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An institutional order for a globalizing world economy

Kiel Working Paper, No. 807

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Suggested Citation: Siebert, Horst (1997) : An institutional order for a globalizing world economy, Kiel Working Paper, No. 807, Kiel Institute of World Economics (IfW), Kiel

This Version is available at:

<https://hdl.handle.net/10419/952>

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Kiel Working Papers

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AN INSTITUTIONAL ORDER FOR A GLOBALIZING WORLD ECONOMY

by

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The Kiel Institute of World Economics

ISSN 0342 - 0787

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April 1997

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Abstract

The paper discusses the most important elements of an institutional order for a globalizing world economy. Rules for the exchange of goods, for factor movements, for the monetary domain and for the allocation of the environment are distinguished. It is analyzed in which direction these rules should be developed. The interdependence of the institutional order for these different areas is discussed.

1. Rules in a Globalizing World Economy

1. The world economy is characterized by the increasing globalization and greater interdependence of economic decisions. Transaction costs based on geographical distance are becoming less important. Declining transport costs *per unit of output*, *more efficient, internationally operating communication networks*, new organizational technologies for fragmenting production and the removal of barriers to international exchange have reduced the market segmentation for goods, services and capital. The allocation mechanism, the world market, is becoming more global, and the international division of labor is also more global — but as in the past economic decisions are still decentralized. Through modern forms of organization they can be even more strongly decentralized.

2. In order to ensure that the international division of labor can occur without disturbances, that transactions will not be burdened with uncertainty, that all countries can derive the greatest possible prosperity from international exchange, and that individual countries will have a net advantage from a globalizing world economy, an institutional order is needed. The basic idea for such a world economic order (Vosgerau 1989) must be that the international division of labor should capture the potential welfare gains between countries endowed with different production factors and different preferences to the advantage of the participating economies.

3. A central element of the institutional framework for a globalizing world economy is that states voluntarily commit themselves to respect rules which prevent strategic behavior by individual countries. Behavior should be prevented that distorts the gains from the international division of labor to the advantage of individual countries — whether apparently or actually, whether long-term or short-

term. Otherwise the potential gains from international exchange could become smaller or even negative. The rules must prevent uncooperative behavior by states; without eliminating competition among states, the rules must induce them to act cooperatively (Haggard and Simmons 1987: 513). Self-commitment by states limits national governments' choice of actions and in this sense represents a negative catalogue. It protects international competition against national governments (Tumir 1983: 72). The self-commitment of states is also a shelter from the power of protectionist groups in the individual economies.

An international order which develops in the course of time (Axelrod 1986, North 1990) represents a public good. It defines the international economic constitution from an economic perspective (Moser 1989). Regardless of such general rules, households, firms and states have varying action parameters — an institutional order should not be mis-understood as a pre-harmonization of the specific actions. There will always be great variety of economic conditions in the world economy — for example, in the prices for non-tradable goods and for immobile production factors such as wages.

4. The contents of the institutional arrangement depend on the different types of interdependence among countries. Traditionally, foreign trade policy rules intended to facilitate trade have mattered. Recently, there have been discussions about socio-political norms as well as about rules for services and competition policies. Norms for the mobility of production factors — physical capital, labor and technology — are receiving increasing attention in the economic policy discussion. There are periodic calls for agreements on the exchange rates. Finally, norms for the use of the environment will acquire greater significance in the future (Table 1).

Table 1 — Elements of an institutional order for the world economy

Type of interdependence	Distortions, Disturbances	Rules
(1) Exchange of goods and services – Goods	Protectionistic foreign trade policy (tariffs, import quotas, "voluntary" export restraints, strategic trade policy and industrial policy, anti-dumping, subsidies, product standards).	Trade rules, above all against new forms of protectionistic trade policy; country-of-origin principle for norms.
	Calls for uniform social norms.	No worldwide standardization possible.
	Market power of firms.	Competition rules. Free access to markets. Competition authorities?
	Discrimination against foreign suppliers.	National treatment.
(2) Factor migration – Technology	Not respecting property rights internationally reduces the incentive for technological progress.	Property rights which protect new knowledge but permit gradual dissemination.
	– Capital Risk of expropriation of foreign investments; tax competition for mobile capital.	Governments compete using their infrastructure, tax system and regulations for mobile capital. Consequently, national self-interest impels countries to make themselves more attractive to outside capital. Aside from this no international rules are necessary.
	– Labor Abrupt mass migrations.	Free trade and free movements of capital as a substitute for labor migration. A right to emigrate (right of exit). Openness in immigration policy. Not achievable: a universal right of immigration.
(3) Financial transactions	Volatility of exchange rates.	Each country must keep the value of its money stable. Discretionary macro-economic coordination is not possible unless each country submits itself to rules giving up sovereignty similar to the gold standard.
(4) Diffusion of Pollutants	Misuse of national environmental policy for strategic trade purposes; free rider behavior of individual countries in regard to global environmental problems.	International rules only for transfrontier and global environmental problems. National environmental problems are subject to national environmental policy. Separation between environmental policy and trade policy.

II. In the Center: Rules for the Exchange of Goods

5. The rule system of the World Trade Organization is intended to make strategic behavior by individual countries more difficult and to strengthen cooperative behavior. In the future it should be further developed and strengthened.

In the international economic order quite a few positive tendencies can be seen. In eight tariff reduction rounds since 1948 countries' traditional trade policy arsenals have been reduced. The principle of non-discrimination, embodied in the GATT by the most-favored-nation and national treatment obligations, aims at precluding the discriminatory application of trade policy measures. The most-favored-nation obligation is intended to multilateralize the reduction of trade barriers. The concept of reciprocity of concessions, although based on mercantilist ideas, is also intended to serve this aim.

However, there are many reasons why free market access can not be established in this framework (Gundlach et al. 1996, Langhammer 1995):

- Countries have circumvented tariff liberalization through other restrictions, such as voluntary self-restraint agreements and export guidelines. The world trade order could not quickly integrate the newly-appearing forms of trade policy instruments into its rules.
- Escape clauses still allow protective measures in the case of sudden increases in imports and in the case of export subsidies, even on a selective basis against individual suppliers.
- Anti-dumping measures have a protectionistic character, especially since they entail uncertainty and since the threat of anti-dumping measures can lead to "voluntary" self-restraint agreements.
- Sectoral exemptions from the non-discrimination principle and from the most-favored-nation treatment in the domains of agriculture and textiles represent a violation of the basic concept of the international division of labor.

- Finally, even after the Uruguay Round the World Trade Organization still disposes of only a very weak sanctioning mechanism against countries which deviate from the rules. Its dispute settlement mechanism is only activated if individual states request it, and even then the new World Trade Organization has only the possibility of moral sanctions. Retaliatory measures approved by the World Trade Organization usually have no effect when employed by individual states against large trading nations. Furthermore, the World Trade Organization cannot bring charges against countries on its own authority.

6. The multilateral trading system is not effectively protected against aggressive bilateral trade policy. It is desirable to limit bilateralism.

An aggressive trade policy on the part of the leading trading nations and regions of the world endangers the multilateral trading system. The United States and the European Union have set up new arsenals of trade policy instruments. These can be employed as retaliatory measures or market openers without regard for the mechanisms of the world trade order (Sachverständigenrat 1994/95: Number 405). Thus with its instrument "Super 301" the USA can react within the shortest period against trade policy measures of other countries. It can independently introduce trade-limiting measures against individual states. Agreed-on preferential trade treatment can be canceled, import restrictions imposed and bilateral export limitation agreements arranged. With the "new trade policy instrument" the European Union has created a similar apparatus. Using these trade policy weapons the two trading blocs, in the sense of result-oriented bilaterally conceived systems (Dornbusch 1990), have exempted themselves from the rules of the multilateral world trade order (Klodt, Stehn et al. 1994: 119). The danger exists that bilateral measures will escalate and that the multilateral order will thereby degenerate. The trade policy instruments of such an aggressive market opening policy must be integrated into the rules of the world trade order. A result-oriented, bilaterally conceived aggressive trade policy for opening markets must not supplant a rule based, multilateral order.

The territorial exception from the principle of most-favored-nation treatment which holds for regional integrations conjures up the fundamental danger that the multilateral order will disintegrated into regional blocs. However, on the basis of previous experience regional integration has not led to significant segmentation. The regional integration efforts in Latin America have tended to remain weak; the new regional integration in East Asia (APEC) is geared to market integration and is not set to create external barriers. European integration has had attractive power — it has not closed itself to the possibility of accepting additional members. Through their growth, *cum grano salis*, the trade diversion effects at the expense of third parties are, despite protectionistic interventions, probably overcompensated. The North American Free Trade Area (NAFTA) lacks the internal coherence found in the European Union. Nevertheless, the danger cannot be dismissed that regional blocs could become entangled in an escalating trade war. Thus in the case of a conflict between the blocs, NAFTA could, even without a *de jure* common trade policy, tend to reinforce a possible aggressive trade policy on the part of the United States. It is therefore important to find mechanisms which multilateralize regional integration. For example, regional trade areas should be kept open for new members. They could commit themselves to "realize the results of the GATT Rounds more quickly than planned, liberalize more than agreed and employ the permitted exceptions less often" (Sachverständigenrat 1994/95: Number 406). Such a GATT-plus could advance the integration process in the world economy. This also holds for dovetailing various regional blocs by establishing a free trade zone between the blocs, perhaps for a trans-Atlantic economic area (cf. Siebert et al. 1996). One way to do this is for the members of integrated regions to grant concessions to third countries, in the sense of limited most-favored-nation treatment (Klodt, Stehn et al. 1994: 118).

7. National subsidies which distort the international division of labor must be reduced.

Through subsidies governments attempt to lower their producers' production costs so that an artificial price advantage arises. One conceivable response to this would be simply to tolerate national subsidies, since a subsidizing country does not employ its resources optimally, and thereby accepts a loss of welfare. One should not, however, be complacent about this. Subsidies by one country take market shares away from the corresponding sectors of other countries and lead to political demands for retaliation. Thus their effect resembles those of protectionist measures. Similar to trade rules, therefore, the existing subsidy code, of which the beginnings are in principle present in the world trade order, must be further developed in order to prevent subsidy competition between governments. According to the rules of the World Trade Organization, subsidies for export goods and import substitutes are forbidden and product- and industry-specific subsidies are inadmissible when they would harm the trade opportunities of other members. Even so it is difficult to demarcate subsidy practices from other admissible practices such as research assistance and aid in adapting to new environmental technologies. It is likewise difficult to punish and stop violations in the framework of monitoring processes. Furthermore, important sectors such as agriculture and the aviation industry are exempted. How difficult it is to monitor subsidies is shown by the European Union's aid supervision.

8. Border-crossing disembodied services should be treated like commodities. With embodied services national treatment can be employed to keep markets open.

In the case of services, a distinction should be made between "disembodied" and "embodied" services (Klodt, Stehn et al. 1994: 128). Disembodied services are not "embodied" in persons, for example, detail engineering using computer supported programs, the development of software and the adoption of accounting systems. For these services no difference from material goods can be found. Just as commodities are carried by the transport system, disembodied services cross national borders by means of communication media. As a con-

sequence, markets must be open for them just as they must be for commodities.

In the case of person-embodied services, non-discrimination can be guaranteed through national treatment. With person-embodied services two cases are to be systematically distinguished. For one thing, foreign enterprises may have a comparative advantage relative to domestic enterprises as a result of their organization, technical knowledge or other factors, without lower labor costs being the decisive factor. For example, a foreign insurance company may have a more favorable risk structure. In this case, national treatment opens up market access. Furthermore, with person-embodied services comparative advantages may be based on the factor of labor alone, in which case national treatment of foreign suppliers is especially controversial. But even in this case it accords with the basic concept of the international division of labor that market access must be free. It must permit suppliers from other countries to offer their services at the prices prevailing in the country-of-origin.

9. The rules for the international division of labor must aim more strongly at establishing free access to markets. They must therefore also include domains which go beyond trade policy, such as national regulations and national competition policy.

The trade order is essentially oriented to denying governments or integrated regions tariff and non-tariff instruments with which the governments could directly intervene in trade flows at their borders. Such instruments should be outlawed through a negative catalogue. However, this still does not guarantee that there will be free access to markets. If we want to ensure this, it will be necessary that:

- National regulations do not limit access for goods and firms.
- National competition policies are not oriented to the advantage of domestic enterprises.

- National competition policies or an international competition policy do not permit firms to build up or exploit monopolistic positions.

Structural barriers which limit effective access to markets should be dismantled. These barriers can include economic policy measures in the broadest sense, such as licensing procedures for economic activities, for facilities and products, technical standards, arrangements for the public contract system and interlocking ties between firms (as with Keiretsu in Japan) on the same or different levels of the vertical production structure, whereby outsiders are excluded (Ostry 1995).

10. In regard to national regulations the country-of-origin principle can maintain the openness of markets.

Recently the tendency has become apparent to link market access more strongly to agreement with the national regulations of the country-of-destination. Such conditions set up additional barriers to the international division of labor, for the country-of-destination principle contradicts the world trade rules which aim at non-discrimination and reducing market segmentation. The different regulations of national countries-of-origin should rather have equal standing competing with each other. A weakening of the country-of-origin principle and a strengthening of the country-of-destination principle will inevitably harm the multilateral order. The goal of the world trade order is therefore in principle to accept the regulations of the country-of-origin for product quality and production processes in order to minimize transaction costs. Only in precisely demarcated cases, for example, public health protection, should the country-of-destination and its standards take precedence over the norms of the country-of-origin. But even then the measures adopted should involve neither discrimination nor protection, and they must satisfy the commensurability of means standard.

11. A world-wide harmonization of social norms should be avoided.

Recently there have been increased calls to equalize social norms (on environmental norms see below), and this is supposed to be accomplished through trade policy measures. Countries which do not employ these standards are supposed to be denied access to markets elsewhere. Above all the developing countries would be negatively affected. For reasons such as lower labor productivity these countries are unable to pay the same wages that industrialized countries can, and for similar reasons neither can they be expected to adopt these countries' social norms. Also in this domain the country-of-destination principle cannot be practiced in the world trade order. What regulations are set for the production of goods should consequently be left to the discretion of the country-of-origin. Besides, trade policy is unsuitable as a means of harmonization.

12. In an international economic order, competition policy has the task of counteracting business practices intended to reduce the contestability of markets and preventing the exploitation of market power.

Markets must not be closed through the market power of firms. The globalization of world markets does make markets more competitive, and in this sense free trade is the best competition policy; all measures which reduce distortions and increase market access support competition policy. However, globalization also enables enterprises to orient their international policies with the aim to create monopolistic positions and to exploit them in structuring prices to the disadvantage of buyers.

In competition policy (Vosgerau 1995) an international institutional framework which could restrict the misuse of monopolistic market positions and discourage competition-limiting mergers is not presently foreseeable. Currently the international community does not appear close to an agreement on a right of complaint which parties injured by anti-competitive policies could employ before an international court or an international competition authority empowered to enforce competition rules (Scherer 1994). Thus at present we can only expect to

establish a few minimal competition policy rules for countries or regional integrations (such as the European Union), either in the framework of the World Trade Organization (Immenga 1995) or the OECD. We must also consider the option that initially only some of the rules would be agreed upon by the most important OCED countries, because there are fundamental differences in their legal systems, as between Anglo-Saxon and Continental European law. What will be necessary is to change the orientation of national competition policies. Restrictions on competition which domestic enterprises impose abroad will have to be taken into account so that a country harmed by another country's competition policy will have the right to obtain changes in the objectionable competition policy. An institutional consultation- and sanctioning mechanism must be created (Graham 1995). The details of how a framework for competition policy can be achieved is currently being intensively discussed in the literature. Under consideration are the effects doctrine with an international right to extra-territorial legal application (Immenga 1995, Klodt 1995), treaty agreements — including bilateral treaties between the USA and Europe — on the concession of mutual competencies (Ehlermann 1995), the harmonization of international competition law (hard law) on the basis of national legal system (Fikentscher and Immenga 1995) and the competition of institutional rules through mutual recognition, thus a Cassis-de-Dijon approach with an international interpretation (Nicolaidis 1994).

III. New in the Foreground: Rules for Factor Migrations

13. Besides the exchange of goods, factor migrations are a further important form of interdependency between economies. Countries compete for mobile technical knowledge and mobile capital. If an economy succeeds in attracting mobile production factors or in keeping them from leaving the country, the real income for the immobile production factors increases, especially for labor. Factor migrations are interlinked with the exchange of goods in complex ways. In the case of technology and non-financial capital, factor migrations can occur

through trade in goods or they even themselves represent trade in goods, as with the purchase or sale of user rights, for example, patents. They can, in a comparative-static sense, take the place of movements of goods and thus serve as a substitute to commodity flows, but in a dynamic perspective they can, in the sense of acquired comparative advantage, also decisively influence future comparative advantages and thereby be forerunners for future exchanges of goods.

14. An institutional arrangement for technical knowledge must be found which, by respecting property rights, would offer sufficient incentives for individual economies to search for new knowledge, but simultaneously would not in the long term block possible diffusion of new knowledge throughout the world.

With technology rules a problem must be solved which is similar to that of structuring a national patent system. On the one hand, user rights to new technical knowledge must be secure, since otherwise there will be insufficient incentives to search for and adopt new technical knowledge. This means that property rights to new knowledge must be respected throughout the world. On the other hand, this property protection must not create permanently exclusive positions and make markets uncompetitive. Rather, the diffusion of new knowledge must be possible after a certain passage of time; accordingly time limits should be set on the protective effect of user rights. The optimal duration of protective rights depends among other things on product life cycles and the time frame of research and development phases; this can differ greatly from product to product. Since countries may have an interest in protecting their firms' technological knowledge for as long as possible (although this reduces the incentives for their own technological dynamics), the solution cannot consist simply in mutually recognizing national patent laws. Rather, it may be desirable to set time limits on the validity of national patents.

National technology policy should be dealt with in the same way as national subsidies. The chances of a strategic technology policy succeeding when it is

sector-specifically limited to certain industries are slight (Klodt 1995). If we pursue this viewpoint, we can be sure that the problem will be solved in the self-interest of individual countries. Nevertheless the problem arises of how sector-specific interests can be controlled. Thus the international subsidy code must set limits for industry-specific research subsidies. In contrast, there is no need in institutional regulations concerning the improvement of the general conditions for research and development, for example, when countries generally improve the tax framework conditions for research and development, innovation, investment and entrepreneurial activity, as well as organize basic research and further technology transfer so that they can be internationally competitive.

15. In the case of non-financial capital it is sufficient to give the production factor capital the exit option and to leave capital mobility to the locational competition of governments.

We can surely start by assuming that it is in the best interest of each country to keep capital at home and attract more capital from outside. Each country should structure its institutional framework accordingly, thus provide for the security of property rights, avoid uncertainty about corporate taxes, develop a tax system and general economic framework conditions which make the country attractive as a location and prepare an efficient infrastructure. Although bilateral agreements can make the direct investments of the sending country more secure for its companies, and multilateral agreements may make potential recipient countries appear less risky for direct investments, in the end it is the host country's responsibility to enhance its own attractiveness.

Capital mobility limits national governments' freedom of action and changes the opportunity costs of economic-policy decisions. This holds not only for the case when capital should be attracted, but also when its emigration should be prevented. Each economic-policy consideration, even those about taxes, the creation of infrastructure and regulations must be submitted to cost-benefit comparison. On balance economic welfare should be increased. The costs of

choices -- these are always opportunity costs, i.e. the costs of missed opportunities -- are more serious if capital can choose between various locations.

An important condition for an efficient international division of labor is therefore that capital should not be prevented from seeking better opportunities for employment abroad. Otherwise countries would force their savers to invest solely at home. The allocation of savings would then be inefficient. An explicit exit right for capital is thereby a decisive element of the international division of labor.

The fear that locational competition will degenerate as a result of capital mobility is unfounded (Siebert 1996a). Despite high taxation rates, non-financial capital will not migrate if the immobile labor supply possesses suitable qualifications, if human capital is thus well developed and if infrastructure capital is adequate. Capital taxation can thus be compensated for within limits through the quality of public production factors, if these are financed in the sense of the equivalency principle (of benefit taxation) from taxes or user prices. Rising marginal costs of production with lower human capital and poorer infrastructure ensure that locational competition for mobile capital finds a self-imposed lower limit. The better its provision of human- and infrastructure capital, the less a country needs to fear locational competition.

16. In all countries citizens should be guaranteed an exit option as a civil liberty. The openness of goods markets and the mobility of capital reduce the necessity of migration.

The right of individuals to leave a country, thus the exit option, can be interpreted as an important element of a liberal order. The individual should have the opportunity to choose to leave given life conditions which he or she finds unacceptable. A credible right to exit which is respected by the government of the potential country-of-emigration is as a rule a limit on the actions of that gov-

ernment and should through this implicit control of governmental actions reduce the incentive for individuals to emigrate.

The exit option does not, however, imply the right to immigrate into any given country. States define their identity by setting their immigration policy (Hiltman 1994). This creates difficult ethical questions which can be resolved if potential countries of immigration — beyond the duty to accept the politically persecuted — are sufficiently open and if regional integrations such as the European Union, although only spatially limited from an international economic perspective, guarantee freedom of movement within their territory. For many reasons labor migration should be replaced by the movement of goods and capital mobility. If a country finds open markets for its goods elsewhere and attracts capital, its citizens do not need to emigrate. The strengthening of an international economic order for the international exchange of goods and the openness of markets reduces the necessity of migration.

IV. An Old Acquaintance: Rules for the Monetary Domain

17. Monetary transaction costs must not burden the international division of labor. The international division of labor presupposes currency convertibility.

It is considerably harder to profit from the international division of labor if currency convertibility is limited by different countries' political decisions. This includes restricting the convertibility of currency for foreigners or citizens, setting different exchange rates for different transaction purposes, for example, for goods considered more or less important or for movements of goods and capital, granting privileged access to better exchange rates, as in a system of import licenses, and exchange rate protectionism. This has negative consequences for the exchange of goods and the efficient allocation of capital.

Therefore as a rule the need for currency convertibility is accepted today.¹ Especially after the experiences of the thirties countries made efforts during the period of reconstruction following the Second World War to ensure convertibility and liberalize capital movements. In recent years the pendulum has threatened to swing in the opposite direction because of the volatility of nominal exchange rates.

18. Stable exchange rates are only possible if all countries voluntarily obligate themselves to a stable, credible currency system, or if they assign high policy priority to the stability of their own money.

Exchange rate volatility leads time and again to demands for greater stability in the international currency system. It is incontestable that nominal exchange rates are greatly influenced by financial flows, that they can overshoot leading to distorted trade flows. There can also be speculative bubbles. But it should be remembered that trade flows depend not on nominal but on real exchange rates, and that too often — if not always — the triggers for exchange rate volatility are political ones reflecting economic policy, above all stabilization policy, monetary and also real economic changes. Exchange rate movements thus represent a barometer of fundamental disturbances.

Economic policy recommendations for limiting the volatility of exchange rates should be regarded skeptically:

- It will not prove possible to set up reference zones for exchange rates (Williamson 1983), if the conditions for stability are not fulfilled.
- The idea of a return to a system analogous to that of Bretton Woods ignores the fact that financial markets are now globalized.

¹ On the question of how to arrange a transition to convertibility over time cf. Quirk (1994).

- Throwing sand into the gears of international financial markets (Tobin-tax; Tobin 1978) works against the aim of reducing transaction costs.

A solution could be for countries to submit to a system which would guarantee stability. Historically the gold standard was such a system. Countries refrained from employing a national stabilization policy. They accepted fluctuations in output and employment in order to maintain exchange rate stability. Such an approach is not internationally practical today: For one thing, no anchor is visible on the horizon; gold can hardly serve as such an anchor. For another, a readiness to submit to an international rule system is lacking.

Small countries can solve the problem of excessive volatility in their exchange rates with an exchange rate oriented monetary policy (the Netherlands, Austria) or a currency board (Argentina, Estonia). They attach themselves to a country with a stable price level. This has often succeeded in the short-term, but in the mid-term it entails great pressure toward monetary, fiscal and wage policy adaptation to the situation in the anchor country. For large countries this solution is as a rule politically unacceptable. In addition, a larger country must be the stability leader. Under these conditions a solution can only consist in each individual country keeping its own house in order and maintaining stable domestic price levels. Then exchange rates will generally remain stable.

V. Tasks for the Future: Rules for the Use of the Environment

19. Insofar as the environment is a national endowment factor, prices can bring the different environmental scarcities of countries to expression. The environment is then fundamentally not the object of an international rule system.

Countries are not only interdependent in terms of goods, production factors and monetary transactions; they also influence each other through the use of nature and the environment as receptacles for wastes and emissions. However, a dis-

inction should be made between whether national usage rights are definable for nature and the environment or whether global or border-crossing environmental goods are at stake.

Similar to the way countries are differently endowed with natural raw materials, there are also territorial differences in the capacity of nature for use in waste disposal. The absorptive and regenerative capacities of regional environments vary. Heavy population density makes it more difficult to spatially separate residential and recreational areas from environmentally-degrading transport and production activities. The preferences of countries for environmental quality can differ as well. If the environment is an immobile resource factor, the prices for environmental services — as a receptacle of wastes — must also differ between countries. Different environmental scarcities will thus be signaled by different prices. A market economy approach to environmental policy which taxes hazardous wastes or establishes prices for environmental services through licensing is consistent with an institutional framework for the international division of labor.

20: If environmental policy employs a regulatory approach to national environments, the non-discrimination and country-of-origin principles should apply.

The measures employed by countries to protect their citizens' health and life and to conserve natural resources (Article XX of the GATT Treaty) must be non-discriminatory. Non-discrimination requires that in the case of market entry restrictions, regulations through production permits, facility permits and product norms must not give preference to domestic producers and domestic goods. Thus it should not be permissible, for example, with the aim of reducing health hazards, as in the Thailand cigarette case (1990), to restrict the import of goods or to tax them unless the same measures are simultaneously taken against similar domestic goods. The similarity of the goods plays a crucial role in non-discrimination. Similarity of products should be defined from the demand side, for example, in terms of possible harmful effects, and not from the production

side. As in the Mexican-American tuna fish case (1991), the principle of similarity should not be applied to the production methods (in the tuna fish case methods of fishing which do not sufficiently protect dolphins). This means that the country-of-origin principle should apply. Non-discrimination should also satisfy the condition that means should accord with the proportionality principle. Measures must accordingly be necessary in the sense that otherwise environmental policy aims or the protection of natural resources could not be achieved. As a rule, these aims are, however, better achieved through specific environmental policy measures rather than through trade policy, which cannot influence the share of production which remains in the producer's domestic market.

21. Trade policy must not be employed to force national preferences on other countries. Any country's environmental policy should not apply to external effects outside its own territorial area.

Since countries have different amounts of environmental resources and also different environmental preferences, those with stronger environmental preferences should not be entitled to impose their environmental preferences on other countries by means of trade-restricting measures (Siebert 1996b). The thesis that the country-of-origin principle should be fundamentally recognized for national environments is generalizable. If harmful effects appear outside a country's territorial area, countries should not have the right to use trade policy to influence the production methods of a country-of-origin. Also, the protective clauses for health, life and exhaustible resources found in Article XX should in the case of national environmental goods be applied only within a country's own territorial area. Countries should thus not have the right to employ unilateral measures to protect the environment in other countries.

22. In the case of global environmental goods a multilateral regime should be developed.

Global environmental goods² are public goods with a world wide spatial dimension. In what amounts and with what quality these public goods should be produced requires the agreement of all countries. What must be decided on is not just the extent to which emissions should be reduced, but rather also the proper distribution of costs among individual countries. It is difficult to reach international consensus, because countries have different preferences and because they have different per capita incomes. In addition, the cost functions for disposal differ from country to country. To what extent a stable international environmental framework with voluntary commitments by states can be created under these conditions using compensatory payments is a complex issue and has been the subject of numerous studies (Stähler 1996).

23. The international environmental order and the international trade order must have consistent aims. The rules of both orders must, however, not be contingent upon each other. The set of instruments of both orders must be kept separate.

Environmental policy aims at protecting the natural conditions for life. An institutional order for the international division of labor should make it possible to increase the prosperity of all countries through exchange. Since environmental policy and international trade intersect at many points, the regulations in both frameworks should not conflict. The aims are not in principle contradictory, since affluence must be defined by taking the natural conditions for life into account. If we accept the principle that the valuation of the goods on which affluence is based, as well as the valuation of environmental quality, must depend on the formation of national will, a contradiction between both regimes can be avoided.

In the past international arrangements for environmental questions and the world trade order were developed separately and independently. In the future it

² On transfrontier environmental systems see Siebert (1995: Chapter 12).

will be important to pay more attention in the case of environmental agreements to the consistency of both orders. The more successfully the environment as a scarce good is integrated into the economic orders of individual countries and the more affluence is defined by taking into account nature and the environment, the sooner congruence of targets will be achieved between both orders. Compared to the administrative approach using regulations, market economy approaches to environmental policy provide more congruence between both sets of rules. The sooner the polluter-pays principle is accepted as a guideline by all countries not only for national, but also for global environmental goods, the easier it will be to achieve consistency of the two orders in the case of global environmental concerns.³

Beyond efforts toward congruence of targets, the following orientational points could minimize aim conflicts:

- The rules in the world environmental order and the world trade order should not be mutually conditional. This would cause considerable uncertainty not only in the international division of labor, but also in the production of environmental goods.
- Judging from past experience it appears ill-advised to create a temporary waiver for environmental issues as an exception to the world trade order. One reason is that the previously created exemptions for the agricultural and textile sectors have become resistant to change and have led to a permanent infringement of the most-favored-nation principle. If an exceptional regulation is questionable even in the case of internationally declining sectors, then a similar procedure appears still less desirable for an area that will be increasingly important in the future.

³ We could also consider a minimal solution which would define deviation in terms of the current state. Since, however, the costs of maintaining a given state of the environment differ from country to country, acceptance is doubtful. Cf. the discussion on the victim-pays principle for cases of border-crossing environmental problems (Siebert 1995).

- Non-discrimination and the priority of the country-of-origin principle over the country-of-destination principle can divide the instrumental level between both sets of rules.
- Trade policy instruments should not be employed for environmental policy purposes. Countries should not have the right to apply their environmental policy conceptions outside their own territory.
- The mediation of disputes by the World Trade Organization should be extended to include the environmental domain.
- In the case of global environmental goods the bottom line is that the polluter-pays principle should define national responsibility for deviations from the present situation.

VI. On the Stability and Interdependence of the Orders

24. The world economic order must be stable. This presupposes that countries gain advantages from it. The benefits for individual countries should increase over the course of time in a growing world economy.

An essential condition for the creation and permanence of an international economic order is that the institutional framework should be acceptable to all countries, thus that all countries can expect to profit from it. The transition from non-cooperative to cooperative behavior must create benefits for all countries. Furthermore, when the rules are expanded the advantages of membership must be greater for each country than the advantages of non-membership. For the stability of institutional arrangements it is crucial that the individual country's cost-benefit calculations should not shift asymmetrically and that the net advantage for each country should increase and in no case worsen. If this condition is not fulfilled, there will be an incentive not to honor the treaty, but instead to withdraw from it.

25. The interdependence of the suborders should be taken into consideration in the development of the overall rule system. In applying the rules, to the contrary, interdependence should play no role.

Inevitably the suborders are interdependent, in Eucken's sense (cf. 1992). Three aspects are relevant. First: A suborder can give one country relatively more advantages, while another suborder may be advantageous for another country. A greater advantage from a suborder can compensate for the lesser advantage of another suborder if the orders are in principle accepted. This aspect is significant for the acceptance of new suborders. However, this "offsetting" between the advantages of suborders should not be carried too far. If in the course of time the advantages of countries shift asymmetrically in the individual suborders, a fragile structure of acceptance could collapse like a house of cards. To avoid domino effects, it makes sense that the suborders should basically legitimate themselves on their own and not be conditionally accepted. Second: Suborders must be mutually consistent. One suborder must not lead to behavior on the part of economic subjects which contradicts and undermines some other suborder. As a consequence, suborders must agree on aims. An important example of this consistency is the world trade order and the world environmental order. Third: One suborder should not in practice depend on another order. The validity of one suborder should thus not depend on the functioning of some other order. This means that the instrumental level should be clearly separated. Economic policy instruments should be limited to specific suborders. Trade policy instruments should not be employed for environmental policy purposes; the instrumental level should thus be modularly subdivided and demarcated.

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