THE FAIR TRADE-FREE TRADE DEBATE: TRADE, LABOUR AND THE ENVIRONMENT

Michael J. Trebilcock*

The emerging international trade policy agenda is now focusing increasingly on what Dr. Sylvia Ostry has called "issues beyond the border".[1] With the dramatic decline in tariffs over the last four decades as a result of multilateral negotiations under the *General Agreement on Tariffs and Trade*[2] and regional trade agreements like the *Canada-United States Free Trade Agreement*[3] and the *North American Free Trade Agreement*,[4] remaining sources of distortion in international trade are often claimed to be divergent domestic laws and policies that may constitute colourable forms of discrimination against foreign producers or at any rate may increase transaction and compliance costs, thereby inhibiting the full realization of economies of scale and scope in production and reducing the gains from international trade and foreign investment. Concerns over the economic effects of regulatory divergence have largely motivated harmonization efforts in the European Union, beginning with the *Single European Act 1986*[5] and culminating in the Europe 1992 agenda. In the recently concluded Uruguay Round of *GATT* negotiations and under *NAFTA*, significant attention has been paid to: international trade in services and domestic regulatory impediments thereto; harmonization of domestic intellectual property laws; removal of domestic impediments to foreign investment; harmonization of product standards; and reduction of domestic preferences in government procurement regimes. In future multilateral and regional trade negotiations, attention is likely to be increasingly focused on regulatory divergences in environmental policies, labour standards, and competition policy. My lecture focuses principally on the implications for international trade policy of regulatory divergences in environmental and labour policies.

---

*Of the Faculty of Law, University of Toronto; director of the Law and Economics Programme. Synopsis of the Viscount Bennett Memorial Lecture, delivered at the Faculty of Law, University of New Brunswick (Fredericton) 3 November 1994. This synopsis is based on a longer paper in progress co-authored by myself and Professor Robert Howse of the Faculty of Law, University of Toronto.

[1] S. Ostry, "Beyond the Border: The New International Policy Arena", in Kantzenbach, Scharrer & Waverman, eds., *Competition Policy in an Interdependent World* (Baden-Baden: Nosmos Verlagsgesellschaft, 1993) 261.

[2] 30 October 1947, Can. T.S. 1947 No. 27, 55 U.N.T.S. 187, T.I.A.S. No. 1700 [hereinafter *GATT*].

[3] 22 December 1987, Can. T.S. 1989 No. 3, 27 I.L.M. 281. (Part A, Schedule to the *Canada-United States Free Trade Agreement Implementation Act*, S.C. 1988, c. 65).

[4] *North American Free Trade Agreement Implementation Act*, S.C. 1993, c. 44 [hereinafter *NAFTA*].

[5] EC, *Single European Act*, O.J. Legislation (1987) No L169.

While free traders have often been major proponents of harmonization efforts in many of the areas noted above, they commonly (and not obviously consistently) take the view that to condition a liberal international trading order on the adherence by states to minimum environmental and labour standards is either disguised protectionism, entailing an attack on the growth prospects of many less developed countries, or well-intentioned but economically illiterate intrusion by busybodies in the domestic affairs and political sovereignty of other countries. Some free traders see current fair trade claims as the most serious challenge to a liberal international trading order since the Great Depression. Fair traders, on the other hand, see free traders, with their near absolute commitment to an unconstrained liberal international trading order, as moral Philistines. The furore provoked by recent *GATT* panel decisions in the Tuna-Dolphin cases ruling *GATT*-illegal a U.S. ban on tuna imports from countries in the Eastern Pacific that had failed to adopt similar regulatory policies to the U.S. to minimize destruction of dolphin widely reflect this view.[6] Herds of dolphin often swim above schools of tuna, and fishermen have in the past adopted the practice of setting their purse seine nets for tuna on the dolphin, killing or injuring many in the process. The *GATT* panels held that the U.S. ban was an impermissible attempt to induce other countries (especially Mexico) to change their domestic regulatory policies where the sanctioning country's own domestic environment was not threatened, violating Article XI of the *GATT* (which prohibits most quantitative restrictions on imports) and did not fall within the exceptions in Article XX(b) and (g) exempting measures necessary to protect human, animal and plant life or health, or measures relating to the conservation of exhaustible natural resources.[7]

I will argue that there is a germ of truth in both these polar positions in the fair trade-free trade debate, but that progress towards a coherent middle ground is only possible by rigorous disaggregation and analysis of what are in fact widely disparate fair trade claims. In particular, I will argue that in debates to date there has been a singular failure to distinguish between: (a) trade sanctions or restrictions designed to attain specific non-trade goals or to vindicate specific non-trade values; and (b) trade sanctions or restrictions aimed at levelling the competitive playing field by neutralizing differences in regulatory compliance costs.

---

[6] *U.S. Restrictions on Imports of Tuna* (1991), 30 I.L.M. 1594 (Tuna/Dolphin I); *U.S. Restrictions on Imports of Tuna* (June 1994) DS 29/R (Tuna/Dolphin II).

[7] See generally, D. Esty, *Greening the GATT* (Washington, D.C.: Institute for International Economics, 1994); S. Walker, *Environmental Protection Versus Trade Liberalization: Finding the Balance* (Brussels: Facultés Universitaires Saint Louis, 1994).

I. Non-Trade Related Goals of Environmental and Labour Sanctions

In a range of contexts, citizens or governments in one country may be legitimately concerned with domestic policies or practices adopted in another. These cases include:

(a) Physical externalities where one country which shares a common air or water body with another country or countries permits trans-boundary pollution;

(b) The global environmental commons such as physical or biological systems that lie wholly or largely outside the jurisdiction of individual states but are valued resources for many members of society – as examples, the high seas, the electro-magnetic spectrum, the stratospheric ozone layer, the global climate system, and endangered species;

(c) Shared natural resources that extend into or across the jurisdictions of two or more states, such as oil reserves or stocks of fish;

(d) Universal human rights that are viewed as belonging to individuals regardless of their national affiliation, simply by virtue of their being human. Certain labour rights or standards have come to be widely regarded as basic human rights of a universal character, such as the right to collective bargaining and freedom of association; the right not to be enslaved; the abolition of child labour; and equality of opportunity in employment for men and women;

(e) International, political and economic spillovers, where extreme forms of human rights abuses and some labour practices such as violent suppression of workers' rights to organize or associate (for instance the attempts to suppress the Solidarity movement in Poland) may lead to acute social conflict which gives rise to general political and economic instability that spills over national boundaries; and

(f) Altruistic or paternalistic concerns where citizens of one country may find purely domestic environmental or labour practices or policies of another country to be misguided or morally wrong, in that the welfare or rights of citizens in the second country are not felt to be adequately reflected in the domestic policies adopted in the second country because of unrepresentative, repressive, corrupt or incompetent forms of government.

In evaluating whether trade sanctions or restrictions may be an appropriate instrument for seeking to change objectionable domestic policies in another country, a number of issues seem relevant. First, one may wish to inquire, within a relatively conventional welfare economics framework, what the welfare

implications of such policies are likely to be. In many cases, a demonstration of substantial negative welfare effects from the invocation of trade sanctions, even in the service of non-trade related objectives, may count against recognition of such an option. Where such measures succeed in altering the targeted country's policies, welfare may or may not be enhanced in the targeted country, depending on whether the policies previously pursued were socially optimal from that country's perspective. As noted above, in a range of contexts there may be reasons for scepticism in assuming that existing domestic policies are always socially optimal. From a global welfare perspective, welfare may be enhanced if trade sanctions or restrictions compel the internalization of physical externalities, or promote political liberalization more generally by reducing human rights abuses or violent suppression of trade unions and perhaps as a result minimizing the regional or global spillovers from civil conflict or instability. In the sanction-imposing country, trade sanctions or restrictions are likely to cost consumers more as prices of imports increase and domestic producers price up to the higher import prices. Similarly, domestic producers may benefit if they have the lowest costs of any country complying with the desired standards. However, in many cases these price increases are likely to be small if some producers in the targeted country or producers in other foreign countries are able to meet the desired standards without significant increases in costs. Where sanctions fail to induce the adoption of higher standards in the targeted country, global welfare may still be enhanced if trade sanctions result in a reduction in the scale of the offending activities. Thus, without a detailed empirical analysis of the likely welfare effect of trade sanctions or restrictions adopted to promote these various non-trade related values or goals, it is impossible to make strong *a priori* claims about the scale of the welfare effects.

A second major issue to be considered in evaluating the appropriateness of the choice of trade sanctions or restrictions designed to induce changes in other countries' domestic environmental or labour policies or practices is the likelihood of such sanctions in fact being successful. Here, it is important to adopt a comparative instrumental perspective by evaluating this response relative to other potential responses. These responses might range from doing nothing, registering diplomatic protests, severing diplomatic relations, promoting consumer labelling or boycotts, adopting a broader set of economic sanctions than trade restrictions alone (such as a total economic embargo), to the extreme of military intervention. In the most comprehensive empirical study of the efficacy of the economic sanctions (not involving labour or environmental issues) undertaken to date, Hufbauer, Schott and Elliott find that in 34% of 115 actions taken over a period of about 40 years the sanctions were largely successful in inducing the countries

targeted by them to change or modify domestic policies or practices.[8] While this may be viewed as a discouraging success rate, one needs to ask whether a systematic policy of appeasement, acquiescence, or accommodation is always more appropriate, even in the face of grotesque human rights abuses in another country, or indeed whether a systematic policy of military intervention is likely to be more successful, given the mixed record of such interventions in countries such as Lebanon, Somalia, Bosnia, Rwanda, Haiti and Vietnam.

A third major issue relates to the potential for corruptibility of such sanctions. Some free traders may concede that, in principle, trade restrictions or sanctions or broader economic sanctions may be justified, in some contexts, as a response to domestic environmental, labour, or human rights policies or practices pursued by other countries, but would nevertheless argue that as a matter of practical politics, the availability of trade policy instruments for these purposes is likely to pose significant risks of subversion in countries imposing such sanctions, by protectionist interests disguising their real motivation in ethical or related rationalizations. I believe that this concern is a legitimate one, and underscores the importance of distinguishing unilateral from multilateral actions in these contexts, given that international regimes are much less vulnerable to protectionist capture than purely domestic trade policy regimes. In making this distinction, some cases are easier than others.

First, some international treaties explicitly contemplate trade sanctions as the principal mechanism of enforcement. These treaties include the *Convention on International Trade in Endangered Species*,[9] the *Basel Convention on the Control of Hazardous Wastes*,[10] and the *Nuclear Non-Proliferation Treaty*.[11] Second, various international environmental or labour agreements (such as the ILO Conventions), while not providing explicitly for trade sanctions as a mechanism of enforcement, do provide for their own independent dispute resolution mechanisms to ensure objective determinations of violations. In reviewing challenges to trade sanctions invoked in response to alleged violations of these agreements, *GATT* dispute resolution panels might properly seek advisory opinions from these specialized dispute resolution mechanisms. Third, other international legal agreements or widely accepted international legal norms neither provide for trade sanctions as a mechanism of enforcement nor provide for specialized independent

---

[8]G. Hufbauer, J. Schott & K. Elliott, *Economic Sanctions Reconsidered: History and Current Policy*, 2d ed. (Washington, D.C.: Institute for International Economics, 1990); see also M. Miyagawa, *Do Economic Sanctions Work?* (New York: St. Martins, 1992).

[9]*Convention on International Trade in Endangered Species of Wild Flora and Fauna*, 3 March 1973, 12 I.L.M. 1085.

[10]*Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal*, 22 March 1989, 28 I.L.M. 656.

[11]729 U.N.T.S. 161.

dispute settlement bodies. In cases such as this, where trade sanctions have been invoked with a view to inducing other countries to change domestic policies that are alleged to be at variance with these international norms, and where these trade sanctions have been challenged before a *GATT* dispute resolution panel under Article XXIII of the *GATT* (or under similar procedures in regional trade agreements), it would seem imperative that panels apply a least trade restrictive means test. This would require the sanctioning country to demonstrate that no means less restrictive of trade was available to it, including attempts to negotiate a cooperative resolution to achieve compliance with these international legal norms. Fourth, where the standards or norms in question are sought to be unilaterally determined and enforced by the sanctioning country in the absence of any widely agreed international legal norms, in most cases *GATT* Panels might properly apply a very strong presumption that such sanctions are violations of a *GATT* member's obligations.

II. Competitiveness-Based Arguments for Environmental or Labour Rights Related Trade Measures

Many fair trade claims view the effects of other countries' environmental and labour policies on the welfare of domestic producers and workers as the principal concern, rather than the nature of the policies *per se*. These claims allege a form of *unfair competition* (unlike the first class of fair trade claim reviewed above). In these cases, domestic producer interests will be completely indifferent between inducing other countries to improve their standards (and raise their costs), and adopting protective trade measures to retain comparative advantage by neutralizing differences in regulatory compliance costs. In other words, these two outcomes are seen as perfect substitutes for one another. These claims, if accepted, have the potential to massively destabilize the international trading system, given that comparative advantage is pervasively influenced by different domestic policies in different states which, directly or indirectly, benefit or burden producer interests in different ways. Only complete global harmonization of most domestic policies could ever meet this objection – an inconceivable and highly undesirable prospect – rendering trade protectionism the default option in a wide range of cases.

Fair trade claims of this kind take two principal forms. First, it is said that it is unfair that our own firms and workers should have to bear the costs of higher domestic environmental and labour standards through loss of market share to other countries with less stringent standards. Second, it is said that it is unfair that downward pressure should be placed on our own environmental and labour standards by virtue of competition with countries of lower standards, thus setting in motion a "race to the bottom" dynamic. Applying the conventional prisoner's dilemma framework, all countries may end up with the same share of international trade as they began with, but at the cost of adopting socially sub-optimal environmental and labour policies in the process of this destructive competition.

With respect to the first of these two fairness claims, the welfare effects are likely to be quite dramatic. Since every foreign producer whose environmental or labour rights compliance costs are less than those of domestic producers will be vulnerable to trade action, trade restrictions based on equalization of comparative advantage are likely to affect imports – potentially very seriously – from a wide range of countries, with corresponding negative price effects on consumers in the sanctioning country. However, it is not obvious that countries with higher standards need to relax these standards in order to remain competitive. In many cases, domestic policies designed to promote more efficient forms of regulation (incentive-based forms of environmental regulation rather than command-and-control forms of regulation), or policies designed to enhance the productivity of labour through job training or re-training initiatives may preserve the productivity differentials that explain prevailing patterns of comparative advantage. Moreover, as a matter of distributive justice, the case for shifting the costs of our more stringent standards onto workers in other, often poorer, countries, who do not even benefit from these standards, seems indefensible, especially where this reflects the failure of the sanctioning country to adopt superior domestic policy instruments to address environmental or adjustment issues.

With respect to the second competitive fairness claim (the "race to the bottom" claim), it is not clear that to preserve comparative advantage we will often need to relax our more stringent standards. In fact such differences in standards among countries have prevailed for decades, in many cases without undermining our comparative advantage. Even in cases where comparative advantage is increasingly threatened by divergences in regulatory standards, the appropriate solution to the prisoner's dilemma problem is a cooperative rather than a non-cooperative one, with agreed constraints on selective regulatory competition, such as the prohibition under *NAFTA* of selective non-enforcement of domestic environmental and labour standards (the *NAFTA* Environment and Labour Side Agreements) or the selective relaxation of standards in order to attract or retain investment (Article 1114). However, it needs to be acknowledged that in promoting international cooperative solutions to these issues there is room for careful game theoretic research on the respective roles of "carrots" and "sticks" (including trade sanctions) in inducing agreement.

I have sought to emphasize the importance of disaggregating the various kinds of unfair trade claims if rigorous evaluation of their normative salience is to be undertaken. Once we have clarified what should count as a good or bad fair trade claim as a matter of principle, the positive challenge must then be confronted of designing institutional arrangements that can screen appropriately these two classes of claims. This enterprise will require minimizing to the greatest extent possible the scope for unilateral assertions of fair trade claims and maximizing to the greatest extent possible the role of international treaties, agreements and norms as the basis of such claims. Free traders, by indiscriminately dismissing all fair

trade claims and eliding the two major classes of such claims reviewed above, indeed run the risk of being discredited as moral Philistines with respect to non-trade related fairness values and thus being marginalized in political debates, a prospect which entails serious risks for a liberal international trading order if credence is given to proponents of competitiveness-based fair trade claims.