

Living, Labour and Environmental Standards and the WTO

Staff
Working Paper

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The views expressed in this paper are those of the staff involved and do not necessarily reflect those of the Productivity Commission.

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Preface

There has been much debate in Australia and other developed nations in recent years about the WTO and the rules governing the multilateral trading system. The Productivity Commission examined concerns about the WTO, and about globalisation more broadly, in its 1999-2000 Annual Report (PC 2000a). It also addressed some of these matters in a submission to the Department of Foreign Affairs and Trade, in the lead-up to the WTO Ministerial Conference held in Doha in November 2001 (PC 2001a). Those publications drew in part on the research now updated and presented in this staff working paper.

The paper examines trade liberalisation and the WTO and their links to:

- living standards, income inequality and poverty;
- core labour standards, and
- the environment and environmental policies.

The paper has been prepared by Tom Nankivell of the Productivity Commission's Trade Policy Research Unit. The author received guidance and useful comments from a number of Commission colleagues, including Richard Snape, Neil Byron, David Robertson and Norm Gingell. Ian Castles of the Australian Academy of Social Sciences, Steve Dowrick and Robyn Briese of the Australian National University, Terry O'Brien of the Commonwealth Treasury and Adrian White of the Department of Foreign Affairs and Trade provided helpful advice on specific issues. The views expressed in the paper are attributable to the author alone.

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Abbreviations

AIDS	Auto Immune Deficiency Syndrome
ATC	Agreement on Textiles and Clothing
CFC	chloroflourocarbon
CGE	computable general equilibrium (model)
CITES	Convention on International Trade in Endangered Species (of Wild Flora and Fauna)
DFAT	Department of Foreign Affairs and Trade
EU	European Union
FOE	Friends of the Earth
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GMO	genetically modified organism
ICFTU	International Council of Free Trade Unions
IISD	International Institute for Sustainable Development
ILO	International Labour Organization
IMF	International Monetary Fund
MEA	multilateral environmental agreement
NBER	National Bureau of Economic Research
OECD	Organisation for Economic Co-operation and Development
PC	Productivity Commission
PPM	process and production method
PPP	purchasing power parity
SPS	Sanitary and Phytosanitary (Agreement)
TBT	Technical Barriers to Trade (Agreement)
TRIMS	Trade Related Investment Measures (Agreement)
TRIPS	Trade Related Aspects of Intellectual Property Rights (Agreement)
UK	United Kingdom
UNCED	United Nations Conference on Environment and Development
UNDP	United Nations Development Program
UNSC	United Nations Statistical Commission
US	United States (of America)
WTO	World Trade Organization
WWF	World Wildlife Fund

Introduction

The World Trade Organization (WTO) is an international forum in which member governments agree on rules for the conduct of international trade (box 1).

There has been much debate in Australia and other developed nations in recent years about the WTO and the rules governing the multilateral trading system. Critics have charged the WTO with being an undemocratic world government, anti-developing and anti-small country, driven by the interests of global corporations, and insensitive to labour and environmental standards and cultural values. Supporters of the WTO argue that many of the criticisms reflect misunderstandings of its history, role and processes, and that the multilateral trading system has generated substantial economic benefits.

This paper examines three areas raised in the recent debates.

One of these areas is the economic effects of trade liberalisation and the WTO. Most commentators accept that the liberal trade policies work to increase total world income. However, many claim that ‘globalisation’, and policies related to it, are increasing inequality and are doing little to reduce global poverty. Critics also argue that the WTO does not adequately look after the interests of small and developing countries, with the governments of larger economies having more influence within the organisation.

Chapter 1 examines evidence on these matters. Understanding them is important, both in their own right and also for considering the merits of proposals to amend WTO provisions — such as those discussed in chapters 2 and 3.

One recent proposal to reform WTO provisions concerns the effects of trade when workers in developing countries are employed under what are seen as exploitative or inhumane conditions. A number of groups voice humanitarian concerns for the workers in developing countries themselves. Some employer groups and unions in developed countries also express fears that their members will be undercut by cheap imports from developing countries. This, they argue, would result in job losses, lower wages and/or poorer working conditions in the developed nations, and a ‘race to the bottom’ in wages and working conditions worldwide.

Trade sanctions against low-wage countries have been advocated on both protectionist and humanitarian grounds (box 2). One view is that tariffs should be imposed on imports made in low-wage countries, irrespective of whether those wages are appropriate for the economic conditions of the developing country. However, the more common

Box 1 The World Trade Organization

The WTO is an international forum where sovereign governments negotiate and execute agreements — which include constraints on their own actions — to foster an open trading system. In the trade negotiations, decisions are generally taken ‘by consensus’ of all member governments.

In broad terms, the WTO agreements work together to require all member governments to apply their trade rules in a consistent, transparent and essentially non-discriminatory way. Once a country’s trade restrictions have been agreed with other WTO members, the restrictions are ‘bound’ and cannot be increased above those levels without risking sanctioned retaliation or other disciplines.

The multilateral trading system was established in 1947 when 23 governments — mainly from developed countries — signed the General Agreement on Tariffs and Trade (GATT). It has evolved through eight rounds of negotiations to cover goods, services, non-tariff trade barriers and certain trade-related issues, such as intellectual property protection. Since the GATT’s inception, manufacturing tariffs in industrialised countries have fallen by 90 per cent and world trade has increased 18-fold. There are now 144 members of the WTO, the overwhelming majority of which are developing nations. Governments can apply to join or withdraw from the WTO at any time.

More details on the WTO and its processes are provided in section 1.3.

proposal in the WTO context is to link ‘core’ labour standards — union rights and bans on discrimination, slavery and child labour — to WTO agreements. Under this proposal, a country’s failure to observe core standards would be grounds for another country to impose trade sanctions on it.

The merits of linking core labour standards to WTO agreements are assessed in chapter 2. While there is some debate in the literature about whether core standards are appropriate in all cases (appendix A), much of the focus is on whether the WTO would be an effective or appropriate mechanism for seeking to enforce such standards.

A second set of proposals to reform WTO provisions stems from concerns about the effects of trade liberalisation on the environment. Although some environmentalists have recognised that trade liberalisation can enhance the environment in certain respects, others have expressed the concern that, by promoting economic growth, trade contributes to the unsustainable use of natural resources and to pollution that threatens the earth’s assimilative capacity. There are also concerns that trade liberalisation causes a ‘race to the bottom’ in environmental standards, and that WTO trade rules constrain the ways in which environmental objectives can be pursued.

These matters are addressed in chapter 3. As with the labour standards debate, the main issue is not whether environmental objectives are justified. Rather, it is whether changes to WTO provisions are an appropriate way of meeting them.

Box 2 Views on labour and environmental 'linkage' to the WTO

In calling for core labour standards to be linked to WTO agreements, the International Confederation of Free Trade Unions (ICFTU 1999) has stated that its campaign:

... focuses on a short list of basic human rights at work. Aimed at preventing repression, discrimination, forced and child labour, they are fundamental rights which all countries regardless of their level of development can and should apply. With these rights, the cruellest forms of exploitation are addressed and workers have a voice, an opportunity to have their say about their working conditions. It is a simple but powerful demand that anybody who professes to believe in democracy and human rights can accept.

According to the Australian Manufacturing Workers' Union (Cameron 2000):

It is possible for everyone to benefit from an expansion of world trade. But if we accept that a global economy is desirable without accepting the globalisation of desirable social conditions and democratic values, we give a green light to the appalling lack of these conditions and values in many countries with which we are expected to compete.

The World Wide Fund for Nature (WWF 2000) has advocated environmental linkage:

The WTO has to respect legitimate environmental rules and agreements unless they can be demonstrated to be protectionist. This means the WTO must clearly recognise the limits of its jurisdiction over environmental questions. At the same time, the environment must be addressed within the WTO in a transparent way... Negotiations on the [UN BioSafety] Protocol ... were blocked by countries which claimed that it would restrict trade and contravene WTO rules.

A statement issued by one hundred Third World academics and non-government organisations (TWIN-SAL 1999) opposed to labour and environmental linkage reads:

We declare our unambiguous opposition to Linkage of labor and environmental standards to WTO and to trade treaties. We also wish to disabuse the media and the governments in the developed countries of the notion that those who oppose Linkage are corporate interests and malign governments.

The demand for Linkage via a 'social clause' in the WTO ... is the result of an alliance of two key groups: politically powerful lobbying groups that are 'protectionist' ... [and] the morally-driven human rights and other groups who simply wish to see higher standards abroad...

The former groups are not interested in improving the wellbeing in the developing countries; they are actuated by competitiveness concerns and hence are selfishly protective of their own turf...

The morally driven groups...genuinely wish for better standards for labor and the environment in the Third World; and for that they must be fulsomely applauded. But their demands for Linkage...while not deceptive or self-serving, are nonetheless mistaken and must also be rejected. Superior ways of advancing these objectives and agendas exist, which lie outside of the trade context and can be pro-actively pursued instead.

The Australian Government (DFAT 1997) also opposes linkage:

On social issues such as labour standards, the Government will oppose the WTO adopting positions that create divisions on the basis of divergent social or cultural values, and are of doubtful or negative trade relevance. Attempts to incorporate such rules would dilute the WTO's core business, and weaken its authority and credibility in the eyes of significant members.

And the World Bank (2001, 18) has stated:

Communities all over the world are struggling to improve living standards and labour and environmental conditions. A real and positive commitment, however, requires real resources... Imposing trade sanctions on countries that do not meet first-world standards for labour and environmental conditions can have deeply damaging effects on living standards of poor people.



1 The economic effects of trade liberalisation and the WTO

Recent debates about the WTO have highlighted concerns about the effects of ‘globalisation’, and policies and institutions associated with it, on inequality and the living standards of the poor. While most commentators accept that the average income of the world’s people is increasing, many hold the view that ‘the rich are getting richer and the poor are getting poorer’. Indeed, a statement released by 1500 non-government organisations in the lead-up to the WTO Ministerial Conference in Seattle in November 1999 read, in part:

In the past five years, the WTO has contributed to the concentration of wealth in the hands of the rich few [and] increasing poverty for the majority of the world’s population (FOE 1999a, cited in Vaughan 2001, 148).

In assessing such claims, sound information is required on living standards around the world. As discussed below, serious deficiencies exist in the statistical studies used to underpin the claim that global inequality is increasing.

To assess the impact of trade liberalisation, it is also necessary *as far as possible* to disentangle it from other aspects of ‘globalisation’ — trade liberalisation does not have the same economic or social effects as investment liberalisation, technological change or migration, for example. Separating the effects of these different forces is not always easy or feasible: often countries will adopt liberal trade, investment and other economic policies more or less simultaneously, as part of a strategy of integrating more fully into the world economy. Nevertheless, various analytical tools exist which can help in isolating the effects of different policies and economic developments.

Similarly, the effects of the agreements reached between governments in the WTO need to be separated from the effects of policies pursued by other international institutions, such as the World Bank, the International Monetary Fund (IMF) or the International Labour Organization (ILO). While these other organisations influence the environment in which WTO agreements take effect, the merits of trade liberalisation through the WTO is *largely* a separate issue from, for example, the merits of IMF lending policies or the merits of the labour standards promulgated by the ILO.

With these analytical requirements in mind, this chapter discusses the economic impacts of trade liberalisation and the WTO, under the following headings:

- the impact of trade and its liberalisation on economic growth;
- the effects on living standards, inequality and poverty alleviation; and
- the contribution of the WTO.

1.1 The impact of trade and its liberalisation on economic growth

The economic literature identifies several ways in which liberal trade policies can enhance economic performance. Trading allows countries to specialise production in their areas of relative strength and to exchange this output for products which other countries can supply at lower cost than can be produced at home. It enables access to a wider range of goods and services. Access to foreign products helps diffuse innovations and new production technologies, which in turn can allow less advanced economies to approach the technology levels and incomes found in more advanced economies. Liberal trade policies increase effective market size, which allows producers to reap ‘economies of scale’ and, thus, lower production costs. And openness to trade provides a source of additional competition to keep local prices in check and domestic producers ‘on their toes’. All these forces work to promote efficient resource use which facilitates economic growth.

While there are many sources of ‘gains from trade’, economists have also shown that, in certain circumstances, restrictive trade policies can potentially enhance economic performance. For example, in theory government intervention in trade in oligopolistic markets may be able to shift profits from a foreign firm to its domestic competitors, with a resultant increase in national income. And in some models, trade restrictions may generate higher growth where they favour technologically dynamic sectors.

In judging the relative merits of liberal and restrictive trade policies, it is necessary to consider the prevalence of the conditions necessary for government intervention to enhance economic performance, and the likelihood that such intervention would be successful, drawing on empirical evidence of the effects of different policies.

The mainstream economic position in favour of liberal trade policies reflects a long history of experience and analysis.¹ Following World War II, many trade scholars were largely neutral as between import substitution strategies and liberal trade strategies, or in some cases favoured import substitution strategies. However, the accumulation of evidence since then has pointed to a general superiority of liberal trade policies for economic development and growth in living standards.

This is not an argument for ‘laissez faire’ or ‘free market’ policies in general. Some regulation of domestic industries is often warranted — for example, to encourage appropriate research and development, or where there is natural monopoly. But restrictions on international trade can be justified less frequently.

¹ There is an extensive economic literature on the effects of trade and trade policies, dating back to Adam Smith and David Ricardo. For a concise discussion of the development of the mainstream economic position on trade liberalisation in the second half of the twentieth century, see Srinivasan and Bhagwati (2001).

Country-level empirical evidence

The empirical evidence in favour of liberal trade policies has several strands.

A series of in-depth country case studies sponsored by the World Bank, the NBER and the OECD from the late 1960s to the early 1980s found that, after accounting for numerous country-specific factors, trade appears to create and even sustain higher economic growth (Srinivasan and Bhagwati 2001). As Lindert and Williamson (2001, 23-24) report, studies of trade opening events in South Korea, Brazil, Colombia and Tunisia between 1960 and 1970 found that growth improved in each case. Economists exploring sectoral connections between protection and growth in 14 developing countries in the 1960s and 1970s found that, in all but one case, trade barriers imposed significant costs. And in studies for 41 countries for the period 1963-85, the World Bank (1987) found a strong correlation between trade openness and growth.

Numerous cross-country regression studies (prominent examples from the last decade being Dollar 1992; Sachs and Warner 1995; and Edwards 1992, 1998) have also found positive links between countries' economic growth and various indicators of their degree of openness to trade. Such studies cannot prove definitively that trade openness causes growth. Indeed, in a recent critique of the trade-growth literature, Rodrik and Rodriguez (1999) make several criticisms of the recent cross-country regression studies, including that the indicators of trade 'openness' used are problematic² or, in some cases, are highly correlated with other sources of economic performance (box 1.1). Notwithstanding these and other possible limitations, the fact that vast numbers of regression analyses find a positive and, in a number of cases, significant link between (measured) trade openness and growth is, at a minimum, suggestive of such a link.

A more recent study by World Bank researchers (Dollar and Kraay 2001) compared the experiences of post-1980 'globalising' and 'non-globalising' developing nations (these groupings defined according to trade-related characteristics). The globalisers increased their growth rates considerably over the period, closing up on the developed nations, while the non-globalising group of developing countries fell further behind. In per capita GDP terms, the globalisers outgrew the non-globalisers by more than 35 percentage points during the 1990s alone.³ The authors concluded that evidence from individual cases, together with regressions designed to overcome certain limitations of earlier analyses (see box 1.1), support the view that globalisation leads to faster growth.

2 Single or composite trade openness indicators have been constructed using various measures, including average tariff levels, indices of non-tariff barriers, exchange rate distortion and variability measures, trade flow measures, indicators of black market premiums on exchange rates, measures of state control of trade or of the economic system, and subjective indices of trade policy openness.

3 Average per person growth rates for the post-1980 globalising group of developing nations — which account for more than half of the developing world's population — increased from 2.9 percent in the 1970s to 5 percent in the 1990s. By contrast, the non-globalising group of developing countries experienced annual average per capita growth rates of just 1.4 percent in the 1990s, down from 3.3 percent in the 1970s. The developed nations enjoyed annual average per capita growth rates of 3.1 percent in the 1970s and 2.2 percent in the 1990s.

Box 1.1 **Cross-country regression studies and the trade policy debate**

While numerous cross-country regression studies have supported the proposition that liberal trade policies promote economic growth, the robustness of such studies has been challenged recently.

In particular, Rodrik and Rodriguez (1999, 37), while emphasising that they know of no credible evidence of (post-war) trade restrictions being systematically associated with higher growth rates, argue that the recent literature is 'largely uninformative' about whether countries grow faster due to lower policy-induced trade barriers. They state:

In many cases, the indicators of 'openness' used by researchers are problematic as measures of trade barriers or are highly correlated with other sources of poor economic performance. In other cases, the empirical strategies used to ascertain the link between trade policy and growth have serious shortcomings, the removal of which results in significantly weaker findings (Rodrik and Rodriguez 1999, 3).

To take one example, Rodrik and Rodriguez argue that the Sachs and Warner (1995) study's indicator of trade openness draws its explanatory strength mainly from two elements — black market premiums and state control of exports — which are highly correlated with other (geographical and macroeconomic) determinants of growth. Rodrik and Rodriguez state that the indicator serves as a proxy for a wide range of institutional and policy differences, and biases estimates of the effects of trade restrictions upwards.

The Rodrik and Rodriguez critique has elicited at least three broad responses.

First, Dollar and Kraay (2001) adopt methodological strategies to address some key criticisms of earlier cross-country regression studies. Among other things, they use regressions that exploit within-country variations in trade and growth, which effectively control for geographic and enduring country-specific factors, such as institutional quality. Again, they find a strong, positive relationship between trade openness and growth. Even so, due to 'multicollinearity' in the data, they remain unable to exclude openness to foreign investment (and some other factors) as an alternative explanation for the observed growth.

Second, Srinivasan and Bhagwati (2001) argue that cross-country analyses on trade openness and growth *are* inherently problematic, but note that such analyses contributed little to the consensus in favour of trade openness that evolved among development economists in the decades following World War II. Rather, they point out that this consensus was based on detailed analysis drawing, in particular, on various nuanced, in-depth case studies of individual countries' economic experiences.

A third response has been to observe that, while cross-country regressions have limitations, they add to the preponderance of evidence that supports the view that trade openness promotes growth. For example, Dollar and Kraay (2001) recognise that cross-country regressions will never be able to prove scientifically that trade openness causes growth, but consider that cross-country statistical results, together with individual cases, provide convincing evidence of such a link. Conversely, Lindert and Williamson (2001, 25) observe that, in studies of trade policy and growth in developing countries, very few have suggested that protection has helped economic growth, or that trade liberalisation has harmed it. And Srinivasan and Bhagwati (2001, 22), while cautioning strongly against drawing firm conclusions from cross-country regressions, state that it may be considered 'suggestive' that vast numbers of such studies tend to support a trade openness-growth link.

Trade policies, trade and growth at the global level

Does the view that liberal trade policies generally promote economic growth also find support in global data?

Demonstrating causative links between trade policies and economic growth at the global level would be extremely difficult. Among other things, there would remain difficulties in constructing a reliable indicator of openness, and trade and growth data aggregated to the global level can conceal countervailing trends in different countries. The issue of the direction of causation between increased trade and greater growth that arises at the country level would also arise at the global level. And obviously, it is not possible to conduct the equivalent of cross-country studies at the global level.

While simple global-level correlations cannot provide definitive evidence, examination of data on trade barriers, volumes and growth at the global level reveals patterns which are at least broadly consistent with the conclusion drawn from country-level studies:

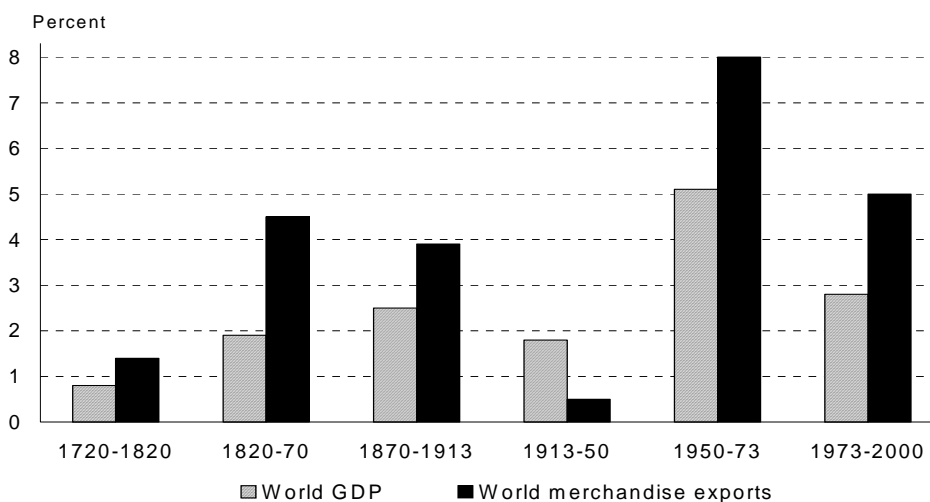
- The substantial increase in global economic growth since the industrial revolution has been accompanied by even larger rises in world trade (figure 1.1).⁴
- The highest growth rates occurred following the creation of the GATT in 1947. Between 1950 and 2000, average tariff levels on manufactured goods in industrialised countries fell by 90 percent, world trade in goods and services rose from one-tenth to about one-third of world GDP, and global economic growth averaged almost 4 percent a year (figure 1.2).
- By contrast with the pre- and post-wars periods, in the interwar period when countries retreated into protectionism, compounding the effects of the international financial crisis, trade growth fell sharply and growth in world income per capita almost halved.

Although global growth has remained historically high since the mid-1970s, it has been lower than in the immediate post-war decades, even though average tariff levels continued to fall throughout the period.⁵ Some groups have cited this relative decline in growth to suggest that policies pursued during the period — including trade liberalisation — may be responsible for ‘diminished progress’.⁶

⁴ Lindert and Williamson (2001, 3-7) consider that, while global economic integration prior to the 1820s was extremely limited, that decade manifested a ‘powerful and epochal move’ from mercantilism towards liberal policies. In combination with falling transport costs and mass migration, this led to significant global integration by 1913, notwithstanding a (relatively moderate) anti-globalisation policy reaction after 1870.

⁵ Not only did manufacturing tariffs continue to decline in industrial countries, but average tariff rates in developing countries were also reduced, from around 30 percent in the early 1980s to 15 percent in the late 1990s (World Bank 2001, 55). On the other hand, as tariffs have fallen, existing non-tariff barriers to trade (such as quotas and anti-dumping measures) have had more effect. There has also been some increase in the prevalence of non-tariff barriers from the mid-1970s (Boltho 1996, 252), although agricultural non-tariff barriers were ‘tariffied’ in 1995.

Figure 1.1 World GDP and merchandise exports, 1720 to 2000
Real average annual growth



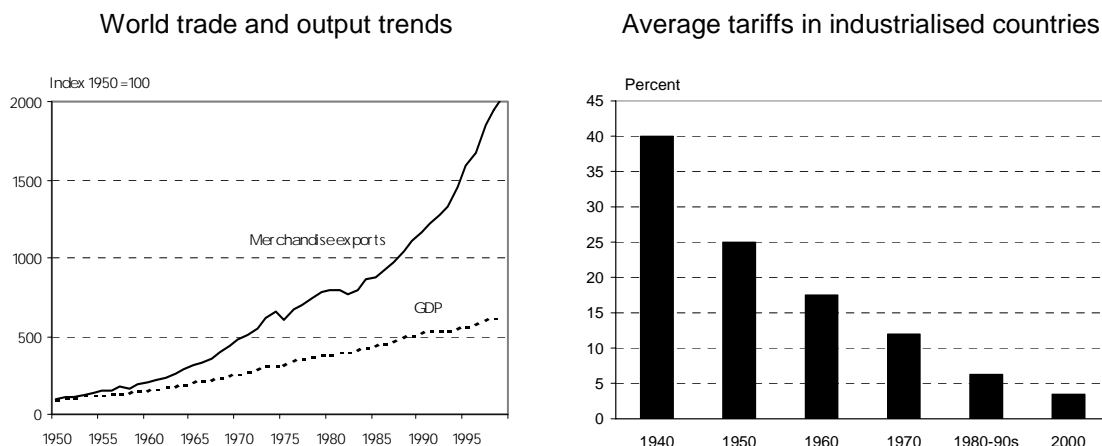
Data sources: (WTO 1998a, 2000a, 2001e).

However, the causes of this relative decline in growth appear to lie elsewhere. For example, Maddison (2000) argues that a large part of the exceptionally high growth in the 1950-73 period can be explained by the delayed exploitation of a backlog of technological opportunities, which arose during the period 1913-1950 but which was not widely capitalised upon due to wars and rapidly growing trade restrictions. (Of course, the cessation of war itself constituted a massive reduction in trade ‘restriction’). Ben-David (2000) also points to the effects of reconstruction in lifting growth rates immediately after World War II, with growth rates then trending downward in developed countries (at least up to the early 1990s) as capital became more ‘fully invested’. And the Commonwealth Treasury (2000) has noted that oil price shocks, exchange rate instability and stagflation led to lower growth in the last quarter of the 20th century compared the immediate post-war decades.

Further, while some countries have indeed suffered ‘diminished progress’ over the last twenty years, the poor performers among developing nations have predominantly been those countries which have largely maintained trade barriers and other economic restrictions, and have not integrated into the world economy. As Lindert and Williamson (2001, 25) note: ‘as far as we can tell, there are no anti-global victories to report for the postwar Third World’. By contrast, those developing countries that have become more integrated in the world economy since 1980 have grown rapidly.

While the global data are broadly consistent with the view that liberal trade policies generally promote higher economic growth, it should be acknowledged that trade is not the only, or probably the most important, driver of economic growth. The economic literature points to a number of additional drivers, including technological change,

Figure 1.2 World gross output, merchandise exports and tariffs, 1940/50 to 2000



Data sources: WTO (1998a, 2000a).

education levels, monetary policy stability, political stability, the rule of law and other aspects of ‘social capability’.⁷ Nor, of course, has the substantial growth in world trade over the last two centuries been driven by policy factors alone. Among other things, transport and communications costs have fallen significantly over the last two centuries, facilitating greater trade in finished goods and more geographically complex production webs (WTO 1998a).

Notwithstanding these qualifications, liberal trade policies appear to have yielded substantial global economic growth. This conclusion is supported by:

- economic reasoning and the empirical evidence, particularly at the country level, of significant, positive and plausibly causative links between trade openness, trade and growth; together with
- the magnitudes of the increases in both trade volumes and global economic growth since early in the 1800s, and particularly over the last 50 years.

⁶ For example, in questioning economic liberalisation policies generally, a paper by a public interest economic think-tank (Wiesbrot et. al. 2001) argues that the period from 1980 to 2000 has been one of ‘diminished progress’ compared to the previous two decades. However, the paper does not seek to disentangle the effects of trade liberalisation from other economic policies, let alone from other determinants of economic performance.

⁷ Liberal trade policies themselves support and enhance these other drivers in many ways. For example, exposure to sound international commercial practices through trade strengthens domestic constituencies for enforcing the rule of law, building strong economic institutions and maintaining a stable commercial and investment environment through good macroeconomic policies. Likewise, while technological change is viewed as a key driver of greater economic growth, trade can drive the diffusion of existing technical knowledge and promote further technological innovation through enhanced competition.

1.2 The effects on living standards, inequality and poverty

Average living standards

This higher global growth has increased living standards substantially.

Over the course of the 20th century, there was an unparalleled increase in people's incomes. At a time of rapid population growth, not least because of increased infant and childhood survival rates (themselves facilitated in part by economic growth), real output per person grew five-fold — with the bulk of the gain occurring in the period since 1950. The richest quarter of the world's population became six times richer. The poorest quarter became almost three times richer (IMF 2000).⁸

A broader measure of living standards would also take account of improvements in life expectancy, literacy and other social indicators. Life expectancy (at birth) in India, for example, rose from 36 years to 63 years in the second half of the century. Child malnutrition rates have declined by a quarter in the last 40 years. And education to at least the primary school level has spread widely over the last 20 to 30 years and is now near universal outside sub-Saharan Africa (Commonwealth Treasury 2000).

More broadly, Easterlin (2000), drawing on various information sources, points out that:

By many measures, a revolution in the human condition is sweeping the world. Most people today are better fed, clothed and housed than their predecessors of two centuries ago. They are healthier, live longer, and are better educated. Women's lives are less centred on reproduction and political democracy has gained a foothold. Although western Europe and its offshoots have been the leaders of this advance, most of the less developed countries have joined in during the 20th century. Although the picture is not one of universal progress, it is the greatest advance in the condition of the world's population ever achieved in such a brief span of time (Easterlin 2000, 7).

Several factors besides trade and trade policies have of course played a part in this transformation. These include technological change and other aspects of 'globalisation' such as migration and capital flows, as well as public health advances and other social and governmental policy choices. Even so, the economic evidence suggests that liberal

⁸ As economists have long recognised, income, GNP or GDP, GDP per capita and similar measures are imperfect indicators of community welfare and, indeed, of economic growth (Commonwealth Treasury 1964, 1973). Among other things, GDP excludes non-monetary transactions such as intra-household services, often undervalues improvements in product quality, includes 'defensive' expenditures such as on pollution-abatement, and does not attempt to incorporate changes in the stock of natural capital. Another strand of the economic literature points to evidence that, beyond moderate levels of per capita income, the link between changes in average incomes and subjective wellbeing is weak, in part due to the effects of higher average consumption levels on people's expectations (Hirsch 1976; Frank, Ng and Oswald 1997). Notwithstanding these limitations, the magnitude of the measured increases in incomes over the 20th century provides a strong indication that living standards have risen substantially during the period.

trade policies have contributed to the substantial global economic growth experienced during much of the 20th century and, by implication, to the rise in living standards that it has facilitated.

Income inequality

While average living standards have risen significantly, critics of trade liberalisation and globalisation point to claims of a growth of inequality between the world's rich and poor and the continuing extent of poverty in the world. For example, a widely cited⁹ series of reports by the United Nations Development Program published in the second half of the 1990s (UNDP 1996–1999) suggested that the gap between people in rich and poor nations has been widening markedly over recent decades. And according to World Bank (2000) estimates, some 1.2 billion people remained in absolute poverty at the end of the century.

However, it seems unlikely that trade liberalisation is responsible for widening the gap between the world's rich and poor, for a number of reasons.

First, while 'global inequality'¹⁰ has clearly increased since the industrial revolution, recent empirical work indicates that global inequality has *not* widened over the last three decades. The UNDP studies, on which most claims of rising global inequality are based, have been found to contain several 'material errors' (outlined in box 1.2). While methodological complications mean that it remains difficult to get a precise fix on global inequality, studies which have corrected for the deficiencies in the UNDP statistics indicate that global inequality is either roughly stable or narrowing. This is largely because the average per capita income growth of 70 percent of the population of developing countries exceeded that in industrialised countries over the last thirty years — reflecting strong economic growth in China, East Asia and India. Hence, the claim that 'the rich are getting richer and the poor are getting poorer' is unfounded at the global level (box 1.2).

Second, liberal trade policies appear to have contributed to some convergence in countries' incomes in recent years. Middle and high income countries that trade extensively with one another tend to exhibit a higher incidence of income convergence

⁹ The UNDP studies have been referred to by numerous non-government organisations to support their claims that global inequality is increasing and/or that globalisation is causing greater global inequality. (See, for example, Wallach and Sforza (Public Citizen) 1999, 135; IFG 2001, 1-3; FOE 1999b; Oxfam 2000). Various governmental bodies, including the IMF and the World Bank, have also made similar statements (see Commonwealth Treasury 2000). In a more recent report, the World Bank has revised its view on trends in global inequality and absolute poverty (see footnote 15).

¹⁰ 'Global inequality' (also termed 'world inequality') refers to inequality among all individuals in the world, regardless of where they live. Other inequality measures include 'within-country inequality' and 'between-country inequality'. Global inequality is a function of these other two measures, but in practice is dominated by changes in between-country inequality (see O'Rourke 2001).

Box 1.2 **Global inequality: lies, damned lies and statistics**

A common theme in recent criticisms of 'globalisation' is that the gap between the world's rich and poor is widening. These claims are often based on statistics such as those reported by the United Nations Development Program in its *Human Development Reports* of the late 1990s (UNDP 1996–1999). Some past statements from the World Bank, the IMF and others have reinforced these concerns (see Commonwealth Treasury 2000).

Following extensive criticisms by the former head of the Australian Bureau of Statistics (Castles 1998, 2000), the United Nations Statistical Commission convened an expert committee to examine the UNDP statistics (UNSC 2000). The committee found several 'material errors' in the UNDP estimates.

A key problem arose in converting different countries' incomes to a comparable basis. The UNDP used exchange rates for this purpose, but the expert committee found that 'purchasing power parity' (PPP) estimates provide a more accurate basis for making international comparisons in living standards. When PPPs are used, '...the gap in per capita income between the countries with the richest fifth of the world's population and those with the poorest fifth is not 74 to 1 [as reported by the UNDP], but 16 to 1, and that gap is not unequivocally widening but moderately fluctuating' (UNSC 2000).

Other problematic methods used to suggest that global inequality is widening include: the failure to weight different countries' average income levels by the number of people in the different countries; the arbitrary exclusion of particular countries from the statistics; and comparisons of the extremes of the income range rather than consideration of the overall global distribution of income.

An array of studies which use PPP estimates and income averages for all available countries, weighted by population, indicate that global inequality has been *declining* over the last three decades. This is mainly because of the large improvements in the living standards of many in China, India and other parts of Asia (see Commonwealth Treasury 2000).

One qualification to this picture is that Dowrick and Akmal (2001) have argued in a draft paper that the commonly-used 'Geary-Khamis' method of calculating PPP incomes overstates the true purchasing power of people in developing countries. Using an 'Afriat' Index to correct for this bias, Dowrick and Akmal find 'no compelling evidence of a significant change in world inequality' over the past twenty years. That said, Castles (pers. comm. 24 August 2001) has raised questions about some of the adjustments and findings in the Dowrick and Akmal draft, maintaining that the most widely-accepted statistical measures indicate that global inequality is decreasing.

A second complication is that *measured* inequality is inflated by rises in birth and survival rates among the very poor. That is, people who might otherwise be dead, or who may not have been born, and thus would not have been reflected in the statistics, may now be represented as low income recipients. While this would increase *measured* inequality, it would be contentious to argue that their birth and/or survival had reduced those people's welfare, or that the globe is 'less equal' as a result.

While these points highlight the difficulties in obtaining a precise fix on inequality, the statistical evidence suggests that global inequality has most probably narrowed, or at worst remained roughly constant, rather than widened over the last three decades.

than other countries (Ben-David 2000), although the economic evidence is mixed on whether there is a systematic relationship between trade liberalisation and income convergence.¹¹ Yet as noted earlier, post-1980 globalising developing countries have enjoyed significantly higher growth rates than the already developed countries, creating ‘...an important trend toward growing equality among open countries’ (Dollar and Kraay 2001, 11). By contrast, the non-globalising developing nations have been falling further behind.

Third, there does not appear to be a systematic relationship between either trade or trade openness and within-country inequality (Dollar and Kraay 2001). In summarising recent cross-country studies on within-country inequality, O’Rourke (2001, 30) notes that ‘...to date, the finding that openness has at most a modest impact on inequality (in either direction) seems fairly robust.’

Even so, within-country inequality has been increasing recently in a number of countries that have adopted (or retained) liberal trade policies. It has increased significantly in developed countries since 1980, reversing its previous trend (World Bank 2001, 47). It has also increased on average in the group of recently globalising developing countries, although the change largely reflects the substantial increase in inequality within China — inequality has remained steady or declined in a number of the other new globalisers (World Bank 2001, 48; Dollar 2001, 17).

¹¹ Some strands of economic theory may be interpreted as implying that trade liberalisation should bring about some convergence in incomes across countries. For example, in certain circumstances free trade in goods can lead to an equalisation in the prices of land, labour and capital (called ‘factors’) as well as in the prices of goods across countries. Trade openness can also allow poorer countries to import capital and modern technologies from wealthier countries, thereby potentially facilitating a ‘catch-up’ in productivity and income levels.

However, as Slaughter (1998) points out, trade liberalisation may have many different effects on cross-country levels of factor prices, quantities and technology. The net effect on cross-country income levels is theoretically ambiguous.

Empirically, Ben-David (2000) combined case studies of regional trade integration with comparisons of income convergence between trading partners and non-trading partners, and time-series analyses of individual country growth paths. He argued that certain trade liberalisation events, such as the formation of the European Economic Community in 1957, had increased income convergence between the participating countries. More generally, for middle and high income countries, he concluded that those that trade extensively with one another generally exhibit a higher incidence of income convergence than other countries, with the relatively poorer countries closing up on the (also rising) income levels of their wealthier trading partners. Similarly, open economies in the Sachs and Warner (1995) study experienced faster growth if their initial income levels were low, implying convergence in growth between open economies. Countries that were closed showed now such relationship.

The robustness of these studies has been challenged recently. For example, Rodrik and Rodriguez (1999) dispute Ben-David’s earlier (1993) treatment and interpretation of some of the historical data, and argue (drawing partly on Slaughter 1998) that there probably is no systematic relationship between trade liberalisation events and income convergence. Rodrik and Rodriguez (1999) have also criticised aspects of the Sachs and Warner study (see box 1.1).

In those countries experiencing greater inequality over recent years, factors such as technological change or domestic policies/characteristics appear to have been more significant causes than has trade liberalisation:

- In the case of technological change, there is evidence¹² that it has driven up wage premiums for highly skilled workers significantly. For example, the incomes of computer-based workers (whether in Britain or Bangladesh) have grown much more rapidly than the incomes of unskilled workers in the same countries. While skilled-biased technological change has been the main driver of this process, a caveat is that trade liberalisation may have facilitated some technological change and/or increased its rate of diffusion, thereby contributing to its effects on earnings dispersion.
- In discussing developments in developed countries, the World Bank (2001, 47-8) has noted that the increase in within-country inequality since 1980 may also be due to recent trends in migration and ‘changes in taxation and social spending unconnected to globalization’.¹³
- In the specific case of China, Lindert and Williamson (2001, 29) attribute the substantial increase in income inequality between 1984 and 1995 mainly to the country’s geography and prohibitions on internal migration within China. These prevented access to the benefits of the ‘new economy’ to those outside the cities and coastal areas. Thus, China’s inequality was characterised by the rise in urban-rural and coastal-hinterland gaps, not by widening gaps in any particular locale. Further, Wei and Wu (2001) compared inequality between people in cities and their immediately adjacent rural counties for around 100 city/county groupings across China between 1988 and 1993. In those city/county groupings that experienced greater degrees of openness to trade, inequality actually *declined*, possibly because the adjacent counties themselves became more industrialised.

¹² Lindert and Williamson (2001, 32), in referring to the United States experience, note that wage dispersion may be caused by several factors, including increases in unskilled worker immigration rates, greater import penetration by goods made with unskilled labour, a slow down in the growth of labour skills, a weakening of labour unions, and skill-biased technological change. However, studies on the causes of disparities generally have focussed on the ‘trade versus technology’ debate and, even then, isolating the contribution of different factors to intra-country income dispersion is methodologically difficult.

Most overseas studies suggest that trade plays a small role in increasing wage disparities within a country, with the influence of technology on rewards for skill by far the dominant factor (Cline 1997, Williamson 1997 and Brown 2000 survey the literature). In Australia, Murtough et al. (1998) found that reduced trade barriers had not been a major contributor to the increasing inequality of earnings or to unemployment over the last decade and a half. The wage and employment effects of changes in trade barriers have been overshadowed by technological change (requiring more high skilled labour) and by other developments such as adverse shifts in international trading conditions for primary commodities. More recently, de Laine et al. (2000) showed that increasing imports are not causing widespread change in the relative demand for skilled workers in Australia, although exports appear to be spurring the demand for skilled workers. Laplante et al. (2001) also concluded that skilled-based technological change is the main factor underlying the increasingly greater employment of skilled labour: trade is not a significant (direct) cause of this shift.

In summary, while it remains difficult to be precise about the effects of trade liberalisation on income inequality, the above points suggest that liberal trade policies are not a primary or systematic cause of widening inequality. In fact, they are probably narrowing the gap between rich and poor at the global level.

Poverty alleviation

The impact of trade liberalisation on poverty within a particular country depends on a complex array of effects, some immediate and direct, others indirect or long-term (box 1.3). Studies of the effects of individual country reform episodes on the poor have yielded mixed results. Bannister and Thugge (2001) note that, although generally there has been an increase in the incomes of the poor as a group following liberalisations, in some cases poor people have been adversely affected. That said, most of the studies take a short-term and ‘static’ perspective whereas the literature emphasises the longer-term and ‘dynamic’ nature of many of the benefits of trade reform (see box 1.3).

The longer-term evidence suggests that liberal trade policies have contributed to a substantial improvement in the material living standards of many of the world’s poor and, in the process, a reduction in the proportion of people living in absolute poverty:

- As noted earlier, notwithstanding significant population growth over the 20th century, economic growth made the poorest quarter of the world’s population almost three times richer. As a consequence, the proportion of people in absolute poverty¹⁴ has fallen from around half in 1900 to around one fifth today.¹⁵ The economic evidence indicates that liberal trade policies have contributed to this economic growth.
- There has been substantial poverty alleviation over recent years in the group of globalising developing countries identified by Dollar and Kraay (2001). These countries, which account for well over half of the developing world’s population, have enjoyed a combination of rapid growth with no systematic change in inequality,

¹³ In making this point, the World Bank (2001, 48) briefly observes that global economic integration is consistent with wide differences in domestic distributional policies, and that inequality differs substantially between equally globalised economies. This supports the Bank’s contention insofar as it suggests that at least some changes in taxation and social spending during the last two decades that have widened within-country inequality may not have been necessary to allow the countries concerned to reap the benefits of greater global economic integration. Even so, it should be noted that some reductions in company tax rates and other tax and spending changes in certain developed countries over the last two decades have been *premised* on a perceived need for countries to have an ‘internationally competitive’ tax regime to attract foreign investment.

¹⁴ Poverty can be defined in absolute or relative terms. The measure of poverty used here is the absolute poverty line of just under US\$400 per year (measured in 1993 PPP terms) as used by the World Bank (2000, 17). This measure captures the World Bank’s concept of ‘income poverty’, rather than its wider concept of poverty as ‘deprivation in well-being’. The wider concept includes not only income-related dimensions such as health and education, but also vulnerability, exposure to risk, and lack of civil liberties, political rights, good governance and other aspects of ‘voice’.

Box 1.3 Trade liberalisation and the poor

The impact of a country's trade reforms on its poor depends on an array of factors. These include changes in the prices of traded goods; flow-on changes in land, labour and capital prices, incomes and employment; 'economy-wide' effects; changes in government revenue and programs for the poor; longer-term effects on investment, innovation and growth; and the impact of openness of the economy's vulnerability to external shocks.

Several case studies have examined the effects of specific reform episodes, while other studies have examined how market reforms and growth more generally affect the poor. In some cases, computable general equilibrium (CGE) models have been linked to data on households differentiated by income strata and other characteristics. The studies (summarised in Bannister and Thugge 2001) generally examine the 'static effects' of reform, such as the short-term effects on the incomes and employment levels of poor households. Many do not address the 'dynamic' effects of reform on growth from investment and technological diffusion etc, and the reductions in poverty they can bring.

The studies' results are mixed. Although generally there has been an increase in the incomes of the poor following liberalisations, in some cases poor people have been adversely affected. For example, following trade reforms in Nicaragua, poor farmers' experienced increases in their real incomes. But following the domestic deregulation of cash crop purchasing (including the removal of transport cross-subsides) in Zambia, poor maize farmers — particularly those in remote areas — suffered as functioning markets disappeared and private markets did not develop in some areas. In relation to sub-Saharan Africa, a study of a reduction of average tariffs from 40 to 10 percent estimated that, while the incomes of urban workers would decline significantly, the incomes of the poorest members of society — rural farmers — would rise by 20 percent. But a study of trade liberalisation in South Africa found that, while reform would increase the incomes of black households on average, the poorest black households — which are reliant on (fixed) government transfers — could suffer a fall in income, as would white households.

The results highlight that the effect on the poor of particular trade reform episodes is contingent on other policies and country or area characteristics. In particular, Winters (2000) suggests that the creation and destruction of markets in which the very poor participate is a key determinant of how a liberalisation event will effect poverty. Which groups (rich or poor, skilled or unskilled) are favoured by the structure of protection prior to reform will also affect the outcomes of liberalisation.

In their review of the various studies, Bannister and Thugge (2001, 19) observe:

Trade reform in these empirical analyses increased the income of the poor as a group, and the transition costs in general were small relative to the overall benefits... Nevertheless, there are cases where the effects of liberalization on the poor, and others, in the short term can be negative and significant. While these negative results cannot be discounted, ...in many cases they are conditioned on the initial pattern of protection. When the poor benefit from rents from trade protection, it is inevitable that in the short-run the removal of protection will result in a reduction in their income... It is also important to note that the studies cited here, particularly the CGE analyses, assume a short-term perspective in which no changes in investment or in the growth path of the economy can occur. The benefits that they impute from liberalization come from static gains in efficiency. But the more important gains from liberalization are known to come from dynamic gains such as more efficient patterns of investment and technological diffusion... Over the medium term, changes in investment and economic growth can (and usually do) significantly overwhelm the negative distributional effects of changes in prices that result from trade liberalization.

Sources: Winters 2000; Bannister and Thugge 2001.

and absolute poverty fell by 14 percent in the five years to 1998. As well as improvements in incomes, other dimensions of poverty improved. For example, both average years of schooling and life expectancy reached levels close to or equal to levels reached by rich countries in 1960 (World Bank 2001, 49-50).

None of this is to say that the remaining levels of absolute poverty are either inevitable or desirable, or that current trade arrangements are ideal from the point of view of people in developing (or other) countries. Among other things, there is a strong case for developed countries to grant developing countries greater access to their markets, particularly in the areas of agriculture, textiles and clothing. Nor is it to say that trade liberalisation by itself is sufficient to address the various economic (or other) problems that afflict people in developing countries, particularly those in the least developed nations. Indeed, the economic literature suggests that policies aimed at strengthening internal institutions and markets and alleviating transitional hardships may well be important prerequisites, or concomitants, to trade liberalisation in some cases (see Winters 2000; Bannister and Thugge 2001; World Bank 2000, 2001).

But as Sen (2001), speaking about globalisation more broadly, notes:

There is much evidence that the global economy has brought prosperity to many different areas of the globe. Pervasive poverty and ‘nasty, brutish and short’ lives dominated the world a few centuries ago, with only a few pockets of rare affluence. In overcoming that penury, both modern technology and economic interrelations have been influential. And they continue to remain important today. The economic predicament of the poor across the world cannot be reversed by withholding from them the great advantages of contemporary technology, the well-established efficiency of international trade and exchange, and the social as well as economic merits of living in open rather than closed societies.

¹⁵ While the precise proportion of the world’s people in poverty in previous centuries is unknown due to the fragmentary nature of the historical data, estimates by Bourguignon and Morrisson (1999) suggest that around 75 percent of the world’s population lived on less than the then-equivalent of about \$400 a year in 1820. This proportion is estimated to have fallen to around 50 percent by 1900. Notwithstanding the almost fourfold increase in global population growth since then, World Bank (2000) estimates put the figure at 29 percent in 1990 and 24 percent in 1998. Even so, due to rapid population growth, the World Bank (2000) estimates indicated that the actual number of people in absolute poverty remained steady at around 1.2 billion people during the decade (and the number on less than about \$800 per year actually increased by 250 million to 2.8 billion).

Economists and statisticians have raised doubts about the World Bank (2000) figures, suggesting that they may overstate the level of absolute poverty due to data deficiencies in certain developing countries, notably India which accounts for one third of the 1.2 billion people estimated to be in absolute poverty. Among other things, national accounts data suggests that the number of Indians on less than the equivalent of \$400 per year is far less than indicated by the less robust household expenditure surveys on which the World Bank figures are based (see Commonwealth Treasury 2000; World Bank 2000, 26).

In its December 2001 report on *Globalization, Growth and Poverty*, the World Bank (2001, 50-51) cites two studies which together suggest that the number of people in absolute poverty has fallen by around 200 million since 1980. The report acknowledges that ‘the long term trend of rising global inequality and rising numbers of people in absolute poverty has been halted and even reversed.’

Indeed, the experience of the past century is that those countries that shut themselves off from the rest of the world have done so at the expense of the living standards of their own people — including access to basic healthcare, education and other community services:

- The series of in-depth country case studies sponsored by the World Bank and others from the late 1960s to the early 1980s found that ‘self-reliance’ (or import-substitution) strategies performed poorly compared with export-oriented strategies.
- The more recent study by World Bank researchers indicates that non-globalising nations enjoyed far less growth than post-1980 globalising nations, and in some cases negative growth. In fact, the number of people in absolute poverty in the non-globalising group of developing countries *increased* by 4 percent in the five years to 1998. Not only did per capita incomes fall, in many of the countries life expectancy and school enrolments declined (World Bank 2001, 49-50).

Clearly, many of the poorest countries — for example, Myanmar, Sierra Leone, Rwanda, Guinea-Bissau, the Republic of Congo, Chad, Burundi, Albania and North Korea — are not in that state because of open trade policies. Rather, responsibility lies with internal institutions and policies and other factors inimical to economic growth such as political instability, poorly defined property rights and civil unrest (see Commonwealth Treasury 2000, 24–27).

In summary, although many of the world’s people continue to live in poverty, liberal trade policies have helped to substantially increase the living standards not only of the world’s rich but also of many of the poor, and thereby significantly reduced the proportion of people living in absolute poverty.

1.3 The contribution of the WTO

The WTO, and its predecessor the GATT, have been effective in facilitating the reduction of protection worldwide and, thus, in promoting trade and the improved living standards to which it has contributed. As noted earlier, since the establishment of the GATT in 1947, average tariffs on manufactured goods in industrialised countries have fallen from 40 percent to 4 percent, and world trade has increased 18-fold (figure 1.2).

Not all of these changes can be attributed directly to the actions of the GATT/WTO. A number of countries have chosen to reduce protection unilaterally and several nations have entered into regional trade agreements. Further, as mentioned earlier, other factors such as falling transport costs have also contributed to the expansion in world trade over time. Nor does the WTO system in all cases bring about ‘first best’ outcomes in terms of trade reform — the failure to significantly reduce protection for agriculture and textiles being examples.

However, as discussed below, several aspects of the multilateral system have helped to keep markets open and to facilitate reductions in trade barriers. Among other things, the GATT/WTO represents a stable, rules-based framework within which trade liberalisation can be pursued, and WTO rules and processes provide small to medium countries, including Australia, with greater sway in trade relations with larger economic powers than they might otherwise enjoy.

The negotiation process

The WTO is essentially an international forum where sovereign governments negotiate agreements — which include constraints on their own actions — to foster an open trading system. Detailed negotiations are conducted in ‘rounds’, over several years. The last (Uruguay) round ran from 1986 to 1994. The new round, agreed to at the recently concluded WTO Ministerial Conference in Doha (November 2001), is scheduled for completion by the start of 2005. As an intergovernmental body, the WTO’s negotiating process does not contain formal channels for input by business, unions or community groups, although governments are free to consult with such groups in devising their negotiating positions.

The bargaining process involves countries making ‘concessions’¹⁶ in some areas, in return for other countries’ concessions, often in different areas. While this facilitates greater reductions in trade restrictions than might otherwise occur, it also means that not all elements of WTO agreements will necessarily benefit all member countries. For example, in the Uruguay Round final agreement, developing countries struck a ‘grand bargain’ in which they agreed to lower manufacturing tariffs and to introduce intellectual property protections (which had been sought mainly by developed countries). In exchange, the developing countries received commitments from developed countries to limit or reduce agricultural, textiles and clothing protection and to cease using (so-called) ‘voluntary export restraints’ (World Bank 2001, 53).

Consequently, in considering the merits of reforms to particular provisions in WTO agreements (including the labour and environmental linkage proposals discussed in chapters 2 and 3), it is important to look also at what other provisions were agreed. Changes ‘after the fact’ to particular provisions, that may seem warranted in isolation,

¹⁶ The ‘concessions’ offered typically involve commitments to reduce, or not increase, tariffs and other trade barriers. The mainstream economic view is that these concessions are nearly always actions that are in each country’s self-interest anyway. The case for reductions in a country’s trade barriers does not rest on whether foreign countries have already reduced, or will also reduce, their trade barriers. The main benefits of trade reform are seen to come from the economic efficiencies created within a country that opens itself to the pressures and opportunities of international competition, irrespective of the trade barriers or subsidies which may prevail abroad. However, the benefits of trade reforms, such as tariff reductions in a particular industry, are diffuse whilst the costs are often concentrated in particular geographic areas and/or industries. This means that the political incentives to undertake trade reforms may be limited, even when such reforms offer significant net community benefits.

may alter the ‘balance of interests’ that underpinned the original agreement. Without compensating measures, such changes have the potential to destabilise the WTO system and put at risk the broader benefits that trade liberalisation brings. These systemic implications need to be balanced against the other merits of reform proposals.

While the negotiation process involves the exchange of concessions in many different areas, the WTO’s ‘consensus rule’ for concluding agreements helps to ensure that the balance of concessions offered and received by each member country is favourable. In principle, consensus requires *all* member governments to be satisfied with an agreement before it can be concluded: that is, they must all consider that the agreement offers them a share of the ‘gains from trade’, or at a minimum leaves them no worse off. In practice, not all countries have the resources to participate in all WTO meetings, and the size of the WTO membership together with organisational constraints mean that not all countries are able to be involved in developing each facet of proposals considered at WTO Ministerial Conferences. Further, the bargaining strength of different countries can influence the content of agreements. This has given rise in some quarters to concerns that small and developing country interests are disadvantaged by the WTO decision-making system. However, developing countries were able to veto attempts by certain developed countries to force through what they saw as an ‘unfavourable’ final agreement at the Seattle Ministerial Conference in November 1999. They were also able to negotiate significant concessions from developed countries at the recent Doha Conference (see box 1.5, below). In summary then, the consensus rule gives all countries the potential to influence WTO decisions and ensures that large trading nations and regional groups cannot ignore the interests of small and/or developing countries, which might not be the case without the WTO.

The general trade rules

Key WTO provisions work together to require all member governments to apply their trade rules in a consistent, transparent and essentially non-discriminatory manner:

- The ‘most-favoured-nation’ rule bars a member country from discriminating between ‘like’ products of other members, or from favouring non-WTO members over members (except within the ambit of customs unions and free trade agreements, and in the case of the provision of ‘special and differential treatment’ for developing countries).
- Under the ‘national treatment’ rule, once foreign supplies have entered a country’s market, they are to be treated the same as locally produced goods.
- Once a country’s trade restrictions have been agreed with other WTO members, the restrictions are ‘bound’ and cannot be increased above those levels without sanctioned retaliation or the withdrawal of other trade rights.
- Special mechanisms to suspend or void these general provisions — such as ‘safeguard measures’ against increased imports, anti-dumping measures and

countervailing action against subsidies in other countries, and exceptions provisions under GATT Article XX for certain other purposes (including environmental protection) — are available to all WTO members but are prescribed and monitored.

These rules assist member countries with limited bargaining power, and help to protect smaller nations from arbitrary and discriminatory changes in the application of trade rules. Some examples of benefits to Australia from these principles are set out in box 1.4.

The dispute resolution system

The WTO dispute settlement system provides a forum in which member governments can defend the treaty rights they have negotiated with other member countries.

Where a trade dispute occurs, WTO members are committed *not* to take unilateral action against perceived violations of their rights. If conciliation is unsuccessful, the parties in dispute must instead argue their case before an independent panel — with appeals to a separate body possible. The outcome is then confirmed by the Dispute Settlement Body, comprising all the member governments.

Member countries have flexibility in how they respond to rulings that they are in breach of their trade commitments. The offending country can change its own law or regulation to make it consistent with its obligations, or compensate the aggrieved country by lowering other trade barriers or by other measures. Failure to comply with rulings ultimately risks (proportionate) WTO-sanctioned retaliation.

Notwithstanding these constraints, the system is stronger than that which existed under the previous GATT system. Some 236 disputes had been brought to the WTO between 1995 and August 2001. Australia had been involved, or had an interest, in 28 disputes, including five as a respondent (of which two involved salmon quarantine issues and two related to automotive leather). Australia and other smaller countries have gained many direct benefits from the dispute settlement mechanism (box 1.4).

Some limitations

While the GATT/WTO has contributed to reductions in trade barriers and the benefits they can bring, it is also open to (valid) criticism in certain respects.

There are clear deficiencies in the content and coverage of some of its agreements. For example, many textile and agricultural products are subject to only limited barrier and subsidy control, while WTO provisions have failed to deter the growth of regional trade agreements which override the most-favoured-nation principle and provide preferential treatment within groups of countries. Criticisms have also been made that the 1994 TRIPS agreement failed to adequately address certain developing country

Box 1.4 WTO benefits for Australia and other smaller trading countries

Examples of the benefits of the trade rules

- The benefit of the *most-favoured-nation* rule to smaller member countries is illustrated by the outcomes achieved from the series of bilateral negotiations China undertook as part of its accession to the WTO. Australia negotiated reduced Chinese tariffs, for example, on wine (down from the then current 65 percent to 20 percent) and butter (down from 50 percent to 25 percent). The European Union negotiated even lower tariffs (14 percent on wine and 10 percent on butter). Application of the most-favoured-nation rule means that the most favourable concessions negotiated by each of China's trading partners will automatically become available to all WTO members.
- As a result of the *national treatment* rule, the European Union could not apply quality or health-based standards to imports of Australian grains that it did not apply to its own producers. Similarly, as a result of telecommunications negotiations, foreign telecommunications companies have the same conditions of access to domestic networks as national companies.

Examples of the benefits of dispute settlement

- *A faster opening of markets* — India, having lost a case taken by the US in the WTO, agreed to remove quantitative restrictions on agricultural, textile and other products two years earlier than previously negotiated with other members, including Australia.
- *Countering market-closing measures* — The US, having lost the case brought against it by Malaysia, Thailand, India and Pakistan, altered its shrimp import regulations, thereby allowing Spencer Gulf prawns access to the US market. This had previously been denied because Australia did not mandate turtle-excluding devices on fishing nets, despite the extremely low incidence of sea turtles in that fishery.
- *The opportunity to challenge marketing restrictions* — Australia's claim that Korean regulations discriminate against Australian beef by confining sales of imported beef to specialised stores and limiting the manner of its display was upheld, as was a similar claim made by the US.
- *Requiring large countries to abide by the rules* — The findings against the US tax treatment of export income and the European Union banana import regime demonstrate that even powerful countries are not 'above the law' even if, as in the long-running banana saga, they delay bringing their arrangements into conformity with their treaty obligations. Similarly, last year's finding against US safeguard measures on lamb imports has allowed Australia to negotiate renewed access to the US meat market.
- *Securing Australia's overall trade interests* — Even though Australia formally 'lost' a dispute in relation to imported salmon recently, Australia benefits overall from the WTO requirement for science-based quarantine protocols. Such protocols help to prevent Australian exports being discriminated against in foreign markets (as they have done with the finding that Japan's testing requirements for different varieties of some fruit were inconsistent with its treaty obligations). They also limit the extent to which Australia can use its quarantine system as an economic protection device — which, while helping the protected industries, would impose costs on consumers and on workers and employers in other Australian industries. WTO rules also reinforce domestic disciplines on the use of certain subsidies and forms of protection.

needs and priorities — as highlighted by the recent debate on access to affordable medicines.¹⁷ And there are concerns about the implementation costs and benefits of the Uruguay Round final agreement to developing countries, as well as developing country participation in earlier trade rounds (box 1.5).

The WTO agreements provide only a framework for the negotiation and execution of trade deals between sovereign governments: they do not specify the details of what those deals must include. Where provisions in a WTO agreement are viewed as inappropriate, this can be seen primarily as a criticism of the governments that agreed to the provisions. For example, to the extent that the outcome for developing countries of the Uruguay Round final agreement was less beneficial than those countries had hoped, this reflects primarily on the deal struck by member governments during the negotiations. Similarly, the effective non-participation by developing countries in earlier GATT rounds largely reflects the choice of those countries, at those times, to pursue development through import substitution strategies. These ‘adverse’ outcomes do not necessarily reflect a fundamental problem with the WTO as a forum for negotiating and executing international agreements itself.

Even so, improvements have been needed to the way developing country interests are represented within the WTO. Resource constraints impede the ability of many poorer nations to identify and defend their interests and to participate actively in many WTO activities. Such countries also face large compliance costs and difficulties in meeting commitments. And with the growth in WTO membership, more inclusive ways of structuring negotiations needed to be found, particularly after the problems that arose at the 1999 Seattle Ministerial Conference. These and related governance issues, which have been raised by the current Director-General of the WTO as well as his designated successor (Panitchpakdi 2000), have constituted a substantial action agenda for the WTO.

¹⁷ The WTO TRIPS Agreement requires WTO member countries to observe and enforce certain intellectual property rights. TRIPS also contains balancing provisions which allow countries to limit such rights in cases of ‘national emergency or other circumstances of extreme emergency’. However, there have been uncertainties about the ability of countries to take measures to combat certain public health problems, such as AIDS or tuberculosis epidemics, without breaching their TRIPS obligations. This was highlighted recently in a dispute involving South Africa. In 1997, the South African Government passed legislation allowing the importation and manufacture of generic versions of patented pharmaceuticals to assist in combating the AIDS epidemic in that country. In 1998, several pharmaceutical companies instigated a legal challenge claiming that the legislation violated South Africa’s TRIPS obligations. Against a background of public concern, the pharmaceutical companies withdrew their challenge in April 2001.

At the Doha WTO Ministerial Conference in November 2001, WTO member governments clarified the rights of individual countries under the TRIPS to address public health issues. They reaffirmed that, under the TRIPS ‘compulsory licences’ provisions, countries can produce patented products without the consent of the patent holder in cases of ‘national emergency or other circumstances of extreme urgency’. They also stated that each country has ‘the right to determine what constitutes a national emergency or other circumstances of extreme urgency’ and that public health crises (including disease epidemics) can represent such occasions (WTO 2001c).

Box 1.5 Developing countries' concerns about previous trade rounds, and the Doha Declaration

Prior to the WTO Ministerial Conference held recently in Doha, developing countries raised several concerns about the outcomes of earlier rounds of multilateral trade negotiations.

- *Inadequate Uruguay Round reform by developed countries:* Many developing countries' governments do not believe they have received the economic benefits promised to them when they accepted the 'single undertaking' requirement in the Uruguay Round final agreement (the Marrakesh Declaration). The 'backloading' of the agreement on textiles and clothing (ATC) meant that most of the improved access to OECD markets under the ATC would not occur until the final phase in 2005. Further, some OECD countries have resorted to anti-dumping and safeguard measures that have reduced anticipated export gains for developing countries. Similarly, reductions in agricultural protection by OECD countries agreed in the Uruguay Round have been offset by new subsidies and other 'hidden' forms of protection (for example, 'administrative' procedures in some countries).
- *Implementation costs of Uruguay Round commitments to developing countries:* Many developing countries (especially the least developed countries) have found difficulty in meeting their Uruguay Round obligations under TRIMs and TRIPs, even with extended transition periods and some (limited) technical assistance. Many of them lack the financial, legal and administrative resources to implement their commitments or to use WTO provisions, such as dispute settlement.
- *Unequal effects of earlier agreements:* Several studies in the 1960s and since have shown that developing countries' growth was handicapped by biases in the historical process of trade liberalisation under the GATT, which focused on goods produced and traded among developed countries. Developing countries accepted trade preferences that were compatible with their choice of import-substitution strategies for development. This amounted to non-participation in GATT negotiating rounds, and developing countries were discriminated against in exports such as processed materials, tropical and temperate agricultural produce and labour-intensive manufactures, both in terms of tariff levels and 'grey area' protection (anti-dumping, safeguards, etc).

At Doha, WTO member governments agreed to assist developing countries, via:

- 'capacity building' and 'technical assistance' to developing countries;
- examining the relationships between trade debt and finance, and trade and transfer of technology to developing countries;
- the objective of 'duty free, quota free market access' for products originating from least developed countries;
- reviewing and strengthening the 'special and differential treatment' provisions for developing countries; and
- working towards facilitating and accelerating the accession of least developed countries and other small economies into the WTO.

In addition, the Doha Declaration clarified the rights of individual governments to address public health issues under the TRIPS agreement (see footnote 17). The Declaration also includes a strong mandate for negotiations on agriculture, as well as mandating negotiations on other matters, although the extent to which potential gains in these areas are realised will depend on the outcomes of the detailed negotiations that lie ahead (PC 2001b).

In relation to the dispute settlement process, large economic powers have proportionately less to lose when threatened with retaliation for breaches of agreed trade rules than do small countries. As a result, they may be less inclined to comply promptly with the findings of the WTO Dispute Settlement Body than smaller countries. This has implications for other proposed reforms to the WTO. In discussing this asymmetry, the World Bank (2001) has noted:

The power imbalance would be even worse if there was no WTO, because then small countries like Bangladesh would have to negotiate one-to-one with the United States without a multilateral set of rules. Still, it is important to keep in mind that developing countries have difficulty defending their legitimate interests in the WTO, and this difficulty is one reason why developing countries generally oppose expanding the organization's mandate to take up non-trade issues such as labour and environmental standards (World Bank 2001, 57).

There are also risks to the dispute settlement procedure. Among other things, the power and success of the dispute settlement process, compared to the previous GATT arrangement, risks encouraging countries to bring disputes of issues to the WTO that are essentially political — the settlement of which is not appropriate for a trade organisation. Such disputes could unravel the dispute settlement processes of the WTO.

Several of these matters were addressed in the context of the recent WTO Ministerial Conference held in Doha. While several steps were taken to address the concerns of developing countries (box 1.5) and other concerns, the extent to which substantive reform takes place in relation to a number of these matters will depend on the course of the detailed negotiations and actions that lie ahead (PC 2001b).

1.4 Summing-up

A range of economic evidence indicates that, in general, liberal trade policies increase economic efficiency and facilitate growth. While other factors are also important, liberal trade policies appear to have contributed to major advances in living standards for both the world's rich and poor. The evidence also suggests that liberal trade policies are not a primary or systematic cause of widening inequality and, in fact, are probably narrowing the gap between rich and poor at the global level. More importantly, liberal trade policies have helped to substantially reduce the proportion of the world's people living in absolute poverty.

The WTO has overseen substantial tariff reductions and increases in trade. Its processes also provide small to medium countries, including Australia, with greater sway in trade relations with larger economic powers than they might otherwise enjoy. Even so, some limitations remain and there are concerns about aspects of some agreements concluded between member governments. Assessments of proposals to reform WTO agreements and processes need to consider the broader, systemic effects on the 'balance of interests' between member countries that such proposals may have.

2 Core labour standards and the WTO

Recent anti-globalisation protests have highlighted concerns about the effects of trade when workers in developing countries are employed under what are seen as inhumane or exploitative conditions.

These concerns have underpinned proposals for a set of ‘core’ labour standards to be *linked* to WTO agreements, such that a country’s failure to observe the standards would be grounds for another country to impose trade sanctions upon it.

After describing the background to this debate, this chapter examines the merits of the ‘labour linkage’ proposal by exploring the following issues:

- is labour linkage feasible?
- does it impinge on a nation’s sovereign rights?
- how effective would labour linkage be in increasing compliance with core labour standards and in lifting living standards?
- what would be the effects on Australia’s trading interests? and
- what other policies could lift labour conditions in developing countries and how would pursuing the labour linkage option affect them?

2.1 The debate about international labour standards, the ILO and the WTO

Labour standards are multi-faceted and vary from country to country depending on each country’s stage of development, per capita income, and political, social, and cultural conditions and institutions. At present, the enforcement of labour standards within each country is essentially a matter for the country’s government.

Most countries are also members of the International Labour Organisation (ILO), which promotes internationally agreed labour standards. Established following the First World War, the ILO is based on a tripartite structure, with representation from employers, unions and governments from member countries. The ILO promulgates international labour standards in the form of conventions which, if ratified by governments, have the force of international law. However, ratification is voluntary, and the ILO has no mechanism or sanctions for prosecuting breaches of its standards.

Consequently, adherence to ILO standards depends mainly on diplomacy, persuasion and the policies of firms and governments.

Although the ILO has developed more than 180 labour standards over its life, in many cases these are not widely agreed to or ratified. In some cases, ILO standards have become obsolete. In others, changing social norms, such as the concept of equal employment opportunity for women, have required nations to de-ratify particular standards they had previously ratified.

However, an international consensus has emerged recently on the components of a set of ‘core’ international labour standards. The ILO defines these as the rights to:

- freedom from forced or compulsory labour;
- freedom from workplace and occupational discrimination;
- freedom of association and collective bargaining (through unions); and
- freedom from child labour.

There has been widespread ratification and recognition of the relevant ILO conventions. This was reaffirmed in the *Declaration of Fundamental Principles and Rights at Work*, adopted at the June 1998 International Labour Conference.¹⁸ Australia has ratified most ILO conventions relating to core labour standards.

Arguments about whether labour standards should be incorporated in international trade agreements — termed the ‘labour linkage’ debate — have a long history. The 1947 Havana Charter on international trade, for example, referred to the ‘common interest’ all countries have in observing fair labour standards. The issue of labour linkage was also raised during the Tokyo Round of the GATT (1973-79), and again at the commencement of the Uruguay Round. International union groups have also pushed for linkage at various times during the century. All up, there were more than sixty instances of linkage or attempted linkage between labour standards and trade during the period from 1919, when the ILO was formed, to 1991 (Hughes and Wilkinson 1998).

¹⁸ The Declaration covered the following conventions: *Freedom of Association and Protection of the Right to Organise Convention*, 1948 (no. 87); *Right to Organise and Collective Bargaining Convention*, 1949 (no. 98); *Forced Labour Convention*, 1930 (no. 29); *Abolition of Forced Labour Convention*, 1957 (no. 105); *Minimum Age Convention*, 1973 (no. 138); *Equality Discrimination (Employment and Occupation) Convention*, 1958 (no. 111); and *Equal Remuneration Convention*, 1958 (no. 100).

The *Minimum Age Convention*, 1973 (no. 138) specifies a minimum age for employment, generally 15 years, or 14 years in the case of countries ‘whose economy and education facilities are insufficiently developed’. In June 1999, the ILO added the *Worst Forms of Child Labour Convention*, 1999 (no. 182) which bans child slavery, forced or compulsory labour, sexual exploitation, illicit activities and work likely to harm the health, safety or morals of children. This convention was given the status of a core standard for the purposes of the Declaration.

A strong debate about whether to forge such a linkage has continued since then. In some developed countries, supporters of labour linkage have argued that the rapid industrialisation of certain developing countries has come on the back of a suppression of workers' rights and the exploitation of labour. Others have accused proponents of labour linkage in trade agreements of disguised protectionism and self-interest and/or of seeking to impose first world values on third world people. They have also argued that labour linkage could undermine the comparative advantage of developing nations, retard economic development and delay the provision of the very conditions that core labour standards seek to protect. Some argue that the development and enforcement of international labour standards is best pursued through ILO processes, not through those of the WTO. Supporters of labour linkage, however, argue that the WTO's enforcement powers make it a useful vehicle with which to push for higher standards worldwide.

In dealing with the labour linkage issue, the First WTO Ministerial Conference held in Singapore in December 1996 declared:

We renew our commitment to the observance of internationally recognised core labour standards. The International Labour Organisation (ILO) is the competent body to set 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 liberalisation contribute to the promotion of these standards. We reject the use of labour standards for protectionist purposes, and agree that the comparative advantage of countries, particularly low-wage developing countries, must in no-way be put in question. In this regard, we note the WTO and the ILO Secretariats will continue their existing collaboration (WTO 1996).

There has been no subsequent progress to link trade and labour standards. Indeed, the push for linkage, notably by the United States, in the face of the refusal of many developing countries to countenance it, was one of the reasons for the breakdown of the Third WTO Ministerial Meeting in Seattle. There has been no determined attempt to elevate the labour linkage issue to the WTO negotiating agenda since then.

2.2 Feasibility

Core labour standards could be incorporated in WTO agreements in two main ways.

- *The Article XX approach:* Article XX of the GATT provides exemptions from some of the general trade rules for certain measures. Article XX currently exempts the products of prison labour from the general trade rules, and could be extended to cover products produced using labour employed in breach of other ILO core labour standards.
- *A 'comprehensive sanctions' agreement:* A more radical alternative¹⁹ would be to specify in an agreement among WTO members that general trade sanctions could be imposed on a country found to be in breach of core labour standards, or found to not have made 'reasonable endeavours' to enforce such standards.

While it is feasible in principle to incorporate core labour standards into WTO agreements, a major practical barrier is the composition and decision-making process of the WTO itself, in conjunction with the views of its members. The WTO comprises more than 140 sovereign nations, the majority of which are developing countries, with decisions generally made by consensus. Many developing nations have signalled a strong resistance to linkage in any form. Indeed, according to Sampson (2000, 19):

Dealing with attempts to discriminate on the basis of production methods turns potentially constructive debates into damage limitation exercises on the part of most WTO members (that is, developing countries). If environmentally unfriendly production methods, unacceptable labour or human rights standards are the basis for restricting trade, then this opens the door to protectionist abuse irrespective of how justified the concerns are. It also raises the question not only of what are in fact the appropriate standards for other countries to adopt, but who has the right to set and enforce them.

Prior to the Seattle WTO Ministerial Conference, the International Confederation of Free Trade Unions (ICFTU 1999, 34) claimed:

There is no possibility that a worker's rights clause would bring about an international minimum wage that will drive the industries in poor countries to bankruptcy; split the world market into two camps and undermine global free trade. ... Developing countries will still be able to enjoy comparative advantages from their abundant labour supply. All that will happen is that governments will not be able to keep these costs down by oppressing their workers; and transnational corporations will not be able to bully countries into competitive repression.

Notwithstanding these assurances, many developing countries refused to countenance proposals to examine labour linkage proposals at the Seattle WTO Ministerial Conference, or since then. Presumably, they would look even less favourably on a comprehensive sanctions agreement than on an amendment to Article XX. This suggests that gaining agreement in the WTO for labour linkage would be difficult if not impossible, at least in the foreseeable future. It might happen only if the major developed nations were to make substantial concessions in other areas, such as reducing barriers to their own markets and/or providing significant financial or other assistance to developing nations. These matters are discussed further below.

2.3 National sovereignty issues

A major concern expressed by many developing countries is that requiring a universal application of labour standards would breach individual countries' rights to determine their own domestic labour policies. In effect, it would be an attempt to dictate to them the labour laws that should apply in their countries.

Some governments have also expressed a concern that the linkage of core labour standards to WTO agreements would add to their countries' industries' costs and may

be ‘the thin edge of the wedge’, leading ultimately to pressures for non-core standards to be included for more overtly protectionist reasons.

Of course, aligning domestic standards with internationally agreed standards has become a normal part of international agreements. For example, the WTO Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary (SPS) Agreements already constrain the regulations countries can adopt in relation to certain domestic matters (chapter 3). This suggests that the question should not be ‘would labour linkage involve dictating standards in developing countries?’, but rather ‘are the standards in question reasonable standards to require developing countries to adopt?’

Proponents of labour linkage have argued that ‘external benefits’ associated with core labour standards may justify the use of trade sanctions to address breaches in developing countries. Compliance with international labour standards by developing countries may generate benefits beyond the border of the countries in two ways:

- by generating psychological benefits to people in (mainly) developed countries who are concerned about what they see as worker exploitation in developing nations; and
- by limiting the potential for a ‘race to the bottom’ in labour conditions.

Evidence and arguments on these matters is presented in appendix A. As discussed there, it seems unlikely that any psychological benefits to people in developed countries would be significant relative to the benefits and costs that different labour market arrangements in the developing countries would have for the workers themselves. And conceptually and empirically, support for the ‘race to the bottom’ hypothesis is limited.

Nevertheless, to the extent that there is some broader public benefit from compliance with core labour standards, the question arises as to whether this justifies international actions to deal with breaches of those standards in developing countries.

In answering with a qualified ‘yes’, Rodrik (1997, 80-81) argues that there may be valid reasons for governments to impose sanctions or to restrict imports because of concerns about the conditions under which the imports are produced. However, he suggests that any such action must be justified with reference to the welfare of the importing country’s people, not that of the people in the country of export:

Nations have the right — and should be allowed — to restrict trade when it conflicts with *widely held* norms at home or undermines domestic social arrangements that enjoy *broad* support...

But it is not acceptable to unilaterally threaten retaliation against other countries because their business practices do not comply with domestic standards at home *in order to force these countries to alter their own standards*. Using claims of fairness to advance competitive aims is coercive and inherently contradictory. Trying to ‘export’ norms by asking other countries to alter their social arrangements to match domestic ones is inappropriate for the same reason.

Others go further and assert that it *is* legitimate to use punitive measures to force changes in social arrangements abroad. The international trade sanctions applied against South Africa's previous apartheid regime were designed with precisely this objective in mind.

Inevitably, a conflict arises between respect for a country's national sovereignty and the willingness of other countries to tolerate what they see as human rights abuses in that country. While measures that encourage countries to reduce their abuses voluntarily will be favoured over more direct measures (other things being equal), there will be cases in which direct, punitive measures are supported by many governments, as the South African example shows.

2.4 Effectiveness

The Article XX approach

The main benefit seen for labour linkage by its proponents is the enhanced powers for enforcing core labour standards that the WTO rules and dispute resolution system would provide. Whereas the current ILO approach is essentially voluntary, under the linkage proposal countries would be able to take trade measures against members of the WTO that fail to adhere to core standards. This in turn would provide incentives for those countries to reform their labour practices.

However, a major limitation of this approach, if pursued through an amendment to Article XX, is that it would directly address breaches of core labour standards only in the export sectors of developing countries, leaving breaches in the domestic sector untouched. Yet the domestic sector is by far the larger of the two, and also where the worst employment conditions generally are found (Duffy 1996).

An additional limitation is that it could be difficult or costly to trace breaches of core labour standards in developing countries. This suggests that, even in the exporting sector, linkage might not affect employment conditions significantly.

Both these limitations would arise in the context of moves to enforce bans on child labour. World Bank researchers have estimated that less than 5 percent of working children are employed worldwide in the export manufacturing and mining sectors, and only 1 to 2 percent in export-oriented agriculture (Fallon and Tzannatos 1998). Further, as the 1996 Tripartite Working Party on Labour Standards in the Asia-Pacific Region (Duffy 1996) report noted:

...the bulk of child labour appears to relate to work in the informal sector, and work associated with agriculture. In urban areas, child labour is found in a range of manufacturing and service industries and also in marginal and illegal activities such as the drug trade, pornography and prostitution. A major barrier to tracking exploitative child labour is the use of subcontractors, and practices such as trans-shipment and re-labelling, which are

often beyond the reach of regulatory mechanisms. Governments can also be reluctant to admit the extent of child labour especially where entrenched social customs are involved.

Together, these limitations suggest that an Article XX amendment would do little to promote compliance with labour standards and/or to help the plight of the poor.

The 'comprehensive sanctions' approach

These limitations of scope would arise to a lesser degree under a 'comprehensive sanctions' agreement — assuming that it were possible to implement such an approach. Depending on the details of the agreement, non-compliance with core labour standards in relation to the production of any product, whether for domestic or foreign consumption, could result in trade sanctions, and those sanctions could potentially apply to all exports to and/or imports from the country found in breach of the core standards.

The greater coverage of this approach is also a weakness. It could open the door to the imposition of sanctions on foreign enterprises quite unrelated to the practices of the enterprise involved, thereby distorting the incentive individual enterprises would have to comply. Its use would also highlight questions about the appropriateness of imposing some core standards universally. For example, bans on certain forms of child labour can harm the children and families affected: indeed, there is evidence that some children have been displaced from factory jobs only to end up working in less desirable jobs, including as beggars and prostitutes (box 2.1). More generally, as discussed in appendix A, while efforts to enforce core labour standards hold out the prospect of enhanced economic and equity/human rights outcomes for workers in developing countries in some cases, the economic literature indicates that such outcomes cannot be presumed to flow automatically or in all cases. In summing-up the literature, Brown (2001, 97) states:

Taking steps to reduce forced labour, child labour, and discriminatory behaviour, or to support free association and collective bargaining, will often have a mixture of effects. Realizing the potential efficiency, equity and humanitarian benefits of core standards may depend on first correcting ancillary market or political failures. Further, we cannot make a general statement that universal labour standards derived from commonly held moral values will always produce positive economic outcomes. The effect on economic performance and the lives of workers and their families of legally imposed labour market constraints of the sort contemplated by labour rights activists cannot be presumed to be positive, but instead must be empirically investigated on a country-by-country basis.

The risk that attempts to enforce core labour standards universally could adversely affect the welfare of some workers in developing countries would also arise under the Article XX approach, but would be greater in the case of the use of comprehensive sanctions.

Box 2.1 **Child labour and some unintended consequences
of consumer boycotts**

In his statement 'Child Labour: Refusing The Intolerable', the (then) Director-General of the ILO (Hansenne 1998) observed:

The last few years have witnessed the proliferation of campaigns against child labour carried out by consumer organizations, trade union organizations or non-governmental organizations in the developed countries. These campaigns have taken on various forms; but those which have been most in the public eye have been campaigns to *boycott* products made totally or partially by children and to promote *labels* guaranteeing that the product or service, bearing the label, has not been produced from work carried out by children. In both cases, the idea is either to encourage the consumer not to buy a boycotted product or to prefer a product or service bearing a label over another for ethical reasons — as the exploitation of child labour is morally reprehensible.

However, these movements might, depending on their origin or methods used, risk being arbitrary or being put to improper use. By attacking a product or a category of products, the labelling or boycott campaign aims at a sector geared to export and overlooks the fate of the majority of children working on other products or for the domestic market alone. Moreover, labelling and boycott campaigns do not involve any accompanying measures for the children themselves who, as a result, might find themselves without a job. Even worse, they might result in children being transferred from one sector of activity to another, which is more or better hidden, and even more hazardous for the children involved.

This situation occurred in Bangladesh in 1994-95: following a threat of boycotts, employers in the textiles industry abruptly dismissed children under 15 years of age working in this sector. Given the lack of adequate education and training infrastructures and accompanying measures, many of these children had no other choice but to work in the informal sector, in workshops subcontracted for the textiles enterprises, under working conditions that were much more precarious and dangerous than those under which they had previously been working. A good number of these children found themselves on the streets of Dhaka, forced to beg or enter prostitution.

Further, the reaction of an offending government to comprehensive sanctions is difficult to foretell. On the one hand, to the extent that the government valued ongoing participation in international trade, it would have an incentive to increase its efforts to enforce such standards. On the other hand, some governments may respond less constructively, curtailing efforts to engage in export activity and thereby accepting the lower levels of economic growth that implies. The country might also retaliate by blocking imports from the country or countries that imposed the sanctions, which would have further repercussions for living standards within the offending country. These outcomes must be considered a significant risk in the case of some countries given that most of the worst abuses of human rights by undemocratic governments have proved intractable in the face of sanctions (Hufbauer 1998).

Overall, a comprehensive sanctions approach is a blunt and risky instrument for addressing issues of poor labour conditions and abuses in developing countries.

2.5 Australia's domestic interests

Linking trade and core standards could affect Australia's trade interests in two main ways.

First, not only might Australian action against nations in breach of core standards provoke retaliation, it has been suggested that Australia itself may face sanctions. This is because Australia is one of the 51 countries, including 11 other OECD nations, which the recent observations of an ILO committee²⁰ suggest are in breach of core labour standards (Cook 2000).

Second, pursuing a labour link within the WTO could affect the progress of the broader trade liberalisation agenda (see section 2.6). From an Australian viewpoint, any effects could be significant as access to export markets, particularly for the primary sector, and the availability of imported products continues to underpin domestic living standards.

2.6 Other approaches

There are several other means through which improvements in labour conditions in developing countries might be achieved. What are these alternatives, and how might pursuing labour linkage limit or complement their effectiveness?

The alternatives

As noted earlier, at present responsibility for promulgating and encouraging observance of international labour standards rests with the ILO. The ratification of ILO conventions is voluntary and, while the ILO monitors compliance with its conventions amongst countries which have ratified them, it has no mechanism or sanctions for prosecuting breaches. Consequently, compliance with ILO standards depends mainly on diplomacy, persuasion and the policies of firms and governments. That said, the 1998 ILO *Declaration on Fundamental Principles and Rights at Work* included an innovative provision whereby, even if a particular member country has not ratified a convention dealing with core labour standards, the convention is still deemed to represent part of its obligations under the ILO's constitution. The Declaration also introduced an annual reporting system under which countries will need to address their compliance with the conventions. The OECD (2000, 10) has noted that, while still early days, some countries appear responsive to the increased international scrutiny.

One approach to improving observance would be to further strengthen the ILO's powers. As part of the debate at the 1998 International Labour Conference, the ILO Director-General proposed that the Declaration be accompanied by a formal complaints procedure and be legally binding, and that countries' be assessed and given a 'social label' to indicate their compliance or otherwise with the standards. Measures such as these would improve the effectiveness of the ILO and would thus give greater credence

to the pursuit of core labour rights solely or primarily through it. However, to date member countries have not agreed to these proposals.

An alternative view is that there is no case for changing current approaches to international labour standards, either by linking core standards to WTO agreements or by further strengthening the ILO's powers. As Lee (1997, 178) notes:

The position of developing countries opposed to the social [labour linkage] clause carries the opposite implication — that the existing [ILO] system is adequate and, indeed, is the best that can be hoped for, given the continued pervasiveness of poverty in developing countries. This is based on the view that developing countries are generally doing the best they can to improve labour standards, given the constraints of their level of development and their limited financial and administrative capacity. To push the process further, either by a social clause or other non-trade-related means of strengthening the supervisory machinery for international standards, would be harmful to the interests of developing countries.

A third approach is to increase financial and/or technical assistance to developing countries, to strengthen their capacity to progressively improve labour standards. Assistance can take many forms, including waiving debt, providing low interest loans, direct grants or project subsidies, educational subsidies for children, or the transfer of technology and expertise abroad. While these forms of assistance vary in effectiveness, a key constraint is the willingness of developed countries to redistribute sufficient funds to developing countries (box 2.2).

A fourth option is the labelling of products to reflect whether they were produced in a 'socially responsible' manner, one aspect of which might be that core labour standards are not breached in the production process. The aim of such labelling is to provide information to allow consumers to 'boycott' products made in ways they disapprove of. One limitation of this approach, however, is that providing such information can have perverse effects when consumers in developed countries do not appreciate the labour market realities facing people in developing countries. Indeed, as noted earlier (box 2.1), some consumer boycotts have adversely affected children in developing countries.

A fifth approach which developed countries could undertake, which can also complement the other alternatives, is to increase the rate of trade liberalisation. Providing developing nations with greater access to the markets of developed nations and removing trade distortions, particularly in areas such as agriculture and textiles, would facilitate exports from developing nations to those countries. This could provide higher incomes for people in developing nations, which in turn would provide those nations with the wherewithal to provide better labour conditions. According to 'conservative' estimates by the World Bank (2001, 53), protection in rich countries costs developing countries more than \$100 billion per year — or twice the total volume of foreign aid. More importantly, the adoption of open trade policies by developing countries appears to be a necessary, though not sufficient, condition for their own growth (chapter 1).

**Box 2.2 Addressing global inequality by putting our money
 where their mouths are**

Calls by groups in developed nations for developing countries to adopt international labour standards have, in the past, prompted requests from the developing countries for ‘compensating’ assistance in the form of substantial financial aid.

But as Lal (1981, 14) writing about events in the late 1970s reports, these requests were not met:

Demands for internationally adopted labour standards made by Western trade unions in the ILO — and in particular at the [1976] World Employment Conference — led to counter-demands by the developing countries that OECD countries should meet the basic needs of poor developing-country workers through enhanced aid flows. But as the New York Times noted... ‘At last year’s World Employment Conference...agreement was reached on the concept of a basic human needs budget for every family. Even so, the delegations representing the United States and other industrialised nations opposed Third World efforts to finance a general lifting of living standards through mass transfer of resources from the richer countries.’

In the context of current debates about globalisation, one question that arises is whether developed nations might now be willing to increase efforts to address global inequality — whether those efforts might be in the form of financial aid, providing greater access to their markets for developing nations, creating new or revamped international institutions to address poverty and/or other means. Indeed, one interpretation of the recent ‘anti-globalisation’ concerns is that they are not fundamentally about globalisation but are a reaction to inequality, in its various forms (Sen 2001).

These matters invoke value judgements about what level of ‘aid’ (broadly defined) developed countries should provide to developing nations, as well as more technical questions about which means of delivering such ‘aid’ are the most cost-effective. While the technical questions are amenable to economic analysis, responsibility for value judgments about equity, and appropriate trade-offs between equity and economic efficiency, lie mainly in the political realm. That said, to the extent that the recent protests do reflect a general strengthening in community preferences for action to address global inequality, one implication is that governments should be increasing their efforts in this area.

The impact of seeking labour linkage on other options

Introducing labour standards into the WTO could help or hinder the feasibility and effectiveness of some of these other options for improving labour conditions.

On the one hand, given the stated opposition of many developing countries (and some developed countries), pushing ahead with attempts to secure labour linkage may ‘cool’ relations between developed and those developing nations. This would reduce the scope for industrialised nations to promote higher labour standards in those countries using other means, such as ILO processes and technical assistance to lift labour standards.

Pursuing a trade and labour link would also impede negotiations for further trade liberalisation. Indeed, this was one reason given for the breakdown of the Seattle

Ministerial Conference. Reflecting these types of concerns, the Government's 1997 White Paper *In the National Interest — Australia's Foreign and Trade Policy* stated:

On social issues such as labour standards, the Government will oppose the WTO adopting positions that create divisions on the basis of divergent social or cultural values, and are of doubtful or negative trade relevance. Attempts to incorporate such rules would dilute the WTO's core business, and weaken its authority and credibility in the eyes of significant members (DFAT 1997, 4).

Given the links between trade and economic growth (discussed in chapter 1), reducing the rate of trade liberalisation could in turn reduce economic growth in developing countries, and retard the adoption of higher labour standards that higher national incomes allow.

On the other hand, the 'threat' of introducing trade-based sanctions for abuses of core labour standards, to the extent that the threat is seen as credible, may encourage a greater willingness on the part of nations in breach of those standards to countenance alternative approaches to dealing with their breaches. Specifically, such nations may be more likely to accept a greater role for the ILO in monitoring compliance and/or enforcing core labour standards if failure to agree to this is seen as likely to lead to the imposition of trade sanctions. As Nyland and Castle (1999, 368) note:

The fact that there exist alternative bodies to which those states that support a social clause can turn, if the ILO loses its credibility, remains fundamental to the labour standards–trade debate. The spirit of compromise that characterises the ILO has always been founded on an amalgam of democratic principles and the threat of alternative strategies being explored if the path of compromise is not embraced.

Further, it has been suggested that failure to link trade and labour standards will itself hinder trade liberalisation as developed nations respond to political pressures, such as those seen in Seattle, by backing away from the WTO. In the words of a senior US trade official:

A multilateral approach through the WTO working together with other international organisations is the best way to address the labour dimension. In the absence of a multilateral approach, pressure will build to advance these concerns in ways that may be less preferable for the global trading system. Further, failure to address the labour dimension in the WTO may lead to precisely the result that critics of the labour-trade link say that want to avoid — an increase in protectionist measures (Samet 2000, 4).

Be that as it may, WTO member governments were at least able to reach agreement at the recent Doha Ministerial Conference for a new round of multilateral trade negotiations, without agreeing to elevate the labour linkage issue to the negotiating agenda.

2.7 Summing-up

There is now a high degree of political consensus on the contents of a core set of labour standards, as embodied in the 1998 ILO *Declaration of Fundamental Principles and Rights at Work*. While there are questions about the appropriateness of these standards in some cases, there has been debate over recent years about what processes should be used to encourage their observance.

Of the alternatives, the ILO is a forum dedicated to pursuing this agenda, though it is hampered by a lack of robust mechanisms to encourage compliance with its conventions. Some recent reforms extend the reach of its monitoring mechanisms. However, more far-reaching proposals to strengthen its compliance powers are yet to be adopted.

The WTO enforcement process is potentially a stronger means of encouraging compliance with core labour standards and its use might satisfy some political demands in sections of developed countries for action on labour conditions in developing countries.

However, its use would entail major problems. Establishing a labour linkage through an amendment to Article XX would be difficult to achieve, would deal directly with only a small part of the problem of exploitative and inhumane working conditions, and could have adverse side-effects for some workers. It would also raise national sovereignty concerns for developing nations, and the process of seeking an amendment in the WTO risks retarding other — and potentially more effective — means of promoting higher labour and living standards in developing countries, including trade liberalisation itself. It could also expose Australia to some risks in relation to its own trade. A ‘comprehensive sanctions’ agreement would overcome the limited scope of the Article XX approach. However, it is a blunt instrument for addressing labour conditions, it would be more difficult (and probably impossible) to gain agreement to such an approach in the WTO, and it would retain the other disadvantages of labour linkage.

3 The environment and the WTO

Recent anti-globalisation protests have highlighted concerns about the environmental effects of trade liberalisation and the WTO. By promoting economic growth, trade is often seen as contributing to the unsustainable use of natural resources and to pollution emissions that threaten the earth's assimilative capacity. Trade-related pressures for businesses to be internationally competitive are sometimes seen as forcing countries into a 'race to the bottom' in environmental standards or, at least, as inducing a 'regulatory chill' on potential increases in standards. A further set of criticisms is that WTO trade rules constrain the ways in which environmental objectives can be pursued. In particular, environmentalists argue that WTO rules:

- constrain the health and environmental standards that governments can set for finished goods within their own borders;
- limit the extent to which governments can apply trade sanctions on imports made using unsustainable production processes; and
- undermine the use of trade sanctions in multilateral environmental agreements.

On the other hand, some environmentalists have also recognised that certain free trade reforms would enhance environmental quality. While advocating changes to aspects of the WTO system, the Australian Conservation Foundation (1999) has acknowledged that:

Trade and investment liberalisation could assist moves towards ecologically sustainable societies. An example is the opening up of markets for efficient, less polluting goods and production technologies and services, while restricting ecologically unsustainable rates of resources exploitation and pollution.

This chapter covers several matters raised by this debate. It commences by briefly describing the relationship between trade and the environment, and the implications for policy-makers. It next identifies a number of prospective 'win-win' trade liberalisation reforms that would directly enhance the environment. The chapter then discusses the basis for, and effects of, WTO provisions that constrain environmental policies.

The aim is not to reach definitive conclusions on the merits of particular WTO provisions, or on the many proposals for their reform. Rather, the chapter explores key areas of complementarity and apparent tension between trade liberalisation, the WTO and environmental objectives, and some of the reasons for the apparent tensions.

3.1 The trade-environment link

Impacts

Trade can affect the environment in several ways:

- By supporting economic growth, trade facilitates greater production and consumption, with attendant implications for resource use and pollution. Transporting products to far-away destinations itself requires resources and involves environmental risks. And there is some evidence, albeit limited²¹, that trade competitiveness concerns may induce some countries to limit the stringency of their environmental standards.
- On the other hand, trade will generally result in more efficient patterns of production between countries, thereby reducing the quantity of resources needed to produce a particular quantity of goods and services. Trade can also facilitate the global diffusion of pollution abatement products and more efficient and cleaner production technologies. And the higher incomes which trade facilitates can provide governments with the financial resources, and community support, to address certain environmental problems.

The net environmental impact of trade is difficult to determine. A recent WTO study (Nordström and Vaughan 1999) accepted that trade can lead to adverse environmental outcomes in certain circumstances. However, it also found that the net environmental effects of trade are complex and ambiguous:

[The repercussions] depend on three factors: (i) trade-induced changes in industrial composition, and hence the pollution intensity of national output; (ii) changes in the overall scale of economic activity; and (iii) changes in production technology. The net outcome is a priori undetermined. Sweeping generalisations about the linkages between trade and environment, whether positive or negative, must therefore be rejected.

²¹ The evidence on trade and the environment was surveyed by Nordström and Vaughan (1999), in a report commissioned by the WTO. Most of the empirical studies of different countries, industries and periods conclude that environmental standards have little impact on trade patterns. Pressures on governments to lower their environmental standards, in order to keep otherwise uncompetitive industries in developed economies or to attract dirty activities to 'pollution havens' in developing countries, do not seem to loom large in firms' locational decisions. Pollution abatement costs are typically a small proportion of a firm's total costs and, while there are exceptions, production technologies tend to be standardised for high environmental performance rather than adjusted for different parts of the world (see also Harris et al. 2000; Vogel 2000). However, Nordström and Vaughan (1999, 5) also found that industries often appeal to competitiveness concerns when lobbying against environmental regulations, and that these appeals on occasion are successful.

Isolating the causes of environmental problems

A major reason for this open finding is that environmental problems are not caused by trade itself, but can occur when *any form of economic activity takes place where environmental policies are deficient*. This is a key distinction for analysing the merits of using trade restrictions for environmental purposes. Its basis and implications are as follows.

In terms of its direct environmental impacts, international trade is intrinsically no different from domestic commerce. Both involve the production, transportation, sale, consumption and disposal, recycling or reuse of goods. Both therefore use resources and can cause pollution or other damage. The only difference is that international trade involves crossing a line on a map. Of course, trade with far-away places normally entails a greater use of resources in transportation. Shipping coal from Wollongong to Kobe would require more resources than shipping it to Perth. That said, shipping coal from Wollongong to Perth would involve more resources than would shipping the coal from Wollongong to Auckland. Hence, it is not *international* trade itself that puts demands on the environment. Rather, it is economic activity.

Further, although virtually all economic activity uses resources and can cause pollution, not all resource use and pollution poses problems for society and the environment. This is because, firstly, there is a rate of resource use that is sustainable, and some level of pollution that is within the earth's assimilative capacity. Secondly, the scarcity of many resources is reflected in the pricing signals of the market. The scarcer a particular commodity becomes (relative to the level of demand for it), the higher its price. This conserves scarce resources. Finally, some people — particularly in developing countries — may be willing to trade-off a degree of environmental amenity to be able to meet their other needs, such as food, clothing and shelter, until they achieve a reasonable material standard of living. This implies that resource use and pollution beyond the environmentally sustainable level may be seen as justified in some societies, at least in the short term.

However, while some level of resource usage and pollution will be justifiable, in certain circumstances 'market forces' alone will not sufficiently constrain environmental damage:

- Where production or consumption of a good or service creates pollution (or environmental 'externalities'), market forces alone will not provide sufficient incentives for people to economise on the product or to reduce the pollution. For example, a factory owner who emits pollution from a chimney has little personal incentive either to switch to cleaner technology or to cut back production. Likewise, a farmer spraying insecticides on crops has little personal incentive to worry about chemical run-off into nearby streams.

-
- Where natural resources are unvalued or underpriced, people will tend to use them more than is warranted. For example, businesses will use more virgin paper than is appropriate if the greenhouse gas abatement value of the trees from which paper is produced is not reflected in the price of the trees to the paper mill, and thus to the paper purchaser.²² Likewise, where fishermen see sea turtles as creatures whose welfare is of small or no value to them, they will have little personal incentive to worry about using ‘turtle-excluder devices’ on their fishing nets, or other forms of conservation.
 - A particular case in which the underpricing of resources may occur is where governments themselves subsidise certain activities that can deplete natural resources. Prime culprits in this respect include a variety of subsidies for energy consumption, some agricultural production, and fishing and forest products (discussed in section 3.2).

Where any of the above problems occur, environmental policies may be justified to treat the particular problem. Of course, sometimes the costs to society of government intervention can exceed the costs to society of a specific environmental problem. Generally though, any significant environmental problems of the types listed can warrant corrective government policy action.

Looked at another way, the absence of policies to address potential environmental problems can be seen as providing the conditions in which economic activity (including trade) can impose excessive pressures on the environment. As the WTO, in its summary of the Nordström and Vaughan (1999) study, has observed:

Without adequate environmental policies, trade can prejudice environmental quality. For example, demand from the world market may encourage unsustainable logging when no proper management scheme is in place (WTO 1999).

The policy challenge

The foregoing discussion highlights that environmental problems are not caused by trade itself, but rather can occur from the conduct of *any* economic activity where:

- environmental externalities result, or resources are underpriced or have no market value; and
- corrective environmental policies are not in place.

Seen this way, the task confronting environmental policy-makers is to address the adverse causes or effects of environmental externalities and underpriced resources.

²² A caveat is that existing government interventions may have offsetting effects on production and consumption outcomes. For example, if governments subsidise recycled paper sufficiently, this may encourage businesses to use less virgin paper, notwithstanding the underpricing of trees.

Environmental problems also need to be addressed in a way that minimises the economic costs entailed. This would leave societies with more resources with which to address other environmental problems or to spend on other priorities.

Direct environmental protection measures will *normally* be more effective solutions and tend to have fewer economic costs and side effects than indirect measures such as trade restrictions. For example, if the goal is to improve air quality, emissions standards that apply to all cars are likely to be far more effective than restrictions of the number of imported cars — the main effect of which would be to simply divert domestic demand to locally made vehicles.

Consequently, as the WTO (1999) states:

Trade barriers are poor environmental policies. Environmental problems are best addressed at source, whether they involve polluting production processes or undefined property rights over natural resources. Targeting indirect linkages, such as exports or imports of goods, can only partially correct market and policy failures, and at a higher price to society. At the same time, governments have found trade measures a useful mechanism for encouraging participation in and enforcement of multilateral environmental agreements in some instances, and for attempting to modify the behaviour of foreign governments in others. However, the use of trade measures in this way is fraught with risks for the multilateral trading system, unless accompanied with rules agreed by all parties.

This is not to say that trade is intrinsically more important than the environment. Indeed, it is important that trade rules do not unnecessarily hinder the imposition of appropriate environmental policies — just as environmental policies should not unnecessarily hinder the application of appropriate trade rules. The inter-relationship between WTO rules and environmental policies is discussed in sections 3.3–3.6.

However, the key point is that often there are likely to be better means to meet environmental objectives than through trade restrictions. Generally, only where other means of enforcing environmental policies are not feasible are trade restrictions likely to warrant close consideration.

3.2 The ‘win-win’ trade reforms

Some policies that distort trade can themselves cause or exacerbate environmental problems. In such cases, trade liberalisation offers ‘win-win’ opportunities.

Trade liberalisation that affects environmental goods and services, including pollution control and waste management, offers obvious benefits. The OECD (2001) estimates that, worldwide, expenditure in the environmental market amounted to US\$518 billion in 2000. Reducing trade barriers on these goods and services could not only increase their diffusion around the world, it would also reduce their prices, thereby allowing current levels of environmental expenditure to go further.

Box 3.1 **The environmental effects of agricultural subsidies**

At present, world agricultural markets are corrupted in various ways. Many countries retain high tariffs on agricultural imports, often in the form of tariff-quotas; certain production and export subsidies remain; some countries impose export taxes and quotas which are intended to ensure low-cost supply for domestic consumers; and State trading activities that may distort prices continue despite privatisation programs.

Support for agriculture within OECD countries amounts to around US\$300 billion a year, concentrated in market price support schemes and export subsidies (Torres 1999, 155). These trade measures are largely a response to the demands of farm lobbies in certain economies, particularly within the European Union and the United States. They come at a cost to consumers and taxpayers in their own economies and, of course, to rival suppliers from abroad. Australia, with a natural comparative advantage in many agricultural sectors, stands to gain from their removal.

As well as worsening resource allocation in an economic sense, these distortions also adversely affect the environment and the wellbeing of many developing countries. Dialogue within the WTO has indicated that:

...agricultural subsidies have led to intensified land use, increased applications of agrochemicals, adoption of intensive animal production practices and overgrazing, degradation of natural resources, loss of natural wildlife habitats and biodiversity, reduced agricultural diversity, and expansion of agricultural production into marginal and ecologically sensitive areas. Agricultural assistance through output-related policies in many industrial countries has imposed high environmental costs on other nations that have a comparative advantage in agricultural production and trade.

There is, however, a clear development dimension in agricultural trade liberalization. First, there are direct links. Many developing countries have an export capacity in agricultural products. If market access restrictions are removed, their exports will increase. Second, quantitative studies reveal that government interventions through trade-related measures in this sector depress world agricultural prices so that poor farmers stay poor. And low prices and rural poverty induce these farmers to cultivate marginal lands subject to erosion and runoff and to clear forests for agricultural extension...

Attempts by developing country governments to offset low prices by providing input subsidies for fertilizers and pesticides produce much the same results of soil erosion and intensive chemical use as in highly protected agricultural markets, but they also involve greater threats to the health of local farmers and consumers from the incorrect application of agro-chemicals (Sampson 2000, 55).

A more critical area for reform is the provision of government subsidies to sectors that can affect the environment adversely. By reducing the cost of production in these sectors, subsidies can increase the rate of resource exploitation and associated levels of pollution. These subsidies can also distort trade.²³

²³ As well as reducing tariffs and other trade restrictions which make imports more expensive, trade liberalisation requires governments to reduce subsidies to many of their own industries. That said, some subsidies will help the environment as, for example, do subsidies for environmental protection products and programs. Current WTO rules give conditional exemptions from trade measures against countries for subsidies of up to 20 percent of the costs of such products.

The WTO has identified agriculture, fisheries, forest products and energy as key sectors in this regard, and has also identified potential ‘win-win’ reforms in metals, leather products, textiles and clothing. (Box 3.1 discusses the environmental benefits of removing agricultural subsidies). Removal of government subsidies for these products would not only advance trade liberalisation, it would also put their production on a more environmentally sustainable footing.

There are two important constraints on the application of ‘win-win’ reforms. First, removing agricultural subsidies provided by developed countries might increase prices to consumers in some developing countries, thus necessitating compensating assistance if those consumers are not to be made worse off. Second, negotiations to secure such reforms will run into political pressures from the beneficiaries of the subsidies.

At the recent WTO Ministerial Conference in Doha, member governments agreed to multilateral negotiations on (among other things) the reduction or elimination of tariff and non-tariff barriers to trade in environmental goods and services, the clarification/improvement of WTO rules on fisheries subsidies, and reductions in export subsidies and trade-distorting domestic support for agriculture.

3.3 Trade rule constraints on environmental policies

Several WTO provisions work together to require members to apply their trade rules in a non-discriminatory manner:

- Under the ‘most-favoured-nation’ rule (GATT Article I), a member country is not to discriminate between ‘like’ products of other members (except within the conduct of customs unions, free trade agreements and preferences for developing countries).
- Under the ‘national treatment’ rule (GATT Article III), once foreign supplies have entered a country’s market, they are to be treated the same as ‘like’ domestic products.

While these *general WTO rules* are intended to facilitate trade, they also have the effect of constraining the use of trade measures for environmental purposes. For example, the general WTO rules are commonly understood²⁴ to not allow a country to discriminate between furniture made with timber harvested using sustainable forestry practices and furniture which is made from timber extracted unsustainably.

²⁴ As discussed below, this view represents the conventional wisdom on the effect of the *general WTO rules*, and in particular GATT Articles I and III (in conjunction with Article XI (quantitative restrictions)), as reflected in a GATT panel report handed down in 1991 in relation to a dispute about a United States’ ban on imported tuna caught without ‘dolphin-friendly’ processes (GATT Council 1991). However, the GATT never formally adopted the report, and some legal scholars maintain that the general trade rules may in fact allow discrimination between products according to their production-method in some circumstances (see, for example, Howse and Regan 2000).

Some *WTO exceptions clauses* (box 3.2) allow member countries to depart from their general trade commitments in order to apply trade restrictions to protect the environment. In particular, GATT Article XX provides conditional²⁵ exemptions for measures which are necessary to protect human, animal or plant life or health (clause b), or relate to the conservation of exhaustible natural resources (clause g).

Even so, the WTO agreements limit the extent to which, or manner in which, trade measures can be used to pursue environmental goals. The resultant tensions have been evident in a series of trade disputes covering issues as diverse as tuna, shrimps, cars, furs, asbestos, and meat of cattle treated with hormones. Environmentalists have criticised the limitations the WTO rules place on environmental policy actions, which in turn has generated debate among WTO member governments about the appropriate role of the body. Reporting on these developments, the former head of the WTO Trade and Environment Division, Gary Sampson, states:

WTO members have made it clear that they do not want the WTO to become an environmental policymaking organization or standards enforcement agency. WTO members are free to adopt nondiscriminatory trade measures to protect their domestic environment. When the objective is to address environmental problems beyond their borders, this should be done through regional and international agreement, not unilateral coercion.

The charge is made by some, however, that by discouraging trade sanctions, the WTO constrains those concerned about global environmental problems from pursuing their goals. The Preamble to the Agreement Establishing the WTO talks of the desire for the 'optimal use of the world's resources in accordance with the objective of sustainable development'. It is argued that, by not permitting unilateral action on the part of some countries to enforce standards or not formally authorizing multilateral action by countries under certain conditions, the WTO is an important player in the field of environmental policy. And by denying access to the WTO dispute settlement mechanism to enforce environmental standards beyond national borders, some say, environmentalists are blocked from using a powerful mechanism and effective tool to enforce standards that could have a direct effect on the global commons (Sampson 2000, 93-94).

Drawing in particular on the approach in Sampson (2000), the following sections explore some of the key areas of contention raised in this debate, under the following headings:

- domestic health and environmental standards;
- unilateral restrictions on imports produced unsustainably; and
- multilateral environmental agreements.

²⁵ The conditions include that the measure is not a disguised restriction of international trade, and is not unjustifiably or arbitrarily discriminatory between countries where the same conditions prevail. The significance of these conditions is explored below.

Box 3.2 'Green' provisions in WTO agreements

- *Preamble to the WTO Establishment Agreement*: recognition of optimal resource use, the environment and sustainable development.
- *GATT Article XX and GATS Article XIV*: measures necessary for protecting human, animal or plant life or health are exempt from normal GATT or GATS disciplines under certain conditions.
- *TRIPS Article XXVII*: governments can refuse to issue patents that threaten human, animal or plant life or health, or risk serious damage to the environment.
- *Technical Barriers to Trade (TBT) Agreement* (product and industrial standards): explicit recognition of environmental objectives.
- *Sanitary and Phytosanitary (SPS) Measures Agreement* (animal and plant health and hygiene): explicit recognition of environmental objectives.
- *Agriculture Agreement*: environmental programs are exempt from cuts in subsidies.
- *Subsidies and Countervailing Measures Agreement*: allows subsidies of up to 20 percent of relevant firms' costs for adapting to new environmental laws.

Source: WTO 2000b

3.4 Domestic health and environmental standards

Standards are often used to limit the health and environmental risks and impacts of products and production processes, but discriminatory standards or differences in environmental standards between countries can impede trade.

The WTO agreements seek to limit the use of standards as unnecessary barriers to trade. One way they do this is by encouraging adoption of standards specified by international standard-setting organisations. At the same time, the agreements also seek to make room for governments to adopt unique standards provided these standards meet certain conditions.

To avoid the abuse of unique standards for protectionist purposes, the WTO agreements specify that such standards must be based on scientific evidence (except where sufficient evidence is currently unavailable) and must not result in unjustified barriers to trade. Even so, the agreements do not prescribe what level of protection against environmental and health risks is acceptable: that is left to a country's government itself to determine, and countries can adopt extremely stringent levels of protection against risk if they so choose. But the agreements do impose disciplines on countries to be able to justify the various standards they adopt to meet their target risk levels.

Although this ‘justification requirement’ may appear to place only mild limits on the extent to which standards can be used to achieve environmental objectives, decisions about these matters can be contentious:

Concern over the implications of standards for international trade is expressed in various agreements of the World Trade Organization, especially the Sanitary and Phytosanitary (SPS) Agreement and the Technical Barriers to Trade (TBT) Agreement. Both agreements seek to avoid unnecessary obstacles to trade. Yet they also recognise the sovereign right of governments to adopt whatever standards are appropriate to fulfil legitimate objectives, taking into account the risks that nonfulfillment would create.

Determining what is ‘appropriate’ in the light of scientific evidence and what constitutes legitimacy in terms of public preference promises to be one of the most contentious areas for environmentalists and trade officials alike. There have already been significant trade disagreements on appropriate standards for meat treated with hormones or antibiotics. Those relating to the trade in genetically modified organisms (GMOs) and trade and consumption of products derived from them involve even greater commercial, health, social and ethical considerations (Sampson 2000, 64).

The reach of the standards-justification requirement has been extended under the WTO. Under the previous GATT arrangement, domestic standards to protect human, animal, and plant life and health were allowed provided that the standards were applied in a non-discriminatory manner. Hence, if both the domestic and imported goods were treated as ‘like products’ and the treatment was equal, the scientific justification for measures was not a relevant consideration under the GATT. However, with the commencement of the SPS Agreement in 1995, governments can challenge regulations to protect human, animal, and plant life and health even when there is no discrimination between imported and domestic products. It is this extension in scope that allowed the United States, for instance, to challenge European Union restrictions on hormones in beef, even though the European restrictions do not discriminate on the basis of the origins of the product.

This raises concerns not only among environmentalists but also amongst other groups who view these provisions as undermining the sovereignty of national governments to develop their own standards. A country’s health and safety standards, for example, can also be challenged under the WTO agreements. In a recent high-profile dispute, Canada challenged EU restrictions on asbestos (although in this case the WTO panel dismissed the Canadian challenge).

This raises two broad questions:

- should governments collectively, through the WTO, circumscribe domestic standards; and
- if so, is the current WTO standards-justification requirement appropriate?

Should WTO agreements constrain domestic standards?

There is a clear trade policy rationale for placing limits on national standards. Even standards that are technically non-discriminatory can impede trade. For example, unique design rules for motor vehicles increase the cost of imported vehicles, which must be modified to be saleable on the local market. They thus also have the potential to be used for protectionist purposes. Without an agreement to prevent this, governments could negotiate in WTO forums for other governments to reduce their tariffs on particular goods, only to find that the other government undermines the value of the agreement by setting unique standards to protect its local industry.

Of course, in agreeing to have their standard-setting powers circumscribed in this way, each country *does* surrender a degree of control over its domestic standards. This is the trade-off each country's government faces when considering whether to join or continue in the WTO. Yet this is precisely the same type of trade-off that governments face whenever they bind themselves in international agreements. Such agreements provide both rights and obligations for the country in question. Whenever a government enters such an agreement, it arguably²⁶ surrenders some sovereignty for the benefits the agreement offers.

Are current WTO constraints on standards appropriate?

The constraining of countries' standards can be justified, on trade policy grounds, only to the extent that it prevents standards being used as covert protectionist devices. Clearly countries may want to have stringent standards for other reasons such as to deal with important environmental risks.

For practical purposes, the WTO agreements need to embody a legal 'test' that can be used for settling disputes about the legitimacy of countries' standards. A key element

²⁶ The viewpoint that the act of agreeing to the WTO provisions, including the strictures on domestic standards, involves a diminution of a country's domestic sovereignty has been contested. Bagwell and Staiger (2001, 54-5) state: 'to the extent that the WTO has any power at all, it uses this power to discourage attempts to tread on national sovereignty. A clear illustration can be found in the beef-hormone dispute itself. In the case, the US government successfully challenged as inconsistent with WTO rules a set of new EU regulations that denied US beef producers the access to European markets that the US and EU governments had previously negotiated. When the European Union refused to alter its domestic regulations, the WTO authorized the United States to retaliate, and this is where environmental groups argue that the WTO trampled on national sovereignty. ... [But] under WTO rules, the permissible US retaliation was limited to apply to an equal volume of European goods. Absent WTO rules, how broadly might the United States have retaliated against what it perceived were unfair European regulations, in an effort to force Europe to alter what Europe in turn perceived as a sovereign domestic-policy choice? It is likely that the US would have been significantly less restrained in its retaliation ... Here and elsewhere, the WTO serves as a moderating force over the temptations of its member governments to utilize their power to retaliate as a means of impinging on the sovereignty of their trading partners.'

of the current WTO test is that standards should have a scientific basis. At face value, the merits of this principle seem difficult to dispute, and it has attracted broad inter-governmental support. For example, in relation to the issue of biotechnology, the G8 Cologne Communique of June 1999 stated that:

Because trade is increasingly global, the consequences of developments in biotechnology must be dealt with at the national and international levels in all appropriate fora. We are committed to a science-based, rules-based approach to addressing these issues.

Yet at a deeper level, there are limits to relying on science to determine appropriate public policy. As Sampson (2000, 66) explains:

The setting of standards requires not only scientific evidence but also the establishment of a level of protection that is considered appropriate by society. In some instances, a particular standard may not be appropriate across countries as the physical conditions may differ between areas... Although such differences across countries can presumably be measured objectively, this is not necessarily the case with respect to how different societies wish to manage the risk. It has been observed that scientific evidence would certainly support the notion that cigarette smoking poses a greater risk to health than eating hormone-treated meat. Yet in the European Union, the first is tolerated and the second is banned...

This highlights the possibility that standards might differ across countries for reasons other than scientific reasons or protectionist motives: community or regulatory attitudes towards risk or the nature of the activity that generates the risk can also differ between countries. In turn, this raises major conundrums for any legal test that seeks to determine the legitimacy of particular standards:

The relative weight assigned to science and societal choice in the determination of standards underpins much of the possible future disagreement over their legitimacy within the context of dispute resolution in the WTO...

Numerous questions surround these issues: What minimum degree of scientific validation is required for a trading partner to be obliged to accept a standard as being appropriate? What is the role of 'precaution' if there is insufficient scientific evidence to establish a standard but substantial potential consequences to society of not setting such a standard? Who has the burden of proof in demonstrating that there is — or is not — a real risk? It would be surprising if matters relating to risk assessment and risk management do not become increasingly important in WTO legal proceedings and, as a consequence, the agreements that deal with them (Sampson 2000, 65).

A key emerging issue is the appropriate definition of, and weight given to, the 'precautionary principle' — a matter on which there is no international consensus. For example, Byron (2001, 29) notes that, compared with the precautionary principle expressed in the 1992 Rio Declaration²⁷, more recent definitions promoted by the

²⁷ The Rio Declaration on Environment and Development states that '...in order to protect the environment, the precautionary approach shall be widely applied by states in accordance with their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.' (UNCED 1992, cited in Byron 2001).

European Commission²⁸ appear ‘to authorize and legitimise governments taking action without due cause, reversing the onus and direction of action.’ Yet both versions are worded more strongly, and imply less of a need for evidentiary support for environmental standards, than the WTO SPS agreement.

Where a liberal approach to precaution is taken, there is scope for resultant trade measures to be unduly restrictive. For example, a Productivity Commission (2000b) analysis found the Cartagena Protocol’s approach to precaution could result in import restrictions on certain genetically modified organisms which could *unnecessarily* delay or even permanently deny producers and consumers the benefits of opportunities for improved productivity and output range. Although a degree of precaution is appropriate, the Protocol fails, among other things, to require sensible measures to reduce scientific uncertainty progressively. (Some legal opinion suggests that the Protocol is also inconsistent with the requirements of the SPS agreement. The issue of how inconsistencies between multilateral environmental agreements and WTO rules might be dealt with is discussed later in this chapter).

Beyond these basic observations, this paper has not sought to provide answers to the questions raised above, or to judge whether the current WTO test is too restrictive or too liberal. Issues relating to precaution, risk, the environment and trade agreements are a complex and evolving area of public policy in which definitive answers are often elusive. What can be said is that no practical test will perfectly isolate those standards that are a result of protectionist motives from those that are a result of legitimate considerations. This in itself, however, does not invalidate the case for having a standards-justification requirement in WTO agreements.

3.5 Unilateral restrictions on imports produced unsustainably

The WTO agreements do not prevent countries from applying trade measures to imported goods according to the environmental attributes of the finished goods, so long as domestically produced goods are treated in a similar manner. Allowable restrictions on products that may cause environmental damage when consumed are, like other products, subject to general negotiation. And as discussed earlier, product standards can be formulated under the SPS and TBT Agreements to address the environmental

²⁸ A concise definition used recently by the European Commission reads: ‘The precautionary principle is an approach to risk management that is applied in circumstances of scientific uncertainty, reflecting the need to take action in the face of potentially serious risks, without awaiting the results of scientific research’ (EC 1998, cited in Byron 2001). In February 2000, the European Commission released a more extensive ‘Communication on the precautionary principle’ which recognises, among other things, that ‘In some cases, the right answer [regarding scientific uncertainty and community concerns about risks] may be not to act or at least not to introduce a binding legal measure’ (EC 2000, cited in Robertson and Kellow 2001, 250).

effects of *all* products — domestic products and imports — provided the standards pass the WTO tests designed essentially to eliminate unnecessary obstacles to trade.

There is less clarity about the extent to which countries can unilaterally restrict imports according to the environmental impacts of *the way they were produced* in the country of origin. As discussed below, the lack of clarity reflects the nature of findings made by panels and the appellate body in different disputes brought under GATT/WTO rules.

Until recently, it was generally considered that such discrimination was not permissible under GATT/WTO rules, in particular because it would amount to discrimination amongst ‘like’ products. The 1991 *tuna-dolphin* dispute demonstrates this point. In this dispute, Mexico challenged a US ban on imports of tuna from Mexico. The ban was imposed because Mexican tuna was harvested without using the same ‘dolphin-friendly’ techniques as the United States required its own tuna fishing fleet to use. In finding that the US ban breached GATT rules, the GATT panel concluded, among other things, that while the United States could apply its regulations on the quality or content of imported tuna, it could not embargo imports simply because Mexican regulations on the way tuna was produced did not satisfy US regulations. The GATT panel also concluded that the Article XX exceptions clause did not permit the ‘extra-territorial protection of life and health’ (GATT Council 1991).²⁹

However, the outcome of the 1997-8 *shrimp-turtle* dispute cast doubt on these positions. In this dispute, four Asian countries challenged a US ban on imports of shrimp. In essence, the ban was imposed because the Asian shrimp were harvested without using the same ‘turtle-excluder devices’ as the United States required its own shrimp fleet to use. The US action was again found to have breached GATT rules, but for different reasons. In this case, the WTO appellate body (WTO 1998b) found that the US measures to protect sea turtles would be legitimate under GATT Article XX(g) — which relates to ‘the conservation of exhaustible natural resources’³⁰ — provided certain criteria, such as avoiding inappropriate discrimination, were met. The United States lost the case because it discriminated between WTO members in ‘an arbitrary

²⁹ As noted above, the GATT panel’s findings are widely cited as reflecting the legal position under the GATT at the time and, depending on interpretations drawn from the 1997-8 *turtle-shrimp* case (see text), until recently. However, although the initial GATT panel’s conclusions were confirmed in a subsequent panel decision (GATT Council 1994), albeit using slightly different reasoning, it should be noted that GATT members did not formally adopt the GATT panel’s findings.

³⁰ Under GATT Article XX, clause (g) allows exceptions from the GATT rules for certain measures relating to ‘the conservation of exhaustible natural resources’. The WTO appellate body (WTO 1998b) interpreted this clause to apply to (living) species as well as non-living natural resources. Further, as all of the seven recognised species of sea turtles are listed as ‘species threatened with extinction’ in the Convention on International Trade in Endangered Species of Wild Fauna and Flora, the appellate body deemed the turtles to be ‘exhaustible’ and thus covered by this clause. However, other living creatures not considered to be endangered species might not be covered by clause (g), but instead might be covered by clause (b) which allows exemptions for certain measures ‘necessary to protect human, animal or plant life or health.’ The inclusion of the term ‘necessary’ in clause (b) makes this a more difficult requirement to satisfy than clause (g).

and unjustifiable manner'. Among other things, it had negotiated an international agreement on sea-turtle protection with countries in the western hemisphere — mainly in the Caribbean — and provided them with technical and financial assistance and significant transition periods for their fishermen to start using turtle-excluder devices. It did not attempt to negotiate an equivalent agreement, nor give the same advantages, to the four Asian countries (India, Malaysia, Pakistan and Thailand) that filed the complaint with the WTO.

Although there remained some debate about the implications of the appellate body's decision, one interpretation was that, had the United States attempted to apply the measure in a different manner, its ban may have been allowed under WTO rules (Snape 1999). This in turn implied that discrimination between imports of otherwise 'like' products, on the basis of the environmental impacts of how they are produced, could be allowable under WTO rules in some circumstances. Another implication was that unilateral action to address environmental issues abroad may be permissible under the WTO. These possibilities, and the perceived 'judicial activism'³¹ that underlay the appellate body's finding, were criticised by several members of the WTO, particularly those from developing nations (see Sampson 2000, 109-111).

A recent WTO panel decision on the *shrimp-turtle* issue (WTO 2001a) has confirmed these implications. In this case, Malaysia took action against the United States for its failure to lift the ban on shrimp imports following the earlier appellate body finding. However, in the interim, the United States had made changes to the way it applied its banning legislation and had also made efforts to establish an international agreement with several Indian Ocean states, including Malaysia, to protect sea turtles. In its decision handed down in June 2001, the WTO panel found that the US policy was consistent with the appellate body's ruling. This decision (which was upheld in a subsequent appeal by Malaysia (WTO 2001b)) confirms that, in certain circumstances, unilateral action and discrimination between products on the basis of unsustainable 'process and production methods' (PPMs) is permissible under the WTO.

This discussion highlights two issues:

- to what extent, if any, should countries be able to apply discriminatory trade measures to products on the basis of the environmental impacts of how they are made? and
- to what extent, if any, should countries be able to use trade sanctions unilaterally to force other countries to address environmental problems?

³¹ Among other things, the WTO appellate body adopted an 'evolutionary' approach of legal interpretation to support its contention that sea turtles are 'natural resources' for the purposes of Article XX. The appellate body drew on the declaratory language in the preamble to the WTO Agreement Act, noting that the preamble's reference to the importance of sustainable development 'must add colour, texture and shading' to the interpretation of the GATT/WTO agreements. It also argued that the WTO agreements must be read 'in the light of contemporary concerns of the community of nations about the protection and conservation of the environment'. As well as these interpretive devices, the appellate body adopted some procedural approaches not clearly provided for by the WTO Dispute Settlement Understanding (see Appleton 1999a; Cone 1999).

Processes and production method discrimination?

The question of whether it should be permissible to discriminate between otherwise 'like' products on the basis of how they are produced arises not only in the context of import restrictions on finished goods: it also arises in relation to the validity of certain eco-labelling schemes under the TBT agreement. Eco-labels provide consumer information on the environmental impact of products over their 'life-cycle'. There is uncertainty as to whether eco-labels that contain 'non-product-related'³² life-cycle information are covered by the TBT agreement. But to the extent that they are, they may not comply with the TBT requirements because such labelling explicitly discriminates between 'like' products.

From an environmental viewpoint, the methods used to make or process products are important. The International Institute for Sustainable Development (IISD 1996, 5) has argued:

Sustainable development requires that producers move away from the old approach of react and cure to the anticipation and prevention of environmental problems before they occur. This approach places a premium on the redesign of production processes and the promotion of 'eco-efficiency' ... The ability to distinguish between sustainably and unsustainably produced goods in international trade is vital to ensuring that trade liberalisation does not undermine essential environmental protection but contributes to sustainable development.

Many trade policy practitioners, however, have cautioned that proposals to allow such discrimination in trade rules would entail a fundamental shift in the basis on which the multilateral trading system has been established and operated. Appleton (1999b, 199) notes that 'with a few notable exceptions (eg intellectual property matters and products made by prison labour), goods have not generally been distinguished for the purposes of the WTO Agreement based on PPMs unless PPMs are detectable in the final product'. Byron (2001) cautions about the slippery slope potential of allowing such discrimination:

Past experience in the GATT/WTO has been that measures taken to protect fauna and flora applied within the boundaries of the country taking the action. This raises the question of whose flora, fauna, exhaustible resources, or public health and safety is at risk? For example, could Australia discriminate against Polish cars because the steel manufacturing process there threatens Swedish lakes and fish with acid rain? Or French cars because they use energy produced by nuclear power stations that some believe constitute a safety risk to the French public? Now these are deliberate exaggerations, stretching the point, but they aim to illustrate the 'slippery slope' of discrimination on the basis of production process. Such differentiation really challenges the definition of 'like product' (GATT Article III),

³² An important technical distinction in this debate is whether the PPM in question has a discernible impact on the characteristics of the final product. Where so, discrimination may be consistent with WTO provisions. However, where not, discrimination is unlikely to be WTO consistent: for example, discrimination against furniture on the basis that timber components were harvested in using unsustainable forestry practices would most likely be inconsistent with WTO provisions. The latter production process is known as non-product-related process (Motaal 1999, 228)

especially when the manner of production cannot be scientifically detected in the finished product (Byron 2001, 32-33).

In effect, trade policy practitioners are concerned that allowing PPM discrimination for environmental purposes would open the door to protectionist abuses and could undermine the operation of multilateral trading system. This is evident in resistance to proposals to allow PPM discrimination within the WTO, particularly among developing countries.

The IISD, in acknowledging these risks, sees the answer as lying in the development of a new WTO agreement on PPM discrimination:

Distinguishing between like products on the basis of their contribution to sustainability could open the door to new forms of protectionism. Protectionist interests in all countries have always proven adept at using trade rules to their advantage. And they are perfectly capable of forming alliances with environmental groups to clothe their traditional concerns in more fashionable green clothing.

To answer this dilemma does not lie in an amendment to the existing trade rules. It will require the development of an Agreement on Trade and Environment (essentially an agreement on the use of PPMs to promote sustainable development)... (IISD 1996, 5)

It is difficult to assess the desirability or feasibility of establishing a new agreement on environment-related PPMs, or of changing existing WTO rules to explicitly allow environment-related PPM discrimination. This is partly because the extent to which the current WTO agreements already allow PPM discrimination is uncertain. Although questioned by some, the conventional wisdom is that the general trade rules do not allow such discrimination. However, the recent *shrimp-turtle* decision does endorse environment-related PPM discrimination under the Article XX exceptions provisions in some circumstances. These conditions are complex, although they appear to be tightly constraining (see below). Additional uncertainties surround the status under WTO rules of trade measures in multilateral environmental agreements that entail PPM discrimination (section 3.6).

While there could be benefits in clarifying the acceptability of PPM discrimination under WTO rules, the merits of a new agreement on environment-related PPMs would depend largely on the ability of such an agreement to tread what might be a fine line between allowing discrimination for legitimate environmental reasons and opening the trading system to protectionist abuse. Developing countries, which comprise the bulk of WTO members, have been reluctant to countenance changes to allow PPM discrimination (although, presumably, they may be willing to agree to a new agreement if it returned the WTO to the situation as previously understood — that of no environment-related PPM discrimination). Given the significant benefits that the multilateral trading system has helped generate (chapter 1), there would need to be considerable environmental benefits on offer, which could not be obtained more efficiently through other means, to justify risking modifications to the trading system to explicitly allow or expand environment-related PPM discrimination.

Unilateral action?

The second area of contention raised by the *shrimp-turtle*, *tuna-dolphin* and like disputes is whether countries should be able to use trade sanctions *unilaterally* to force other countries to address environmental problems within their own borders.

The trade policy concerns in relation to such action are reflected in the reasoning underlying the GATT panel's 1991 decision to disallow the US ban on Mexican tuna imports:

...if the US ban was allowed to stand, then any country could ban imports of a product from another country merely because the exporting country has different environmental, health and social policies from its own. This would create a virtually open-ended route for any country to apply trade restrictions unilaterally — and to do so not just to enforce its own laws domestically, but to impose its own standards on other countries. The door would be opened to a possible flood of protectionist abuses. This would conflict with the main purpose of the multilateral trading system — to achieve predicability through trade rules.

Of course, prohibiting unilateral action to address environmental problems abroad clearly limits the avenues through which countries can pursue environmental goals.

Such limits have been justified on the basis that, where international environmental action is warranted, it should be pursued through bilateral or multilateral cooperation, rather than through unilateral means. Under this viewpoint, actions such as the United States' bans on Mexican tuna and Asian shrimp are seen as one country attempting to impose its environmental policies on others, raising concerns about the infringement of nations' sovereignty. The viewpoint that this is undesirable is reflected in Principle 12 of the Declaration of the 1992 Rio Earth Summit, which states in part:

Trade policy measures for environmental purposes should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade. Unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided. Environmental measures addressing transboundary or global environmental problems should, as far as possible, be based on international consensus.

Similarly, WTO member governments at the 1996 Singapore Ministerial Conference endorsed and supported:

... multilateral solutions based on international cooperation and consensus as the best and most effective way for governments to tackle environmental problems of a transboundary or global nature. WTO Agreements and multilateral environmental agreements (MEAs) are representative of efforts of the international community to pursue shared goals, and in the development of a mutually supportive relationship between them, due respect must be afforded to both.

In effect, the WTO member governments are saying, not that action to address environmental problems abroad should not be taken, but that any action that is justified

should be taken through cooperative international action — that is, through the development where appropriate of multilateral environmental agreements.

Nevertheless, some see requirements for environmental problems abroad to be pursued through international agreement, rather than unilateral action, as being unduly constraining, for three reasons. First, negotiating international agreements can be a costly, time-consuming and uncertain process. It can entail the possibility of greater compromise on specific environmental goals than unilateral action might deliver, as well as the risk that ‘urgent’ environmental actions may be delayed. Second, unilateral trade measures can act as catalysts for countries to ‘come to the table’ to negotiate multilateral environmental agreements, and the threat that a government might use unilateral measures, should an ‘appropriate’ international agreement not be reached, may provide it with ‘leverage’ during the negotiations. Third, the legal status of trade sanctions in multilateral environmental agreements themselves is unclear under WTO rules. (See, for example, Stevens 1995, 245; Parker 1999, 9; Jackson 2000, 416, cited in Briese 2001, 39; and section 3.6).

On the other hand, the widespread use of unilateral action to address specific environmental problems abroad would also entail strategic risks for the broader environmental agenda, as well as raising more general concerns about the conduct of international relations. As Neumayer (2000, 55) argues:

Unilateral measures aimed at extrajurisdictional environmental protection might do more harm than good, even for the environmentalists’ case. It would represent a falling back into a world where power dominates rules in solving international conflicts, and the stronger countries unilaterally prescribe what the weaker ones have to do, which is exactly why developing countries are unambiguous in their united opposition (see ICTSD 1999). Permitting unilateral measures would create a world in which every country could try to impose its particular value system on others, but only the powerful ones would succeed. Such actions would run counter to the spirit of cooperation that the world is so direly in need of for solving international and global environmental problems.

Proponents of unilateral action, however, see these possibilities in more benign terms. For example, according to Bodansky (2000, 344-5):

In the environmental realm, multilateral negotiations are particularly prone to bog down, and tend to gravitate to the least common denominator, given the increasing reliance on consensus decision making. In the context, the threat of unilateral nation regulation, which other states wish to forestall, can be one of the principal motivations to develop international standards. As in the customary lawmaking process, unilateral action is primarily available to powerful states, and a thin line may at times divide leadership on the one hand from coercion on the other... [Nevertheless] the threat of unilateral action can produce multilateral regimes that command widespread support and are consequently stable over time.

The current position under WTO rules, as elaborated in recent case law, entails a degree of compromise between these various positions. While the recent *turtle-shrimp* panel (and appellate body) decision confirms that current WTO rules do not proscribe

unilateral action in all circumstances, the decision appears to set a high hurdle for unilateral measures to be permissible under Article XX. First, the panel found that a country cannot simply apply trade measures to ensure that the same PPM requirements that it applies within its own borders are applied extraterritorially. Rather, the country needs to ‘take into account the different situations which may exist within the exporting country.’ Second, the panel decision indicates that the country seeking to impose a trade measure unilaterally needs to make serious and sustained ‘good faith’ efforts to secure a multilateral agreement to address the environmental problem before the measure is permissible under Article XX. Third, the panel emphasised that multilateral action is to be preferred to unilateral measures and that, in the case of sea turtles, its decision that a unilateral measure is justified is ‘to be seen, for the purposes of Article XX, as the possibility to adopt a provisional measure allowed for emergency reasons rather than as a definitive ‘right’ to take a permanent measure’ (WTO 2001a). A fourth issue is whether a unilateral trade measure to affect environmental actions extraterritorially, that passed these other tests, would be allowed if it did not relate to a shared or common resource but, instead, related only to the resources or environment of foreign countries. It is plausible that such trade measures may not be allowable under Article XX, although the panel and appellate body reports on the *turtle-shrimp* matter have not addressed this matter directly.³³ Together, these points suggest that the decision is unlikely to ‘open the floodgates’ to unilateral actions under Article XX.

3.6 Multilateral environmental agreements

Global environmental problems have led to the creation of multilateral environmental agreements (MEAs). There are presently around two hundred MEAs, of which about twenty contain trade-based enforcement mechanisms. Examples include the Montreal Protocol which aims to protect the ozone layer by reducing the use of CFCs and other ozone depleting substances, the Basel Convention which regulates the trans-boundary movement of hazardous waste, and the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES).

³³ The 1998 appellate body report (WTO 1998b) stated, at paragraph 131: ‘We do not pass on the question of whether there is an implied jurisdictional limitation in Article XX(g), and if so, the nature and extent of that limitation. We note only that in the specific circumstances of the case before us, there is a sufficient nexus between the migratory and endangered marine populations involved and the United States for the purposes of Article XX(g).’ The appellate body had earlier noted that sea turtles migrate through the waters of several countries, including the United States, as well as through the high seas.

It has been claimed that trade restrictions which can be imposed under certain MEAs are in conflict with WTO rules, thereby rendering the environmental agreement potentially less effective. Specifically, the concern is that, if a WTO country that was party to the environmental agreement attempted to impose its trade sanctions on a WTO member country that is not a party to the environmental agreement, the latter may be able to circumvent this action by invoking the WTO rules. In Sampson's words:

Environmentalists and trade experts alike are concerned about the relationship between MEAs and the WTO. When negotiating MEAs, WTO members are free to forgo their WTO rights and ratify the use of trade restrictions to enforce environmental standards. Problems can arise, however, when the memberships of the WTO and of MEAs are not identical. In cases like these, a trade-related measure implemented under an MEA could violate WTO obligations. Under which of the two bodies of law would the conflict be resolved? More broadly, the objectives of MEAs and the WTO may not always be mutually supportive. It is possible, for example, that challenges will be mounted in the WTO to import restrictions on genetically modified organisms implemented under the new Biosafety Protocol.

Some argue that the potential for conflict between MEAs and the WTO has been overstated, since few MEAs authorize trade restrictions and no trade dispute has arisen to date over an enforcement measure imposed under an MEA. But others, noting the growing commercial and political importance of MEAs, assert that appropriate measures should be put in place before conflict between the environmental and trade law regimes occurs (Sampson 2000).

To reconcile MEAs with WTO rules, one proposal is to authorise trade sanctions contained in MEAs under Article XX. As noted earlier, Article XX already provides exemptions from general GATT rules for measures which are necessary to protect human, animal or plant life or health or which relate to the conservation of exhaustible natural resources. Under this proposal, the trade sanctions in certain MEAs could be deemed to be 'necessary' or 'relevant' measures for the purposes of the article such that trade sanctions taken in accordance with the MEAs would not be actionable in the WTO. An alternative approach would be to cross-link certain MEAs with WTO rules through the development of a separate Agreement on Trade and Environment, which might also clarify other trade-environment issues.

The case for 'linking' MEAs to WTO agreements (whether through Article XX or a separate cross-linking agreement) depends on an array of considerations, the main ones of which vary from MEA to MEA. In particular, they would depend on the merits of the environmental objectives sought in each MEA, the requirements on parties to an MEA, and whether the use of trade sanctions contained in the MEAs is an efficient means of pursuing the MEA's objectives or, at least, of enforcing its requirements.

As noted in section 3.1, trade sanctions are generally unlikely to be the best means of dealing with environmental problems. Direct environmental protection measures will *normally* be more effective solutions and tend to have fewer economic costs and side

effects than indirect measures such as trade restrictions. Indeed, Oxley (1999) has argued there is little point in using the WTO to legitimise measures, such as trade-based sanctions in MEAs, which in his view 'are widely seen as inappropriate, ineffective or inefficient instruments of environmental policy'. The Commission itself has expressed specific concerns about *some* MEAs which embody trade sanctions — such as the Cartagena Protocol on Biosafety (mentioned above).

Notwithstanding these concerns, trade sanctions may have a legitimate role as a regulatory mechanism for certain MEAs in which, for example, action is required of foreign governments when alternative mechanisms to enforce compliance are not available.

Without judging whether 'linkage' would be warranted in the case of any particular MEA, linkage is more likely to be warranted for environmental measures in MEAs than for labour standards (chapter 2), for two reasons.

First, some environmental issues have significant cross-border implications for other countries. The Montreal Protocol on CFCs and the Kyoto Protocol on Climate Change are examples. By contrast, a country's labour standards predominantly affect the inhabitants of the country. The cross-border nature of certain environmental issues provides a greater justification for robust international action, and reduces the weight that might otherwise attach to national sovereignty concerns.

Second, several MEAs already contain trade provisions and have attracted support from a large number of governments. Many governments have been willing to ratify the Montreal Protocol, for example, knowing that doing so would expose them to the possibility of trade sanctions for non-compliance. They have done so partly in return for the assurance that other signatories would similarly bind themselves to meet the requirements of the Protocol. A caveat to this argument is that:

It is not inconceivable that strategic manoeuvres have been in play; for example, that countries have (reluctantly) accepted trade provisions in the MEAs confident that the WTO/GATT would preclude them from ever being actually exercised or, in other cases, might provide an 'escape clause' (Byron 2001, 33).

This caveat aside, the broad support for some MEAs containing trade sanctions contrasts with the situation in relation to core labour standards. While many ILO members have endorsed core labour standards, they have not agreed to substantive measures that would penalise them for not observing those standards.

Even so, there will be practical difficulties in gaining agreement to link the environmental measures in MEAs to WTO agreements. As is the case with the linkage of labour standards, many developing countries are strongly opposed to the linkage of environmental standards in MEAs. They are concerned, in part, that linkage would have the effect of seeing developed country preferences for environmental protection being imposed on developing countries that cannot afford the same level of

environmental protection. Without a guarantee of offsetting assistance from developed countries, the result would be to reduce the competitiveness of some industries in those countries. As Torres (1999, 161) states:

The richest trading partners have been asking for a very sensible thing: trade measures prescribed in an MEA should be considered ‘necessary’ (according to the wording of Article XX of GATT) and consequently should not be challenged by parties to that MEA. This has been resisted by many developing countries. Why? Trade measures are not the only tool of the enforcement kit of an MEA. Some other measures, erroneously known as ‘positive measures’, such as technology transfer..., financial support and capacity building did not deserve the same interest from those countries that were eager to exempt trade measures from WTO scrutiny. Here again we see capital scarcity dividing the waters. Less rich countries are not willing to give away their rights in the WTO if there is no guarantee that the rest of the tools previewed by the MEA are faithfully complied with.

Further, as with the case of core labour standards, there are concerns that pushing for linkage in the environmental area could stall the trade reform process and the benefits that come with it. Snape and Gunasekera (1997) argue that introducing exemptions may encourage a range of interest groups, which might either directly or indirectly threaten free trade, or hinder its accomplishment by adding complexities or potential disputes in the negotiation and implementation process.

On the other hand, as Esty (2001, 116) notes, failure to address environmental linkage issues may itself diminish political support for the trade liberalisation agenda.

At the recent WTO Ministerial Conference in Doha, in response to pressure from the European Union, member governments agreed to consider the relationship between existing WTO rules and specific trade obligations set out in MEAs during the forthcoming round of multilateral trade negotiations.

3.7 Summing-up

The trade-environment relationship, and its implications for policy makers, is more subtle and complex than usually presented.

The prospect of environmental improvements represents an additional, and essentially coincidental, reason for pushing ahead with a number of liberal trade reforms. Removing trade barriers on environmental goods and services, and reducing subsidies to agriculture, fisheries, forest products and energy, would generate clear environmental benefits. More broadly, trade liberalisation can increase the diffusion of clean production processes and technologies, and reduce the level of resources needed to sustain a given level of global production. The higher income levels that trade helps to sustain can provide governments with the financial resources, and community support, to address environmental issues. And there is only limited evidence of a ‘race to the bottom’ in environmental standards caused by trade competitiveness concerns.

The focus of environmentalists and policy-makers should be on ensuring that environmental policies are appropriate to address the potential effects of any form of economic activity. Direct environmental protection measures will normally be more effective solutions and tend to have fewer economic costs and side effects than indirect measures such as trade restrictions.

However, important questions arise in relation to the constraints WTO rules place on the ways in which environmental objectives can be pursued. Domestic environmental standards (for finished goods) require scientific justification under the WTO rules, and trade discrimination to favour products produced sustainably is circumscribed. And while unilateral trade measures to affect environmental practices abroad are also tightly circumscribed, the status of trade sanctions in MEAs is unclear under WTO rules.

While there are arguments for modifications to (further) green the WTO rules, or at least to clarify aspects of the current rules as they affect environmental issues, the merits of any substantial modifications are by no means clear-cut. An appropriate standards 'test' depends on balancing various requirements, including those of national sovereignty, environmental precaution and safeguards against covert protectionism. Allowing trade policy to favour products made sustainably may have environmental benefits but creates national sovereignty concerns and may destabilise the trading system. And although some MEAs address significant trans-boundary problems and have attracted support from many governments, the question of whether trade sanctions are appropriate for enforcement remains. Beneath these broad considerations, the merits of particular WTO provisions, and of proposals for their reform, depend on many complex legal, economic, scientific and political matters. And whatever the merits of particular reform proposals considered in isolation, whether individual governments support such proposals in practice will also depend on their trade negotiation strategies and on how supporting the proposals might effect the overall 'balance of interests' within the WTO.

Appendix The economic literature on core labour standards

An international consensus has emerged recently on the components of a set of ‘core’ international labour standards. This consensus was reflected in the ILO’s 1998 *Declaration of Fundamental Principles and Rights at Work*. It defines core labour standards as the rights to:

- freedom from forced or compulsory labour;
- freedom from child labour;
- freedom from workplace and occupational discrimination; and
- freedom of association and collective bargaining.³⁴

Chapter 2 of this paper assesses the merits of ‘linking’ these core standards to WTO agreements, such that a country’s failure to observe core standards would be grounds for another country to impose trade sanctions upon it. That assessment focuses mainly on the merits of WTO processes as a means of enforcing core standards. However, the benefits that compliance with core standards would bring — however they might be enforced — are also relevant for the assessment.

This appendix provides an overview of the key economic arguments for countries to comply with core labour standards. An extensive array of studies covers various aspects of this matter. The following discussion draws mainly on reports by the OECD (1996, 2000), an analysis prepared for the World Bank by Maskus (1997), a survey of the recent literature prepared for the OECD by Brown (2000), and review articles by Lee (1997) and Brown (2001). Of course, arguments for and against the observance of core labour standards can turn on more than just their economic efficiency effects: equity and human rights concerns are also raised (box A) and, in some cases, may be the predominant consideration. While noting these matters, this appendix examines core standards primarily from an economic efficiency perspective.

³⁴ Technically, the Declaration covered the following conventions: *Freedom of Association and Protection of the Right to Organise Convention*, 1948 (no. 87); *Right to Organise and Collective Bargaining Convention*, 1949 (no. 98); *Forced Labour Convention*, 1930 (no. 29); *Abolition of Forced Labour Convention*, 1957 (no. 105); *Minimum Age Convention*, 1973 (no. 138); *Equality Discrimination (Employment and Occupation) Convention*, 1958 (no. 111); and *Equal Remuneration Convention*, 1958 (no. 100). In June 1999, the ILO gave a new convention — the *Worst Forms of Child Labour Convention*, 1999 (no. 182) — the status of a core standard for the purposes of the Declaration.

Box A Two views on international labour standards as human rights

The International Confederation of Free Trade Unions (ICFTU 1999) argues:

The ICFTU Campaign on Labour Standards and Trade focuses on a short list of basic human rights at work. Aimed at preventing repression, discrimination, forced and child labour, they are fundamental rights which all countries regardless of their level of development can and should apply. With these rights, the cruellest forms of exploitation are addressed and workers have a voice, an opportunity to have their say about their working conditions. It is a simple but powerful demand that anybody who professes to believe in democracy and human rights can accept. But these rights are all too often abused, and as a result legitimate grievances and aspirations are suppressed.

According to Bhagwati (1994, 59):

Universally condemned practices (such as slavery) are rare ... Indeed, the reality is that diversity of labour practices and standards is widespread in practice and reflects, not necessarily venality and wickedness, but rather diversity of cultural values, economic conditions, and analytical beliefs and theories concerning the economic (and therefore moral) consequences of specific labour standards. The notion that labour standards can be universalized, like human rights such as liberty and habeas corpus, simply by calling them 'labour rights' ignores the fact that this easy equation between culture-specific labour standards and universal rights cannot survive deeper scrutiny.

A1 Labour market efficiency arguments

The main economic argument advanced for the observance of core labour standards is that they can enhance the standard of living of a country's inhabitants by overcoming deficiencies in the functioning of its labour market.

Forced and compulsory labour

The practice of forced labour represents a clear departure from the freedom-of-choice that workers need to be able to move from one job to another to match their skills and aspirations with the different types of work available (OECD 1996, 79). Technically, the practice of slavery provides benefits to the slave owner or slave merchant. However, when the welfare of the slaves is considered, slavery is likely to entail no net benefit, and potentially large net costs, to society. (Of course, most people consider slavery to be grossly inequitable and, for this reason alone, desire its cessation).

That said, while the practice of slavery still exists in some parts of the world, the related institution of 'bonded labour' is more common. This occurs when people pledge their labour services for a period of time, generally in order to discharge a debt. Maskus (1997, 3) notes, however, that often the time period becomes open-ended because the labour is implicitly valued at no more than the interest on the debt, with the sustained principal becoming a *de facto* property right to workers.

Brown (2001, 95) points out that the economic efficiency implications of bonded labour contracts (which are also prohibited under ILO convention 105) are a grey area. The act of choosing to be bonded can be voluntary (although once bonded the worker is no longer free), and may be the 'least worst' option for extremely poor workers who are unable to access formal capital markets. The literature suggests that banning such contracts may still be economically efficient where they result from imperfect information or irrational decision-making on the part of the worker. It also suggests that the legality of bonded contracts can itself inhibit the development of capital markets in poor societies.

While forced and compulsory labour will generally be economically inefficient, in the case of prison labour the use of labour resources which might otherwise lie idle may increase aggregate welfare. Compulsory labour for criminals may also be seen as serving a rehabilitation function (Maskus 1997, 3).

Child labour

Child labour is a common feature of most societies at early stages of development and, as Maskus (1997) reports, the economic literature has shown that children's participation in the labour force falls as a country's per capita incomes rise. Other important determinants of children's labour force participation rate include the educational attainment and income levels of the parents, particularly the mother. This work suggests that child labour can be seen predominantly as a result of household poverty.

Drawing on a series of country studies on the social impact of globalisation, the ILO (1998-9, cited in OECD 2000, 32) argues that child labour is detrimental to development since it means that the next generation of workers will be unskilled and less well educated.

However, several authors have argued that seeking to ban all child labour, as envisaged in the ILO's set of core labour standards, could cause more harm than good. For example, Srinivasan (1994, 37) has argued:

Parents would allow their children to be employed in their own economic enterprise or as wage earners only if, given their market and non-market constraints, family welfare is enhanced by the use of the children's time in such employment rather than in other activities (including being in school). Thus, proscription of such labour, if strictly enforced without compensation, would lower family welfare of those who are already desperately poor.

International evidence cited in Brown (2000, 37-38) and the OECD (2000, 40) also raises questions about the merits and likely repercussions of an outright ban on child labour. For example, evidence from Bolivia and Venezuela indicates that child workers make an important contribution to household income, while a Peruvian study found

that child labour actually assists families to afford to send their children to school. This suggests that (part-time) work by children can in some cases complement education, and thereby help children gain the skills necessary to raise themselves out of poverty. Drawing on evidence from Mexico, another study suggests that aid in the form of subsidies to enable families to keep their children at school is likely to be a superior policy option. Another consideration is that enforcing compliance with outright bans is difficult, and may simply divert children into less visible and more exploitative forms of employment, or into destitution (Hansenne 1998; see box 2.1 in chapter 2).

There are several other strands to this debate³⁵, including some studies which identify potential net benefits from bans on child labour. In models of household behaviour in which parents make decisions with little regard for the welfare of the child, it can be shown that, in some cases, the child would benefit from a ban on child labour. More generally, the literature highlights problems, such as incomplete asset markets in developing countries, which can lead to excessive child labour — in times of financial adversity or illness, parents in developing countries who lack collateral may be forced to offer their children as bonded labourers (Brown 2000, 29).

However, the literature casts doubt on the merits of blanket bans on *all* forms of child labour. Brown concludes that employment of older children can be productively and humanely combined with schooling, and that prohibiting children from working will frequently leave them with inferior alternatives.

Without negating this broad conclusion, the OECD (1996, 81) has argued that the elimination of ‘exploitative’ forms of child labour *would* have clear benefits. It would help preserve or enhance society’s ‘human capital’, which is likely to depreciate rapidly when children work under unsafe or unhealthy conditions.

Maskus (1997, 6-7) concurs in principle, but cautions that determining what constitutes ‘exploitation’ is difficult and that prohibitions may not always produce desired outcomes:

Some treatments of child workers are universally condemned as exploitative, such as kidnapping, delivery into bonded servitude or prostitution, and work that imposes physical dangers that young children are incapable of handling. A broader definition would involve any activity that employs young children in long hours in dangerous conditions, or in jobs of excessive responsibility, or in ways that reduce educational opportunity, or in ways that

³⁵ Other matters discussed in the literature include: the implications of ‘multiple equilibria’ in the labour market for the efficacy of child labour bans; the role of societal norms in determining the willingness of parents to place their children in employment; the role of other market failures — such as underdeveloped capital markets in developing countries — in inducing parents to place their children into bonded employment; the impacts of labelling schemes to identify products produced with child labour; the potential role of educational subsidies as a means of reducing child labour without harming family or child welfare; the potential for trade sanctions against child labour to divert children from formal to informal employment; and the historical impact of legislation compared to growing prosperity in reducing child labour in developed nations. Brown (2000, 28-38) provides a summary and discussion of the literature on these and other issues.

limit social, psychological and physical development. Such definitions have some economic justification to the extent that prohibiting such activity would improve the educational opportunities and health status of children, with a consequent important gain in dynamic productivity for the economy. However, these desirable outcomes may well not be the result of such a prohibition...

In summary, the literature suggests that blanket bans on child labour could have adverse effects on the welfare of children and their families. While the elimination of some forms of child labour is clearly desirable, proscribing all child labour might be justified only if preceded, or at least accompanied, by other policies to alleviate poverty.

Discrimination

Labour market discrimination is defined as the practice of setting different working conditions, access to employment and wages for different labourers on the basis of characteristics, such as gender or race, that are not evidently related to the ability to perform work (Maskus 1997, 4).

Regulations on non-discrimination in employment can help reduce distortions to labour market mobility across both occupations and sectors, and can stimulate more active labour-market participation among certain categories of workers, with beneficial economic effects. The ILO (1998-9) has argued that discrimination faced by women and minority groups are important obstacles to economic efficiency and social development. (More important to many people may be what they see as the strong equity rationale for such regulations.)

However, while prohibitions against discrimination are common in the world, discrimination persists. Sometimes governments themselves engage in workplace discrimination in pursuit of social objectives. Job set-asides in the United States and ethnic employment preferences in Malaysia are examples.

Maskus (1997, 23-27) notes that cultural and religious customs may be conceived of as generating a preference for discrimination. Satisfying this preference comes at a cost to the employer, and reduces the competitiveness of the firm concerned. However, given the employer's preference, he or she may be willing to incur this cost, and the lower profitability it entails, in order to satisfy his or her preference.

Rodrik (1999, cited in Brown 2001, 96) has also noted that, where discrimination has been prevalent historically, maintaining discrimination in some sectors may help overcome political resistance to reforms elsewhere which would enhance the wellbeing of the group discriminated against.

Restrictions on labour market discrimination thus involve a trade-off between (among other things) the benefits of improved labour utilisation and the benefits to some people (or governments) from being allowed to satisfy their cultural or other preferences.

Union rights

The economic literature identifies several ways in which freedom of association and collective bargaining can produce positive economic effects. They can help counter-balance the market power of employers in cases where such power exists. Collective bargaining can provide an incentive for workers to share their views with management about improving the efficiency of the enterprise, and for management to provide enterprise-based training, both of which can be important for workplace productivity. Union presence can impose greater internal disciplines on managers to accurately disclose their performance to shareholders. It can also deter managers from engaging in productivity-reducing discrimination in the workplace. In summarising studies of the effects of union rights on productivity, Brown (2000, 41) reports:

Freeman (1993) claims that the connection to productivity growth is weak. However, Levine and Tyson (1990) report a survey of 43 studies on worker participation and productivity. They find that nearly all the studies report that worker participation either raises productivity or leaves it unchanged. Very few studies found any negative effects.

More broadly, the ILO (1998-9) has argued that collective bargaining and tripartite dialogue are necessary elements for creating an environment that not only encourages innovation and higher productivity, but also attracts foreign direct investment and enables the society and economy to adjust to external shocks such as financial crises and natural disasters. The OECD (1996, 87 and 131; 2000, 32-33) also cites other evidence that countries with improved freedom of association have enjoyed increased growth and are better placed to deal with economic shocks.

Returning specifically to labour markets, the OECD (1996, 81) has noted that collective bargaining is not the only way of addressing problems that arise in such markets. Trade liberalisation or other forms of product-market competition can also address imbalances of market power in labour markets. Nor will collective bargaining always have desirable outcomes:

Some authors, while being in favour of world-wide promotion of core standards, including freedom of association, have highlighted possible distortions associated with certain expressions of the right to freedom of association. One strand of the economic literature emphasises the economic costs of unions. These costs arise when unions protect the rights of their members to the detriment of non-unionised workers and the unemployed. For example, there is strong empirical evidence that forming a union introduces a distortion between union and non-union workers in terms of a wage (and fringe benefits) premium (Freeman and Medoff 1984). Also, unions might impose a high level of employment protection, thus creating a dual labour market. In this context, workers in unionised sectors (the so-called ‘insiders’) are protected against wage competition from the unemployed (the

‘outsiders’). As a result, the latter cannot underbid unionised workers, making their re-employment difficult (OECD 1996, 81-82).

Accordingly, the effects of freedom of association and the right to collective bargaining depend largely on the objectives of the unions. In particular, Maskus (1997) notes that where unions attempt to set minimum wages and conditions at a sufficiently high level to generate unemployment, international sanctions that seek to enforce union rights may promote inefficient outcomes. However, if unions simply offset monopsony power of employers and bargain for a wage that is equal to the worker’s marginal value product, the unions’ actions may improve economic efficiency.

A2 Public good/externality arguments

A second group of arguments for encouraging the general observance of core labour standards revolves around the broader global benefits that observing such standards are said to create. Under these arguments, when a developing country complies with core labour standards, it provides benefits to people or governments in countries beyond its own borders. As the benefits are ‘external’ to the complying country, the arguments continue, economic theory indicates that the country concerned will have insufficient incentives (from a global viewpoint) to observe those standards. In turn, this may justify international action to encourage compliance with the standards.

The ‘race to the bottom’

Some proponents of universal labour standards argue that, in the absence of cooperative international action, increasing competition in the era of globalisation will lead to downward pressures on labour standards, as countries cut their costs of production in search of higher export shares and to fight off imports. These pressures are said to be reinforced by the competition for foreign investment, in which countries will cut standards to attract investors. As long as some trading nations resort to such behaviour, the argument continues, the remaining countries wishing to preserve higher labour standards are placed at a competitive disadvantage unless they follow suit. According to the International Confederation of Free Trade Unions (ICFTU 1999, 8-9):

Rather than trade being the well-spring for the improvement of living and working conditions through the resources provided by higher exports, it is all too often the source of misery as governments actually reduce workers’ rights out of their belief that minimising labour costs is the best way to attract foreign investment and compete successfully with countries such as China. This ‘beggar-thy-neighbour’ competition has effects on all countries, including the industrialised, but it goes without saying that the countries most affected are those developing countries genuinely seeking to protect workers’ human rights and raise basic living standards.

While there is evidence of poor labour conditions and the repression of worker rights *in particular developing countries* (Lee 1997), the economic literature casts significant doubt on the extent of any ‘race to the bottom’ *between countries* in labour standards.

Conceptually, higher labour standards need not translate into higher labour costs, as the costs of mandated benefits and conditions might ultimately be shifted to workers in the form of lower wages. To the extent that this occurs, total labour costs and hence international competitiveness will be unaffected by higher non-wage benefits embodied in labour standards (Freeman 1994, 108, cited in Lee 1997). Even if some initial change in industry competitiveness does occur as a result of mandated standards, this may prompt compensating adjustments in exchange rates and other economic variables — again leaving industry competitiveness essentially unchanged relative to the period before the standards were imposed.

Further, at least in ‘well functioning democracies’, governments would not have an incentive to follow other countries in any ‘race to the bottom’ in some labour regulations, as doing so could reduce economic efficiency and simply shift costs from producers to other parts of the economy (Brown 2000, 22). In fact, trade may provide incentives for some countries to increase labour standards. For example, when a high-income country opens to trade, goods formerly produced by inexperienced and low-skilled workers can be replaced with low-priced imports. This may provide the country with an incentive to raise the minimum age of employment to increase educational attainment among the young (Bagwell and Staiger 2000, cited in Brown 2001, 102).

Empirical support for the ‘race to the bottom’ hypothesis is limited. First, as Lee (1997) reports, it is difficult to find systematic evidence of developing countries keeping labour costs *artificially* low through the repression of labour standards. On the one hand, Rodrik (1997, 46-47) found that ‘in a cross-section of countries, lax labour standards were associated with lower labour costs’ and that ‘the more relaxed the standard, the larger the revealed comparative advantage in labour intensive goods.’ On the other, Rodrik also concluded that productivity-adjusted wages are very similar across countries. Similarly, a study by Golub (1997) of six newly industrialising countries showed that productivity levels and wages were generally closely related and moved together over time. It also revealed that the countries’ unit labour costs (which take into account output as well as labour costs) were in some cases higher than those of the United States. Second, the OECD (2000, 34) concluded that ‘there is no robust evidence that low-standard countries provide a haven for foreign firms’. Further, in its 1996 study, the OECD found ‘no solid empirical support’ for the view that low-standards countries will enjoy gains in export market shares to the detriment of high-standards countries. And Rodrik (1997, 46-47) found that ‘countries with poor labour standards received less foreign investment than would have been predicted on the basis of their other characteristics.’

In summarising its review of the literature, the OECD (2000) stated:

The empirical literature on this [race to the bottom] hypothesis is inconclusive. For example, Levinsohn (1996) finds little evidence of labour standards affecting firm location. In contrast, Elmslie and Milberg (1996) claim to find considerable *historical* evidence of a race to the bottom. They observe that up until the US Congress passed the Fair Labour Standards Act of 1938, there was considerable competition between state legislatures in setting child labour laws.^[36] Oman (2000) concludes that there is little evidence in support of stronger versions of the ‘race to the bottom’ hypotheses, while pointing out that the evidence cannot tell us to what extent competition to attract FDI [foreign direct investment] may inhibit a socially optimal raising of standards.

The ‘social moral consciousness’

A developing country’s observance of core labour standards may provide benefits to people in developed countries in the sense that it soothes a ‘social moral consciousness’ that many people have (Swinerton and Schoepfle 1994). According to this view, people are concerned if their fellow human beings in other countries are required to work under what they see as exploitative or inhumane conditions. People may thus obtain a ‘psychological benefit’ if these working conditions were not to exist. As Maskus (1997, 8) notes:

...to the extent that individuals in different countries are bothered by the use of child labour and limited worker rights, there is a spillover impact across levels of national welfare. It is clear that demand for strong labour standards rises with per-capita income (or economic development). Accordingly, one would expect some disutility among rich-country consumers as they become aware of labour conditions in poor countries.

Hence, the observance of core labour standards throughout a developing country can be seen as a ‘public good’ which offers benefits beyond any benefit to the workers in the country itself.³⁷

³⁶ In examining the decline in child labour in the United States between 1880 and 1910, Moehling (1999, cited in Brown 2001, 107) concluded from census statistics that minimum age laws had little practical impact on the incidence of child labour. Brown (2000, 37) also summarises several other studies on the causes of the reduction in child labour in developed countries in the 19th and early 20th century. In some cases, laws prohibiting child labour or requiring the schooling of children appear to have been influential. In other cases, child labour disappeared completely in the absence of legislative intervention, suggesting that growing economic prosperity alone was sufficient to reduce child labour.

³⁷ To some extent individual consumers can satisfy their own ethical preferences by choosing products that are produced using labour employed under what they see as non-exploitative or humane conditions, and this is one argument for labelling products to provide information about the conditions under which they were produced. However, people’s concerns are likely to extend to all workers in developing countries employed under such conditions. Many workers in developing countries work in the domestic sector and so would be beyond the ‘reach’ of product boycotts or labelling schemes. The merits of labelling schemes and other options are discussed in section 2.5 of chapter 2.

This raises the issue of whether people's views about what is exploitative and/or humane should influence the conditions in other countries which may have quite different social norms and economic needs to their own, and which may not be well understood outside the country. As noted earlier, there is evidence that boycotts by consumers in Western countries of products made using low wage or child labour have in some cases led to the cessation or scaling back of production employing such labour, to the detriment of the workers involved (Hansenne 1998).

Even where moral concerns are well informed, it seems unlikely that any psychological benefits to people in developed countries would be significant relative to the benefits and costs that different labour market arrangements in the developing countries would have for the workers themselves. This is because most people in Western countries are unlikely to be aware of the circumstances of any individual worker in a faraway developing country. And even their concerns about the plight of foreign workers in aggregate may not be of significant proportions compared to the numerous other factors that affect people's day-to-day sense of wellbeing in the Western world. By contrast, the labour market arrangements applying directly to individuals in developing countries are likely to have significant ramifications for their welfare — potentially affecting their sole 'legitimate' source of income and thus, in some cases, their ability to avoid destitution.

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