would reduce the supply of tropical timber to the import markets and drive up prices there. So far so good. But in the tropical

timber exporting countries, it is demand that has been cut, while supply remains unchanged and the price of timber and the value attached to the forests will consequently fall. In other words, an already under-valued resource will be devalued still further, leading perhaps to the clearing of forests to make way for the higher commercial returns to be had from the land by grazing cattle.

That is surely a perverse result, given what the import restrictions set out to achieve. The reason is that no attention was paid to cooperative action with the exporting countries and, therefore, to resource management policies at the source of the problem. These hold the key to proper pricing of environmental resources. Local production and sales restrictions on tropical timber are needed, backed up as necessary by export restrictions, something that would be readily accommodated under the WTO rules.

This reasoning leads to the conclusion that WTO rules, as they stand at present, make good economic sense and are a valuable point of reference for environmental policy-makers to help them choose trade policies that will achieve, not undermine, their objectives. Import restrictions cannot be counted on to operate predictably to change process or production methods because they are applied so far away from the source of the distortion.

This feature of the WTO legal system gave rise to one of the most fiercely argued claims of the environmental community some years ago, that the rules of the trading system were antithetical to the maintenance of high national environmental standards. Producers in "high" standard countries, it was claimed, would incur higher costs of production than their competitors in "low" standard countries.

One response might be for those producers to resist any increase in environmental standards at home on the grounds that they would otherwise be forced out of business – a result that, for obvious reasons, caused concern from an environmental point of view. If environmental standards were nonetheless raised, in spite of opposition, market forces would result in the migration of industry from high to low environmental standard locations and encourage the proliferation of so-called "pollution havens", to attract foreign investment by footloose, polluting industries. The net result would be a higher level of pollution per unit of output in the world economy – which again caused evident concern from an environmental point of view.

In order to allow producers in high environmental standard countries to remain competitive, so the argument went, it would be necessary to permit countries to introduce under new WTO rules some form of offsetting trade restriction (so-called eco-dumping duties) against imports produced abroad at lower cost in a more polluting way to combat "unfair" trade.<sup>12</sup>

Demands from some environmental groups that eco-dumping duties be imposed on goods produced in a polluting way resulted in one of the most controversial issues in the early stages of GATT work on trade and environment. It brought out more directly than anything else suspicions that the environmental agenda was being driven by barely disguised "green" protectionism.

Empirical evidence does not support arguments that genuine problems of international competitiveness are created by differing environmental standards in different countries.<sup>13</sup> Even if such arguments were found to be of real concern in business circles, the important question is whether trade restrictions are an effective way of trying to compensate for international differences in environmental standards. If, as was suggested earlier, they will not act predictably to change an overseas producer's methods of production, the argument for using trade restrictions boils down, essentially, to one of a domestic industry's need for protection against foreign competition.

The reason for lack of international competitiveness, whether environmental or something else, is a secondary consideration. The WTO already provides possibilities for protecting domestic industry temporarily against foreign competition, for instance through safeguard action, and it hardly seems necessary to invent and bless a new protective instrument with a specifically green label attached to it.

In certain circumstances, a particular production method may be viewed as causing such a high degree of environmental prejudice of a global or trans-boundary nature that coordinated action at multilateral level will be required to suppress it. Cooperative negotiations through international environmental agreements are then called for. Attempts to force the harmonization of production methods or to compensate for national differences in them through second or third-best policy instruments such as trade restrictions have little to recommend them.

Developing the Polluter Pays Principle and the notion of environmental cost internalization into internationally accepted standards could be a helpful way forward, accepting of course that environmental resources do not need to be valued in the same way around the world. It is worth noting, in this context, that it is the policy objectives (standards) that need to be harmonized, not the policies themselves. The same policy can produce different results in different countries, while the same standard can usually be achieved in different ways. It is natural that not all countries will choose to tackle specific policy objectives with the same policy tools.

## **TRADE AND LABOR STANDARDS**

*"We renew our commitment to the observance of internationally recognized core labor standards. The International*



*Labor Organization (ILO) is the competent body to set out and deal with these standards, and we affirm our support for its work in promoting them. We believe that economic growth and development fostered by increased trade and further trade liberalization contribute to the promotion of these standards. We reject the use of labor standards for protectionist purposes, and agree that the comparative advantage of countries, particularly low-wage developing countries, must in no way be put into question. In this regard, we note that the WTO and ILO Secretariats will continue their existing collaboration.*<sup>14</sup>

With this short statement in December 1996, the first WTO Ministerial Conference concluded a long-running and frequently bitter debate over proposals by the United States and several European countries that the WTO should play a more direct role in commanding support for core labor standards in its member countries. All sides seem to be satisfied from the result.

The protagonists, including the international labor movement, claimed success in raising the profile of core labor standards and having them endorsed by the trade community. WTO member countries which, in the months preceding the Singapore meeting, had staunchly resisted any mention of the issue in the Singapore Ministerial Declaration, welcomed the result as providing guarantees that if it were ever raised again in the WTO the ensuing debate would have to be confined within narrow parameters. In particular, they felt there would be no scope to resurrect suggestions that WTO rules should accommodate a so-called social clause or allow trade sanctions to be used to penalize countries whose enforcement of labor standards was deemed to be unsatisfactory.

Since 1996 there has been no formal exchange of views in the WTO on the subject. But it has clearly not gone away for good. Proposals for Seattle were prepared by the United States and the European Union to initiate a new WTO work program that would examine the social dimension of the liberalization and expansion of world trade. In and of itself, a work program can hardly be considered objectionable; indeed, there are good reasons for analyzing the subject more carefully, as has been done in the GATT/WTO on the subject of trade and the environment, in order to dispel the many myths that exist, about trade causing social injustice of one kind or another and to draw out the complementarities between the WTO's activities and the international social and labor agenda. It would be a mistake, though, if a work program were to amount to an attempt to introduce a "social clause" into the WTO. The arguments against doing so are overwhelming.

### **Enforcing Labor and Other Standards**

The debate over the role of the WTO in international efforts to raise labor, social and human rights' standards is a debate about

the means to an end, not about the end in itself. The WTO has the capacity to make a significant contribution to those efforts. It deserves the support of all the interest groups involved if it is to develop and deliver that contribution to the maximum.

From a commercial point of view the benefits of trade are well known. What is sometimes less readily appreciated is that the resources it generates allow governments to broaden their range of political choices beyond the sphere of trade and respond to new political challenges, such as raising social and humanitarian standards and, as noted above, protecting the environment.

The political appeal and value of the international trading system is even less well known, yet it is of importance not only to trade but also to many other areas where governments aim to maintain orderly international relations and to encourage international policy coordination. The trading system increases international solidarity and provides an enduring reason to remain on friendly terms with one's neighbors. Friendship is the best possible basis from which to exert moral influence and build mutual respect. Obstructing the functioning of the trading system in any significant way would most certainly mean closing off opportunities to agree on other international policy objectives in a cooperative spirit with one's trading partners.

Stressing the value of the trading system in this way is not to suggest it stands above other international policy goals. A sufficient range of policy instruments is available to governments to address multiple objectives at the same time. Moreover, a number of effective international organizations exist, each with its own specific area of competence, to assist them to coordinate their policy approaches.

Until quite recently it was considered largely uncontroversial to view the GATT simply and solely as a commercial contract between its member governments. Beyond the inevitable value judgments that are involved in accepting the paradigm of a competitive market economy as a desirable model for economic growth and development, the trading system sought to avoid other values intruding into its day-to-day functioning. Its capacity to deliver "free and commercially fair trade" was the slogan used by many to measure its accomplishments and, although different opinions were expressed about what "commercially fair" really meant, it seems clear that to most it did not mean conditioning market access on non-commercial factors.

Under the self-enforcing contractual system of WTO agreements, market-access commitments, once negotiated, become an unconditional right for each member country. One can be critical of that or irritated by it, but the GATT's single-mindedness in this respect contributed without doubt to its success for almost 50 years in dismantling trade barriers, attracting new members in

large numbers to join its ranks and developing an effective framework of rules and dispute-settlement procedures to govern multilateral trade relations.

What possibilities are there for the WTO to contribute, while remaining within its core mandate, to improved labor, social and human rights conditions in the world?

### ***1. Mounting Liberalizing Negotiations***

First of all, there is the possibility to organize successful rounds of multilateral negotiations to liberalize trade and [trade-related] investment. The complementarities between this and the policy objectives mentioned earlier are evident: more resources, improved economic and social prospects, and the removal of those trade restrictions and distortions that are themselves at odds with, and interfering with, the other policy goals. For example, the social benefits, in terms of higher incomes and employment, of reducing highly restrictive international trade regimes in areas of particular export interest to developing countries (e.g. agriculture, and textiles and clothing).

There is clearly no automaticity between trade liberalization and more social justice (any more than there is between trade restrictions and that objective). Social policies are needed to redistribute the benefits that trade brings, and to target particular policy goals. But the relationship between these different areas of policy-making is essentially complementary. Trade liberalization generates the economic resources that allow more ambitious and costly social policies to be put in place. Those policies in turn foster a more favorable climate for countries to sustain their commercial competitiveness, and to participate more effectively in the international trading system.

### ***2. Making and Implementing Rules***

The second area in which governments can turn confidently for results to the WTO is in the negotiation and implementation of multilateral rules and disciplines to ensure coordinated trade policy-making. Over time those rules have been extended, particularly through the Uruguay Round negotiations, from covering only traditional border measures to policies and measures with their roots more firmly planted in domestic policy objectives within a country's borders.

It needs to be emphasized that there has never been any intention, under the GATT or other WTO agreements, to intrude directly into this area of policy-making, certainly not to impede governments' ability to pursue domestic policy objectives. The legitimacy and importance of those objectives is stressed in all WTO agreements. The one particular optic through which these policies *are* viewed under WTO rules is the extent to which they

interfere unnecessarily with the ability of foreign goods and services to compete on equal terms with local production for a share of the domestic market.

Non-discrimination through national treatment, and the avoidance of measures that are more trade restrictive than necessary, most particularly of protectionist measures, are the core WTO requirements in this regard. Subject to them being respected (and it is not evident why domestic policy measures should need to rely on overt discrimination or protectionism to achieve their objectives), the guarantees provided to WTO member countries by WTO rules against unwarranted commercial challenges to their social or human rights standards is to all intents and purposes absolute.

At the same time, the WTO rules contribute to the effectiveness of domestic policies in enforcing those standards. Domestic bans on the sale or use of equipment that is hazardous to the health or safety of workers, for example, must be backed up by import prohibitions if they are to be effective, and the WTO rules provide ample means for doing that and for reinforcing domestic regulations.

One therefore finds here again a broad seam of complementarities between the WTO rules and policy-making in the social and humanitarian areas. Any regulations and standards that are applied to domestically produced products can be applied equally to imported products. WTO rules impose no constraints whatsoever on a government's ability to regulate domestic processes and production methods for social or human rights purposes.

Where the potential for conflict does exist, however, is in the constraints imposed by WTO rules on a government that wishes to apply its domestic process and production standards to foreign suppliers of imported goods. Under WTO rules, products can be differentiated at the border and subjected to different trade restrictions or internal regulations if their physical characteristics differ, but not if the only differences between them are to be found in the way they are processed or produced. Carpets produced in factories employing child labor cannot be differentiated from carpets made by an entirely adult workforce. And products supplied from countries whose governments do not respect human rights cannot be differentiated from products coming from those that do. Governments can apply domestic process and production standards to their trading partners in a passive way by permitting, for example, producers voluntarily to label their products and allowing consumers to make the final choice between high and low standard products. But WTO rules do not allow stronger measures to be taken.

There are reasons why the WTO rules have been structured in that way.

One relates to the legal paradigm underlying the WTO – one of national sovereignty that does not permit extra-jurisdictional action to be taken through trade policies. The GATT/WTO was conceived narrowly as a commercial contract, not as a broad base from which governments could pursue non-commercial aspects of their foreign policies. Member countries can take action to protect their domestic economic interests from commercial damage caused by “unfair” trade practices of their trading partners. But they have no rights under the WTO to attack those practices at source. That is the case, for example, in the much quoted WTO provision relating to “the products of prison labor” (Article XX[e]), for it is “the products” that are the centre of attention, not the “prison labor”.

The second reason is economic and derives from the principle of proper economic policy assignment. The point here is that efficient policy intervention – that with the lowest incidental costs and the highest probability of achieving its objective – should take place as close as possible to the point where an economic distortion is identified. Based on that principle, trade policies are ill suited to being used to try to change processes or production methods used abroad.

Examples of this were given above in the case of the environment. The same principle applies in the case of labor or humanitarian standards. Consider, for example, the reaction of a foreign supplier who is using child labor to the imposition of a higher import tariff than is applied to his competitors. One reaction may be for him to move to a production process that does not involve child labor. Equally, however, he might decide to lower even further the standards he applies to his workforce in order to try to recoup the competitiveness he has lost from having to pay the additional tax, or simply switch to less discriminating markets. In other words, the result of the trade policy intervention is ambiguous, which strongly suggests a mis-assignment of policies. Trade policies cannot be counted on to operate predictably when they are applied so far away from the source of the problem, yet the secondary costs of using them are ever present.

Identifying other corrective measures, and most notably improving domestic policies in the exporting country, can probably be agreed universally as offering the best policy option, and the one on which governments need to focus their attention through the relevant international organization responsible for and competent in that area of policy-making. Placing all of the burden for correcting social or human rights problems on trade policies will not necessarily, or in many instances even probably, yield satisfactory results, but it will surely come at a high cost to the trading system. If multilateral consensus cannot be reached voluntarily on raising process standards internationally – be they social or humanitarian – in other international organizations dedicated to those policy areas, on what grounds are we to believe that consensus can be

reached among much the same group of governments in the WTO to use less efficient and effective trade policy measures?

### ***3. Enforcement and Dispute Settlement***

On that doubtful note, the third element on which governments can look for effective action from the WTO is enforcement and dispute settlement. It is one that can be argued to answer partially the question just posed. The expanded and improved enforcement mechanism of the WTO that resulted from the Uruguay Round negotiations was designed explicitly and exclusively with member governments' WTO trade obligations in mind, yet it has quickly proved to be a lightning rod attracting interest for its potential in enforcing other, non-trade objectives.

The missing piece of the puzzle remains the incorporation of a relevant new rule into the WTO – a “social clause”, for example – but if it were assumed for one moment that this could be done, would not the WTO dispute-settlement process, and its capacity to enforce its rules, be the ideal vehicle for making international social or humanitarian standards far more operational than they appear to be at present? Several elements need to be considered here.

One element is that the primary role of the WTO is to avoid trade disputes, not to encourage them. A trade dispute reflects the failure of the underlying system of voluntary policy cooperation and coordination. Repeated disputes over the same or similar issues suggest a need to correct through re-negotiation the basis for that cooperation. This was the kind of situation that prevailed in the area of agricultural trade prior to the Uruguay Round negotiations. Without the negotiation of the WTO Agreement on Agriculture, one can expect that agricultural trade disputes would have become more bitter and intransigent and the multilateral trade rules would have become more irrelevant and ignored. The role assigned to dispute settlement in the WTO therefore sits uncomfortably alongside demands that it should be used to correct forcibly the behavior of those countries it has not proved possible to persuade to cooperate voluntarily through negotiations conducted in other intergovernmental organizations.

A second element is that the WTO has a powerful enforcement mechanism at its disposal – so powerful in fact that great care has to be taken not to abuse it. The economic prosperity of many countries in the world is now highly dependent on international trade and the process of globalization is increasing their dependence further. Their growing prosperity is widely acknowledged to be a key to their ability to adopt higher social and humanitarian standards. In increasingly competitive global markets, arming the multilateral trading system with the means to threaten their prosperity for breaches of non-commercial behavior could all too easily turn the use of trade restrictions into a first-choice instrument rather than the measure of last resort which



The **mockingbird** is the state bird of Tennessee.



Cordell Hull represented a district of Tennessee in the Congress of the United States, and was elected a senator from there, before becoming U.S. Secretary of State (1933-44).

### **Trade Policy Analyses**

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proponents of a social clause have claimed it should be and, in doing so, create a tantalizing target for protectionist pressures and undermine international trade on a significant scale.

Very few members of the WTO can claim to meet the wide array of multilateral standards that the United Nations and other international bodies have established and are continuing to negotiate. Most would therefore be vulnerable to some degree or other to the threat of trade restriction. Were trade restrictions to be applied on any such scale, the probability would be high of significant obstruction of the trading system, and of collateral damage to other policy objectives and to international cooperation generally.

Third, using the WTO as an enforcement mechanism presumes that the imposition of trade restrictions would make a positive and constructive contribution to resolving the problem that is at stake. Where the simple threat of imposing trade restrictions fails to bring about a change in a government's behavior, there must be a commitment to following through and impose the restrictions. Yet in many instances when the problem involves low social or humanitarian standards, the imposition of trade restrictions would appear, on the face of things, to be more likely to make matters worse rather than better, for it would hurt most directly those sections of the population who are already disadvantaged.

Banning exports from a country which denies social or humanitarian rights to workers in its export sectors and processing zones would certainly lower further the conditions of those workers, but whether it would have the desired political effect of forcing a change in government policy is far from clear. Trade sanctions do not have a successful track record as tools of persuasion when used against political regimes that have already indicated their lack of respect for multilateral opinion. There is little reason to believe that situation would change because the trade sanctions were to be authorized by the WTO.

Fourth and finally, the WTO system is based on the individual rights and obligations of its member countries. The WTO contains no obligation to impose trade restrictions (it contains the right to do so under certain circumstances), and no basis for the collective imposition of trade restrictions by the whole membership acting together. That leaves the WTO ill-suited to applying trade sanctions in a concerted and uniform manner, as has been proposed by some in the context of the so-called "social clause", and it creates a high risk of irregular and incomplete action by different members which could seriously undermine the effectiveness of such a clause and, once more, leave it open to protectionist abuse.

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<sup>1</sup>. This paper was presented at a seminar of the Cordell Hull Institute's Trade Policy Roundtable, Washington, DC, on July 21, 1999.

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<sup>2</sup> By and large, but perhaps not entirely, as disagreements over food safety and the use of genetically modified organisms are demonstrating.

<sup>3</sup> GATT Document DS21/R (unadopted) of 3 September 1991, reproduced in *General Agreement on Tariffs and Trade: Basic Instruments and Selected Documents*, hereafter cited as *BISD*, 39th Supplement (Geneva: GATT Secretariat, 1992), p. 155.

<sup>4</sup> The debate in the United States does not appear have been greatly informed by the distinction between *surrendering* national sovereignty, as in the European Union, or *exercising* national sovereignty as in the North Atlantic Treaty Organization (NATO), the European Free Trade Association (EFTA) and the WTO, besides countless other international agreements.

<sup>5</sup> See, for example, Steve Charnovitz, "Trade Negotiations and the Environment", *International Environmental Reporter*, Bureau of National Affairs, Washington, DC, 11 March 1992; Hilary French, *Costly Trade Offs: Reconciling Trade and the Environment*, Worldwatch Paper 113 (Washington, DC: Worldwatch Institute, 1993); "The General Agreement on Tariffs and Trade, Environmental Protection and Sustainable Development", WWF International Discussion Paper (Gland, Switzerland: World Wildlife Fund, 1991); "International Trade, GATT and the Environment", WWF International Position Paper (Gland, Switzerland: World Wildlife Fund, 1992); and Daniel Esty, *Greening the GATT* (Washington DC: Institute for International Economics, 1994).

<sup>6</sup> See, for example, Steve Charnovitz, "Trade Negotiations and the Environment", *International Environmental Reporter*, Bureau of National Affairs, Washington, DC, 11 March 1992; Hilary French, *Costly Trade Offs: Reconciling Trade and the Environment*, Worldwatch Paper 113 (Washington, DC: Worldwatch Institute, 1993); "The General Agreement on Tariffs and Trade, Environmental Protection and Sustainable Development", WWF International Discussion Paper (Gland, Switzerland: World Wildlife Fund, 1991); "International Trade, GATT and the Environment", WWF International Position Paper (Gland, Switzerland: World Wildlife Fund, 1992); and Daniel Esty, *Greening the GATT* (Washington DC: Institute for International Economics, 1994).

<sup>7</sup> See D.H. Meadows *et al.*, *The Limits to Growth: a Report for the Club of Rome's Project on the Predicament of Mankind* (New York, Universe Books, 1972). For a contemporaneous response to the Club of Rome, see Harry G. Johnson, *Technology and Economic Interdependence* (London: Macmillan, for the Trade Policy Research Centre, 1975), especially ch. 7 on "Economic Growth and Man's Environment".

Not everyone has abandoned the "limits to growth" view. See, for example, Herman E. Daly, "The Perils of Free Trade", *Scientific American*, New York, November 1993; H.E. Daly and Robert Goodland, "An Ecological-economic Assessment of Deregulation of International Commerce under GATT", *Ecological Economics*, Vol. 9, No. 1, 1994; and Paul Ekins, Carl Folke and Robert Costanza, "Trade, Environment and Development: the Issues in Perspective", *Ecological Economics*, Vol. 9, No. 1, 1994.

<sup>8</sup> Kym Anderson, "Effects on the Environment and Welfare of Liberalizing World Trade: the Cases of Coal and Food", in Anderson and Richard Blackhurst (eds), *The Greening of World Trade Issues* (London: Harvester Wheatsheaf, for the GATT Secretariat, 1992); and André de Moor, *Subsidizing Unsustainable Development* (Institute for Research on Public Expenditure, 1997).

<sup>9</sup> See, for example, Anderson, "Agricultural Trade Liberalization and the Environment: a Global Perspective", *The World Economy*, Oxford and Boston, Vol. 15, No. 1, 1992; Anderson, "Agricultural Policies, Land Use and the Environment", 14th Denman Lecture, University of Cambridge (Cambridge: Granta Editions, 1992); and C. Ford Runge, "The Environmental Effects of Trade in the Agricultural Sector", *The Environmental Effects of Trade* (Paris: OECD Secretariat, 1994).

<sup>10</sup> In particular, the Convention on International Trade in Endangered Species (CITES), the Basel Convention and the Montreal Protocol.

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<sup>11.</sup> For a summary of the arguments governments have brought to this issue in the WTO, see the *Report of the WTO Committee on Trade and the Environment* (Geneva: World Trade Organization, 1996). For more detailed analysis, see for example the relevant contributions by Jagdish Bhagwati, T.N. Srinivasan, John D. Wilson, Robert Hudec and Daniel A. Farber, among others, in Bhagwati and Hudec (eds.), *Fair Trade and Harmonization: Prerequisites for Free Trade?* (Cambridge, MA: MIT Press, 1996); and Ernst-Ulrich Petersmann, "Settlement of International Environmental Disputes in GATT and the European Community: Comparative Legal Aspects", in Niels Blokker and Sam Muller (eds.), *Towards More Effective Supervision by International Organizations* (Dordrecht, Netherlands; Boston, MA: M. Nijhoff; 1994).

<sup>12.</sup> This set of arguments has been reviewed critically by Bhagwati and Srinivasan in Bhagwati and Hudec, *op. cit.*, Vol. 1, ch. 4.

<sup>13.</sup> See, for example, Gene M. Grossman and Anne O. Krueger. *Environmental Impacts of a North American Free Trade Agreement*, Working Paper No. 3914 (Cambridge, MA: National Bureau of Economic Research, 1991); Grossman and Krueger, *Economic Growth and the Environment*, Working Paper No. 4634 (Cambridge, MA: National Bureau of Economic Research, 1994).

<sup>14.</sup> Singapore Ministerial Declaration, WTO Secretariat, Geneva, December 1996.