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Intereconomics

*Suggested Citation:* Kulesa, Margareta E. (1992) : Free trade and protection of the environment: Is the GATT in need of reform?, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 27, Iss. 4, pp. 165-173,  
<https://doi.org/10.1007/BF02926373>

This Version is available at:

<https://hdl.handle.net/10419/140356>

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Margareta E. Kulesa\*

## Free Trade and Protection of the Environment: Is the GATT in Need of Reform?

*The GATT negotiations under the Uruguay Round have almost run their course. However, consultations are certain to continue, as critics regard the GATT rules on environmental protection as inadequate. What aspects need to be reformed, and how might the initial reform measures look?*

According to the traditional principle of free trade, unhindered commerce maximises both international welfare and the social welfare of the individual countries involved. However, the pure theory of free trade is based on an array of restrictive premises that are neither all met in practice nor are wholly desirable. As a result, the original theory has been further refined, modified and qualified.<sup>1</sup> A number of more recent variants argue for abandonment of the principle of free trade in favour of a targeted strategic trade policy, but the majority opinion among economists is still that free trade has the greatest welfare-raising effects, even under imperfect competition.<sup>2</sup>

Another criticism has been voiced with increasing vehemence of late, however. According to the critics, the one-sided concentration on the theory of free trade means that the needs of environmental policy are being ignored; the principle of free trade is ecologically blind and in practice works to the detriment of the environment. The increase in this ecologically motivated questioning of the free trade principle is partly a reaction to the current eighth round of negotiations within the framework of the General Agreement on Tariffs and Trade (the Uruguay Round) and should also be seen against the background of the United Nations Conference on Environment and Development held in June of this year.<sup>3</sup>

In reality, the level of environmental protection differs markedly from one country to another. In only a very few

cases can effective environmental protection be said to exist at multilateral level, although a whole series of international agreements on the protection of the environment have been signed.<sup>4</sup> For this reason states resort to environmentally motivated trade practices (so-called eco-protectionism) to compensate for competitive disadvantages and to ensure that the original environmental measures are effective. The extent to which such practices conflict with the rules of free world trade or the provisions of the General Agreement on Tariffs and Trade (GATT) is examined below.

The intentions of the founder members of the GATT, which came into force in 1948, was to create a world trading system based on free trade principles. The GATT was to create a framework for international trade relations that would prevent the world from reverting to the neo-mercantilistic trade policies of the twenties and thirties. The preamble to the Agreement recognises that member states' "relations in the fields of trade and economic endeavour should be conducted with a view to raising

<sup>1</sup> For an exposition of the classical theory and its variants, see for example K. Rose: *Theorie der Außenwirtschaft*, 10th edition, Munich 1989, pp. 271 ff.

<sup>2</sup> Cf. W. Kösters: *Freihandel versus Industriepolitik*, in: *Wirtschaftsdienst*, Vol. 72 (1992), No. 1, p. 56.

<sup>3</sup> On GATT, see N. Dunne: *Fears over "GATTzilla the trade monster"*, in: *Financial Times*, 30. 1. 92; C. Arden-Clarke: *The GATT, Environmental Protection and Sustainable Development*, WWF Discussion Paper, 1991. On the UNCED, see E. Daly: *Free Trade, Sustainable Development and Growth*, in: *Independent Sectors Network '92*, Reviews of Agenda 21, No. 1, 1992, pp. 1 ff.

<sup>4</sup> For example, the Convention on International Trade in Endangered Species, the Montreal Protocol to protect the ozone layer and the Basle Convention on hazardous wastes.

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standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods". These objectives were to be achieved by "entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce".<sup>5</sup>

The most important principles of the GATT in this connection are the most-favoured-nation clause (Article I), the requirement to give equal treatment to like products produced domestically and abroad (Article III), the prohibition of quantitative restrictions (Article XI) and the obligation to notify trade-promoting or trade-restrictive subsidies (Article XVI) and the almost total prohibition of export subsidies on manufactured goods (the subsidies code). However, the GATT reflects not only the commitment to free trade but also the limitations placed on it, as the so-called exception articles demonstrate. Firstly, trade restrictions are explicitly permitted if they meet one of the requirements of the Article on General Exceptions (Article XX). This covers, *inter alia*, intergovernmental agreements on goods (e. g. the commodity agreement or the Multi-Fibre Arrangement), which can be explicitly exempted from the general principles of the GATT (Article XX(h)). Secondly, there is provision for special exemptions, for example for temporary measures to safeguard the balance of payments (Article XII) or to alleviate food shortages in times of crisis (Article XI, paragraph 2). In addition, poor developing countries enjoy "special and differential treatment" in that the fundamental principles can be waived in their favour (Article XVIII and Part IV of the GATT).<sup>6</sup>

The GATT recognises few exceptions that take direct account of environmental considerations: protectionist measures are permissible if they are taken to protect human, animal or plant life or health (Article XX(b) and Article 2, paragraph 32 of the standards code). They are also allowed if their purpose is to conserve natural resources (Article XX(g)) and if domestic consumption is simultaneously reduced. Environmental subsidies are acceptable firstly if they help eliminate serious environmental pressure, and secondly if they are the most

appropriate environmental instrument (Article 11, paragraph (f) of the subsidies code).

Many critics regard these GATT rules as inadequate and call for the content of existing Articles to be reformulated or new Articles to be inserted. Others also demand a complete re-orientation of the GATT, in other words renunciation of the principle of free trade.<sup>7</sup> The controversy between environmentalists and advocates of pure free trade will be examined on two levels below.

The first level consists of a portrayal of the fundamental links between foreign trade and the protection of the environment. My aim will be to examine the extent to which the principles of free trade actually run counter to environmental policy objectives. The second level deals with the configuration of the GATT. Here the aim will be to examine concrete ecologically motivated trade measures to establish whether they comply with the GATT.

### Effects of Environmental Policy

Given the interdependence between foreign trade and protection of the environment, the effects of environmental policy on trade on the one hand and the consequences of trade for the state of the natural environment on the other can be distinguished one from the other. As early as 1950 Haberler pointed out that the emergence of externalities alters the welfare-raising effects of free trade, and in some circumstances may cancel them out.<sup>8</sup> In the mid-seventies economists referred to this approach among others to demonstrate the theoretical effects of national environmental policy on foreign trade. In the meantime the debate has been much refined and developed. Most analyses are based on a comparative-static two-country model with two products and two factors of production.<sup>9</sup> The conventional assumptions of pure foreign trade theory are retained, but they are supplemented by ecological aspects (externalities, government environmental policy, the environment as a production factor).<sup>10</sup> One of the traded goods is generally regarded as making comparatively intensive use of the environment. The models differ as regards the initial state of the environment in the two countries, the mobility of capital, the type of

<sup>5</sup> Preamble of the General Agreement on Tariffs and Trade.

<sup>6</sup> For example, they can be granted tariff preferences, as in the Lomé Convention between the EC and the ACP states.

<sup>7</sup> At the beginning of this year an alliance was even formed in the USA between environmental groups and Congressmen who, officially at least, wanted the Uruguay Round to fail on environmental grounds. Cf. Amerikanische Umweltschützer wollen GATT-Verträge blockieren, in: Frankfurter Allgemeine Zeitung, 11. 2. 92.

<sup>8</sup> G. Haberler: Some Problems in the Pure Theory of International Trade, in: *Economic Journal*, Vol. 60, 1950, pp. 223 ff. See also H. G. Johnson: Optimal Trade Intervention in the Presence of Domestic Distortion, in: *Trade, Growth and the Balance of Payments*, Chicago and Amsterdam 1965, pp. 14 ff.

<sup>9</sup> For a summary of theoretical findings to date, see H. J. Leonard: *Pollution and the Struggle for the World Product*. Multinational Corporations, Environment, and International Comparative Advantage, Cambridge, Mass., 1988.

<sup>10</sup> Cf. J. Altmann: Das Problem des Umweltschutzes im internationalen Handel, in: *Umwelt und Entwicklung*, Schriften des Vereins für Socialpolitik, NF 215, Berlin 1992 (forthcoming).

environmental protection (in one country or both), the nature of the pressure on the environment (national and/or cross-border), environmental preferences (income) and the manner in which the environment is specifically factored into the model.<sup>11</sup> The models are used to compare trade flows and welfare levels before and after the abandonment of environmental *laissez-faire* (in one country or both) and to compare the effects of alternative trade measures to offset any welfare losses due to the original environmental measures as a result of trade interdependence.

The theoretical results differ according to the premises adopted. Most of the simpler models indicate similar trends: in accordance with the theory of comparative cost advantages, production of the good with the greater environmental impact migrates to country B, which has cheaper environmental protection or none at all. Country A therefore takes over a greater proportion of the manufacture of the good whose production causes less environmental harm. In this way environmental protection modifies the composition of trade flows. The level of prosperity – note that no account is yet being taken of the welfare effects of externalities – falls relative to the past in the country with more stringent environmental protection (country A), usually as a result of a decrease in international competitiveness, while it rises in country B. In most cases trade and production can be expected to decline worldwide.<sup>12</sup> However, the reduction need not be borne entirely by the population of the more ecologically oriented country A, but can also affect the inhabitants of country B via rising import prices for the less environmentally intensive product.

There is no need to describe the many models and their findings in greater detail here. The essential point is that environmental protection measures modify both the composition and level of international trade flows and also the level and distribution of welfare.

### Ecological Effects of Trade

International trade relates to goods, services and also patents, licences and capital in the broad sense (direct investment and technology transfer). Merchandise trade will be the main concern here, although services now account for 25% of total world trade in goods and services (a proportion that is continuing to rise) and in some respects their ecological implications are quite different.<sup>13</sup> During the last twenty years the volume of world exports

grew at an average rate of 5.2% a year and is now estimated at US\$ 3,200 billion at current prices.<sup>14</sup> Access to the world market is regarded as one force driving production, which increased worldwide at a real average annual rate of 3.4% over the same period and is put at around US\$ 20,000 billion in 1991.

This brings us to the first ecological implication. As (unhindered) foreign trade is recognised to be an engine of growth, it potentially has a harmful environmental impact via the pure volume effect of the induced expansion in production. This finding must be set in context, however, as it assumes *laissez-faire* environmental policies. Wießner has shown that if all external environmental costs are internalised worldwide, international trade contributes to achieving the optimum factor allocation in environmental and economic terms.<sup>15</sup> The causality is simple. If there are no trade barriers and if all external consumption and/or production costs are actually charged to those who cause them, the international price mechanism ensures that goods are always produced where the required environmental factor is least scarce, and that this will continue to be the case as long as the worldwide costs of using the environment do not exceed the worldwide benefits. Admittedly, this assumption is as far from reality as that of complete *laissez-faire*.

Comparative cost advantages arise not only as a result of a better environmental endowment but also because of less stringent environmental regulations in one country by comparison with another. If this is the case, trade can have an adverse environmental impact. A lack of environmental safeguards becomes a cost and locational advantage. The result is that particularly harmful production (and waste) is shifted to the countries with the least environmental protection. This may improve the quality of the environment in countries with strict environmental protection laws, but the worldwide level of pollution remains suboptimal. As a result of the exporting of external effects (beggar-thy-neighbour ecological policies), the destruction of the environment may actually increase globally.

<sup>12</sup> On the empirical relevance of the theoretical findings, see J. A. Tobey: *The Effects of Domestic Environmental Policies on Patterns of World Trade: An Empirical Test*, in: *Kyklos* 43, 2/1990, pp. 191-209. On the estimated effects of a future increase in environmental protection, see J. Whalley: *The Interface between Environmental and Trade Policies*, in: *The Economic Journal*, 1991, pp. 180-189.

<sup>13</sup> Cf. M. E. Kulessa: *Welthandel, Ökologie und GATT*, in: Projektstelle UNCED (ed.): *Ökologische Dimensionen weltwirtschaftlicher Beziehungen*, Bonn and Mainz 1992, pp. 75-79 and 88-96.

<sup>14</sup> IMF: *International Financial Statistics*, Washington, D. C., various issues.

<sup>15</sup> Strictly speaking, Wießner demonstrates this only for the case in which there is no cross-border environmental pollution and no global common goods. Cf. E. Wießner, *op. cit.*

<sup>11</sup> Wießner explains environmental damage as a joint product associated with labour and capital. Cf. E. Wießner: *Umwelt und Außenhandel. Der Einbau von Umweltgütern in die komparativ-statische und dynamische Außenwirtschaftstheorie*, Baden-Baden 1991, pp. 64 ff.

The problem grows worse if cross-border environmental pressures are also considered. The example of the ban on the use of DDT in Germany illustrates that foreign trade can make nonsense of environmental legislation, for foodstuffs tainted with DDT continue to reach German tables in the form of imported agricultural products. Measures to reduce industrial emissions of CO<sub>2</sub> can have an even more critical effect; if they are introduced in a country with a generally high level of environmental protection, production may migrate to countries with lower energy efficiency, so that global CO<sub>2</sub> emissions rise.<sup>16</sup> Hence, if countries internalise external costs to differing degrees, national environmental policy may be ineffective or even counterproductive because of foreign trade flows.

### Differentiated Environmental Effects

The statement that foreign trade as an engine of growth has an adverse environmental effect also implies that growth *per se* is ecologically damaging. The extent to which growth and environmental protection are compatible is still the subject of heated debate between "growth optimists" and "growth pessimists", at least in the industrial countries. The question whether the environment can be effectively protected in a context of simultaneous economic growth has generally not been resolved, but it is purely academic from the point of view of the poorer developing countries; for them, the principle is that effective environmental protection is not even possible in the absence of economic development.<sup>17</sup> In the Third World poverty is often the primary destroyer of the environment. Hence, if foreign trade stimulates growth, it creates a necessary precondition for environmental measures in the Third World. Free world trade may therefore potentially work in favour of environmental protection, precisely because of its growth effect.<sup>18</sup>

International trade also contributes to the spread of comparatively environmentally friendly products and so-called environmental protection technologies. It has been shown that tougher environmental regulations do not necessarily lead to an increase in production costs but may help raise the country's competitiveness.<sup>19</sup> This is the case if environmental policy stimulates innovation that

leads to the development of new products and processes, which quite apart from their lower environmental impact are of higher quality and hence more competitive. If the country in question is a pioneer in the field of environmental policy, its industry will also gain an innovative lead over producers from those countries that only are more backward in environmental matters. If many countries operate environmental controls and create demand for effective environmental protection technologies, the international market offers individual countries the possibility of specialising in different environmental protection technologies, with the result that international competition will contribute to a quantitative and qualitative improvement in environmental protection technologies.<sup>20</sup>

Around one-fifth of world output is traded on the world market. This proportion indicates the considerable amount of freight-kilometres involved in international commerce. Transport is one of the causes of the worldwide increase in air pollution, including the worsening of the greenhouse effect. In environmental terms, it is absurd that Columbian cut flowers or Canadian cornflakes can be sold on the German market at the same price as the equivalent German or Dutch products only because the price does not include the ecological cost of transporting them. In order to reduce such environmentally inefficient trade, the external costs of transport would have to be internalised, i.e. added proportionately to the pure transport costs.<sup>21</sup>

### Global Common Goods

The so-called "global commons" pose a series of particular environmental problems. In the narrow sense, global commons are (international) environmental goods over which no particular countries, let alone individuals, have rights of ownership or use. These public goods include the atmosphere and space, the oceans, the Arctic and Antarctic and species living there (e. g. whales and dolphins). In principle, no-one feels responsible for protecting and conserving global commons, although they are often vital resources. An existing user suffers if he abstains from exploiting the resource, but his abstinence is

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<sup>16</sup> As there are no hot spot problems with CO<sub>2</sub>, only worldwide emissions are of direct environmental interest.

<sup>17</sup> Cf. U. E. Simonis: Poverty, Environment and Development, in: *INTERECONOMICS*, March/April 1992, p. 84; M. E. Kulesa: Schulden- und Umweltkrise, Auswirkungen der Schuldenkrise auf den umweltpolitischen Spielraum des Südens, in: *Politische Ökologie*, May 1992.

<sup>18</sup> This naturally presupposes that world trade actually stimulates growth in countries at a relatively low level of economic development. Cf. P. R. Krugman: *Rethinking International Trade*, Cambridge, Mass., 1990, pp. 93 ff.

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<sup>19</sup> Cf. L. Wicke: Europa '92 – Umweltbedeutende Maßnahmen und ihre Konsequenzen für Umwelt und Wirtschaft, in: *Umwelt und Energie, Handbuch für die betriebliche Praxis*, 1991, p. 353. This also qualifies the statement that countries with a relatively high level of internalisation must accept a trade-related material reduction in prosperity. Cf. J. Altmann, *op. cit.*

<sup>20</sup> The field of environmental protection technology is thus an example of the way in which environmental protection measures can generate a (sectoral) stimulus to trade.

<sup>21</sup> The internalisation of external transport costs is another example of the trade-reducing effects that environmental protection can have.

unlikely to bring him a perceptible ecological benefit, as other countries continue to destroy the resource and at the same time benefit from the abstention of others (the free rider problem).

That being the case, the world community will only agree "voluntarily" on restrained and hence sustainable use of the global good if it can be ensured that all user countries abide by international agreements in this regard. With regard to free trade principles, it is relevant first that in the context of free trade a country cannot be forced to abide by international conventions by means of trade sanctions and secondly that countries that themselves do not overexploit the resource cannot prevent the importation of goods produced at the expense of global commons.<sup>22</sup>

As well as global commons in the narrow sense, there are also environmental goods that are indisputably situated in the sovereign territory of a particular country but which produce high external benefits beyond national borders, such as the tropical forests. The question of the right to exploit these production factors, which will be referred to as global commons in the wider sense, raises additional problems. The rights to ownership of the particular resource are clear, at least as far as the country in which it is located is concerned, but the interests of domestic and foreign users differ considerably.<sup>23</sup> If a potential importing country attempts to use trade measures to regulate the importation or direct production of goods whose manufacture harms that country's interests in the natural resource (e. g. the tropical forest), it is interfering in the sovereignty of the exporting country over its own territory.

It can therefore be seen that free trade and environmental protection are neither in complete harmony nor always conflicting with one another. If conflicts do occur, national governments sometimes impose trade restrictions, such as environmentally motivated quantitative limits on exports or imports and customs duties, or conclude international environmental and trade agreements. The question whether such measures clash with the provisions of the GATT will be examined below, in the second level of this study, and will be illustrated by the concrete example of the tuna dispute.

### The Tuna Dispute

The Marine Mammal Protection Act (MMPA) has been law in the USA since 1972. It includes the provision that tuna fish may be caught and sold in the United States only if fishing methods that lead to the death of dolphins (especially drift-net fishing) are not used. In 1990 the MMPA was extended to cover imports of tuna. Mexico, as an exporting country, saw this as a violation of the GATT

and appealed in the same year to a GATT arbitration panel. A year and a half later, in September 1991, the panel ruled in Mexico's favour.<sup>24</sup> The rejection of the MMPA was justified on the grounds that the import ban violated the principle of most-favoured-nation treatment (Article I) and the equal treatment requirement (Article III), for "in the final analysis", one tuna fish is the same as another". Moreover, the MMPA led to a clear restriction of imports that should be eliminated in accordance with Article XI.

The advocates of the import ban on "dolphin-unsafe tuna", on the other hand, argue on the basis of the general exceptions under GATT Article XX(b, g), claiming that the main purpose of the import restrictions was to protect animal life and health or to conserve natural resources, so that the MMPA complied fully with the GATT. In justifying its decision, however, the GATT panel did not deal with Article XX in detail, but even if it had examined the applicability of the exceptions clause the result would have been little different. The generally accepted view is that the protection of natural resources and of human, animal and plant life and health applies to the territory of the country imposing import restrictions; the seas (or the "foreign" environment) do not count.<sup>25</sup>

The upshot of the GATT panel's decision is that no country can take environmental measures to protect global commons if the measures affect trade.<sup>26</sup> This discouraging finding applies not only to dolphins but also to tropical forests, which the EC wants to protect by means of a "qualified ban on the importation of tropical timber"<sup>27</sup>, a measure the Federal German Government has already announced on a voluntary basis.<sup>28</sup>

### Ecological Import Duties

How would the GATT panel have ruled if the USA had imposed import duties on "dolphin-unsafe tuna" rather than an import ban? Such action would have violated not only the most-favoured-nation clause but also the principle of equality of treatment. As the technical term "like product" relates to the properties of the product and not the way in which it is produced, the same product, in

<sup>22</sup> The relevance of this problem to trade policy is illustrated below by the example of the tuna dispute.

<sup>23</sup> On diverging interests in the tropical forests, see M. E. Kulesa, *Welthandel, Ökologie und GATT*, op. cit., pp. 51 f.

<sup>24</sup> Cf. Focus, GATT Newsletter, March 1988, pp. 5 f.

<sup>25</sup> Because of public protests, the US Administration did not immediately comply with the ruling but instead in February of this year extended the ban on imports of particular types of tuna to 30 producing countries. Cf. *Süddeutsche Zeitung*, 3. 2. 92. EC countries (Portugal and Spain) are now among the countries affected.

<sup>26</sup> Cf. B. Britton, quoted in: American Cetacean Society et al.: *Trade Panel Declares U. S. Dolphin Protection Law Must Go*, Washington, D. C., August 1991.

other words the same tuna fish, would have been subject to different customs duties; discrimination between trading partners would therefore have been based solely on their production processes, in this instance their fishing methods.

Eco-tariffs of this kind also have to be examined to see whether they would comply with the GATT as countervailing duties (margin of dumping). The anti-dumping provisions (Article VI and Articles 2, 3 and 8 of the anti-dumping code) do not explicitly indicate that the failure to internalise external costs should be described as a trade-distorting subsidy. This can probably be explained by the fact that the GATT assumes that external production

costs are largely internalised or regards the failure to do so as a problem solely for the country concerned. In other words it ignores the phenomena of cross-border environmental pollution and global commons.

Some authors nevertheless interpret the GATT in such a way that in certain circumstances environmental dumping can provide implicit justification for anti-dumping duties.<sup>29</sup> In my opinion this is not the case; according to Article VI of the GATT, dumping takes place when the goods of one country are introduced into the market of another country at unfairly low prices. Assessments of "fair" prices are based either on the prices of like products in the exporting country or, in the absence of such domestic prices, on the prices of like products in third countries or on production and marketing costs plus a profit margin.<sup>30</sup> If dumping seriously jeopardises a branch of economic activity in the importing country, Article VI of the GATT allows that country to levy "countervailing"

<sup>27</sup> A qualified import ban means that tropical timber from so-called sustainable forestry may be imported or will be given tariff preferences over imports from unregulated felling. Cf. Commission of the European Communities: The Conservation of Tropical Forests: The role of the Community, in: Official Journal of the European Communities, C 264, Brussels 1989.

<sup>28</sup> Cf. Bundeswirtschaftsministerium: Tagesnachrichten No. 9832, 11. 2. 92, pp. 1 f. For a critique, see: Tropenholzimport verbieten, SPD: Selbstverpflichtung der Industrie ist nur Heuchelei, in: Frankfurter Rundschau, 18. 2. 92.

<sup>29</sup> Cf. J. Altmann, op. cit.

<sup>30</sup> Cf. Dumping, in: Gablers Wirtschaftslexikon, 3rd edition, Wiesbaden 1990, pp. 170 f.

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NEW PUBLICATION

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Manfred Holthus,  
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**PRINCIPLES AND INSTRUMENTS  
OF THE  
SOCIAL MARKET ECONOMY**

Many developing countries and former socialist industrial nations are more amenable today to the idea of a market-based economic order. When seeking examples to follow increased attention is now given to analysing the social market economy system as it has been put into practice in the Federal Republic of Germany. Increasing significance is being attached to information on the elements which constitute the decentralized decision-making mechanisms of the social market economy and how those mechanisms function, on the surrounding legal and economic frameworks, on how these are institutionally anchored and on the possibilities and problems involved in transferring the basic principles of this form of order to other countries. The present volume endeavours to make a further contribution in this direction. This book is a translation of a collection of contributions in German entitled "Elemente der Sozialen Marktwirtschaft", which is essentially based upon lectures given and discussions held at a seminar in the Hamburg Institute of Economic Research (HWWA).

Large octavo,  
305 pages, 1992,  
price paperbound DM 55,-  
ISBN 3-87895-435-2

VERLAG WELTARCHIV GMBH - HAMBURG

duties on the dumped goods in order to offset the price advantages unrelated to economic efficiency. The amount of the countervailing duty is determined as the difference between the dumping price and the "fair" price of the same or similar products.

In view of the definition of the "fair" price, in the majority of cases it is the product characteristics that are relevant and not the environmentally friendly or harmful manner in which an imported good is produced. Even if fictitious prices have to be used in the calculation, ecologically motivated anti-dumping tariffs are not permissible, for although underlying production costs are used net of any subsidies, the GATT definition of subsidies (Article XVI and the subsidies code) does not include indirect subsidies attributable to inadequate environmental protection legislation. In addition, the literature points out that for an action to be recognised as dumping it must entail price discrimination between different locations.<sup>31</sup> It is as unlikely that this condition will be met in the case of ecological dumping as it is in that of social dumping.<sup>32</sup>

The General Assembly of the United Nations decided in December 1991 that drift-net fishing should be banned from 1993. The decision is not binding, however. Nevertheless, this raises the question as to the extent to which international environmental agreements are affected by the GATT.

The Director-General of the GATT, Arthur Dunkel, has himself pointed out that multilateral environmental protection measures might run counter to the trade provisions of the GATT.<sup>33</sup> First, trade bans are not allowed as a matter of principle. Furthermore, under the GATT regulations is it constitutionally impossible to punish the violation of international environmental protection regulations by means of trade sanctions.<sup>34</sup> In its latest publication on trade and the environment the GATT Secretariat states that there is always the possibility of obtaining a waiver from the General Assembly for such cases.<sup>35</sup> This means that if two-thirds of the GATT contracting parties want trade sanctions to be permitted

on environmental grounds no formal objection would be possible. Consequently, an international environmental protection agreement would generally be valid only if the signatories included two-thirds of the GATT contracting parties.<sup>36</sup>

### More Far-reaching Environmental Protection

Under Article XX(g) of the GATT, quantitative export restrictions can be introduced to conserve natural resources only if domestic consumption of the resource is simultaneously reduced. Only a country prepared to make economic sacrifices may restrict the exploitation of its natural resources in the world market. Such a constraint is understandable from the standpoint of a disciple of the school of pure free trade, but not from that of an ecologist. In the context of environmental objectives, quantitative export controls are beneficial if total consumption of the resource declines. Put another way, export restrictions make environmental and economic sense as long as the cost of worldwide renunciation of this resource does not exceed the benefit to be derived from conservation of the resource.

In many cases the main exporters of raw materials are developing countries, so that a development policy criterion must also be applied in judging GATT Article XX(g). The example of tropical woods illustrates the problems involved. Very few countries with tropical rainforests will restrict exports on purely environmental grounds, as they are developing countries that cannot afford such a "luxury" or do not wish to do so. Economic considerations are more likely to be a factor. For example, quantitative export restrictions may be imposed at the same time as domestic wood processing is promoted.<sup>37</sup> If this is successful, economic conditions in the country may improve and foreign exchange receipts may increase.<sup>38</sup> This may make environmental sense, as ecological improvements in the Third World will come about only if there is an accompanying improvement in economic conditions.

Nonetheless, such protectionist measures should be

<sup>31</sup> Cf. Dumping, in: A. Woll: Wirtschaftslexikon, 6th edition, Munich 1992, p. 139.

<sup>32</sup> Cf. Sozial-Dumping, in: Gablers Wirtschaftslexikon, op. cit., p. 726.

<sup>33</sup> Cf. N. Dunne, op. cit.

<sup>34</sup> The Montreal Protocol on the reduction of CFC emissions does provide for this possibility. Another example is the international agreement on the protection of whales, from which Iceland withdrew at the end of 1991. Iceland would have gone its own way sooner and Japan and Norway might have done likewise if the USA had not threatened trade sanctions.

<sup>35</sup> Cf. GATT: Trade and the Environment, Geneva 1992, p. 6 (reproduced in: GATT Activities 1991).

<sup>36</sup> A waiver requires a two-thirds majority of the parties represented and an absolute majority of all contracting parties.

<sup>37</sup> Indonesia applies export restrictions to tropical timber but at the same time engages in and promotes the processing of this resource, precisely for export. Japan, which is the largest importer of raw tropical hardwood (1986: 54% of world imports) has therefore lodged a complaint with the GATT Secretariat.

<sup>38</sup> Higher foreign exchange receipts may arise because the prices or profit margins for processed products are often higher than for raw materials. See for example Netherlands Committee for IUCN: The Economic Value of Non-Timber Forest Products in Southeast Asia, Amsterdam 1989.

<sup>39</sup> In principle, the "approval" of such an ecologically and economically motivated measure should be coupled with the start of an overall improvement in the environment. In other words, reduced damage to forests must not be accompanied by worsening environmental pollution of other kinds as a result of increased domestic processing of wood.



accepted only if, to continue with the example of forests, the destruction of the forests actually slows down.<sup>39</sup> On the basis of the same considerations, countries with tropical forests could levy export duties on tropical timber.<sup>40</sup> However, an export duty to curb exports would also fall foul of the GATT, because it would constitute a disguised restriction of international trade.

### Environmental Protection Subsidies

On the basis of findings so far, it can be concluded that ecologically motivated quantitative import restrictions or customs duties are compatible with the GATT as long as they relate to the characteristics of the product. External costs resulting from the consumption of an imported product can thus be internalised, provided there is no discrimination between trading partners or in favour of domestic producers. In this way a country can protect its economic interests in domestic markets. On the world market, however, domestic "environmentally friendly" products may continue to compete with cheaper products of the same micro-economic utility.<sup>41</sup>

Competitive disadvantages nevertheless remain in both foreign and domestic markets if environmentally induced cost increases are due simply to the method of manufacturing a product that is otherwise identical to foreign goods, in other words if the external costs of the imported good arise at the production stage. As explained above, the resulting competitive disadvantages may not be offset by trade-restrictive measures even in the domestic market. The question therefore arises whether the country may not and should not subsidise domestic production in order to offset competitive disadvantages in the domestic and/or world markets.

Environmental subsidies are a highly questionable instrument as regards both their economic efficiency and their ecological effectiveness.<sup>42</sup> The fundamental shortcomings of generalised subsidies are well-known, but even if a country grants only special export subsidies to

offset environmentally induced cost disadvantages in foreign markets, there is a danger that subsidised exports will be re-imported. In practice, the country would have to subsidise all production both for domestic consumption and for export, which in turn would be undesirable from the points of view of budgetary as well as environmental policy.

Even if re-importing could be successfully prevented in order to make special export subsidies feasible, popular resistance would be very strong. For one thing, domestic taxpayers would be unwilling to pay for reducing the external costs of consumption abroad. Then there is the psychological factor, in that domestic consumers would become envious if consumers abroad paid less for the same domestic product, even if its consumption or production was now less environmentally harmful. In certain circumstances the subsidies code does allow environmental subsidies, even if they have trade effects.<sup>43</sup> However, in my view there is no need to consider in which few cases ecologically motivated (export) subsidies may be compatible with the GATT, for their use conflicts not only with the principle of free trade but also with the requirements of efficient environment policy.

### Need to Reform the GATT

The remarks so far have shown that the GATT is in need of reform from the ecological point of view. However, the concrete amendments give rise to a number of difficulties, which can only be sketched out here:

□ *Preamble.* The preamble of the GATT should be extended to include environmental protection among its objectives, as has been done with the EEC Treaty, for example. In particular, the objective of "developing the full use of the resources of the world" needs to be qualified. The wording "sustainable use of the resources of the world" would be a conceivable alternative.

□ *Like products (Articles I, III and VI and the Dumping Code).* The concept of "like products" should be explicitly widened to allow the ecological costs of production to be used as a differentiating criterion. Redefinition along these lines would also widen the concept of dumping. However, a careless formulation would leave the door wide open to the "new eco-protectionism". The question therefore arises as to who will determine the level of uninternalised costs and hence the amount of countervailing duty. If this is done by the importing country the costs will be set either too high (for competing products) or too low (for intermediate inputs), depending on the country's protectionist objectives. If responsibility is given to the exporting country, costs will generally be underestimated.<sup>44</sup>

□ *Protection of the environment (Article XX(b)).* Up to

<sup>40</sup> The extent to which this instrument may have direct ecological effects (effect on the level of exports) or indirect effects (generation of revenue that can be used for environmental purposes) is not considered here.

<sup>41</sup> For example, if domestic industry is forced to produce only motor vehicles with three-way catalytic converters, these cars compete against cheaper products with the same micro-economic utility in foreign markets where no such requirement applies. (The lower the demand from countries with similar product regulations and the greater the demand from countries without comparable requirements, the greater this competitive disadvantage is.)

<sup>42</sup> Cf. H. Siebert: Das produzierte Chaos. Ökonomie und Umwelt, Stuttgart 1973, pp. 172 f.

<sup>43</sup> See the description of the GATT above.

<sup>44</sup> This illustrates the impossibility of estimating environmental damage precisely.

now, trade restrictions aimed at protecting human, animal or plant life or health have been permitted. So that the use of the exception clause for environmental purposes is more predictable than in the past, the protection of the natural environment should be explicitly named as a legitimate criterion.

□ *Conservation of exhaustible natural resources (Article XX(g)).* Developing countries at least should be permitted to impose export restrictions in order to conserve domestic resources if they lead to a reduction in overall consumption of the resource. The problem of the monetary valuation of external effects again arises if one also wishes to prevent the ecological benefits of conservation from being outweighed by other environmental damage caused by an increase in domestic consumption.

□ *International environmental protection agreements.* In the same way as international commodities agreements qualify for the general exceptions to the GATT (Article XX(h) and (i)), international agreements to protect the environment, including potential trade sanctions, should be exempted from the GATT rules.

□ *Global commons.* It is worth considering whether Article XX(b) for the protection of human, animal and plant life and health should not be explicitly extended to include global commons. In the case of global commons in the broad sense (e. g. tropical forests), the sovereignty of the exporting countries is an obstacle to such an exception. Moreover, each case must be examined individually to ascertain whether quantitative import restrictions (the usual instrument) are actually effective in ecological terms.<sup>45</sup>

□ *Product and production standards.* Not only (alleged) ecological dumping but also product standards can lead to protectionism that cannot be justified on environmental grounds. First, requirements are tailored so specifically to the importing country that other countries can meet them only at high cost, if at all, and secondly the sheer volume of

regulations makes them extremely difficult to comprehend.<sup>46</sup> In order to limit the misuse of an "ecologised" GATT, a condition of all trade restrictions aimed at protecting the environment should be that they are clear, scientifically justified and ecologically effective. In the long run, however, international rules on the formulation and content of environmental standards should be drawn up.<sup>47</sup>

### Prospects

The interaction between foreign trade and environmental protection policy is many-faceted. Whether the relationship between the objectives of free trade and environmental protection is antagonistic, neutral or harmonious depends on the environment policy parameters at the national and international levels and on the actual environmental and trade policy instruments. Unrestricted free trade and environmental protection are compatible only if the external costs of environmental pollution are internalised to a high degree worldwide.<sup>48</sup> National and international environment policy is a long way from achieving this. The General Agreement on Tariffs and Trade, which in principle rests on the theory of free trade, is therefore in need of reform.

In 1948 environmental protection was not an economic and social priority, but the situation has changed since then. Part IV on Trade and Development was added to the GATT in 1964, thereby acknowledging the findings of a more sophisticated free trade theory that took account of the important influence of sharp differences in levels of development between the contracting parties on the distribution of prosperity.

Once the Uruguay Round of negotiations has been completed, it will be time to commence a "green Round".<sup>49</sup> At the request of the EFTA countries,<sup>50</sup> supported by the EC and other countries, the GATT Secretariat reactivated the Working Group on Trade and the Environment in January of this year.<sup>51</sup> Its task should be to formulate a Part on "Trade and the Environment" in collaboration with other experts and the contracting parties. As the German Federal Minister for Economic Affairs Möllemann has also said, environmental protection should become the underlying theme for the ninth round of GATT negotiations.<sup>52</sup> The challenge will not be easy to meet.

<sup>45</sup> A ban on the importation of tropical timber is to be judged unfavourably in this connection; cf. M. E. Kulesa: *Welthandel, Ökologie und GATT*, op. cit., pp. 52 ff.

<sup>46</sup> Developing countries complain particularly of the increase in the misuse of eco-protectionism; see the Environment Minister Salim: *Ohne Entwicklung keinen Umweltschutz*, in: *Evangelische Information* 5/92, p. 14.

<sup>47</sup> A negotiating group in the Uruguay Round deals with the harmonisation of trade-related sanitary and phytosanitary standards. However, environmental objectives often impede the desired minimum harmonisation, i. e. that no country should restrict the import or export of goods meeting the standards.

<sup>48</sup> In my view, this Nirvana approach is adopted by some authors who regard a fundamental "ecological" reform of the GATT as unnecessary. See, inter alia, E. U. Petersmann: *Trade Policy, Environmental Policy and the GATT*, in: *Außenwirtschaft*, Vol. 46, 1991, No. II, pp. 197-221.

<sup>49</sup> See the pronouncements of US Senator Baucus, quoted in: *Die nächste GATT-Runde soll "grün" werden*, in: *Handelsblatt*, 7. 11. 91.

<sup>50</sup> EFTA Statement on Trade and the Environment to the Trade Negotiations Committee, December 1990.

<sup>51</sup> The Working Group has existed officially since 1972 but has not met for the last 20 years. Cf. *Focus, GATT Newsletter*, Jan./Feb. 1992, p. 8.

<sup>52</sup> Bundeswirtschaftsministerium: *Tagesnachrichten* No. 9722, 5. 6. 91, p. 4.