

The Balance of Trade

Proposals for Reforming International Trade

Policy Paper 12



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Summary

Liberal Democrats aim to build a world in which all peoples share the same basic rights, in which they live together in peace and in which their different cultures will be able to develop freely. The freedom of individuals and companies to trade is important in achieving these aims. Trade has positive effects beyond the benefits of the exchange to the parties concerned, allowing economies to utilise resources efficiently, fostering the spread of knowledge and technology, promoting dynamic economies and workforces and furthering the development of international cooperation and effective global institutions. Liberal Democrats therefore argue for the removal of barriers to trade. But we recognise that this freedom to trade cannot be absolute. Where other freedoms and values - such as environmental sustainability, labour standards or the position of poorer countries - are at stake, market forces must be guided and regulated.

International trade should be based on a clear framework of rules deriving from the principles of multilateral cooperation and non-discrimination, promoting both open markets and a trading practice that respects universal human rights and environmental sustainability. The General Agreement on Tariffs and Trade provides the necessary basis for this system, but is in need of significant reform.

We urge the rapid implementation of the Uruguay Round agreements together with further action on trade liberalisation. A framework for global competition policy needs to be developed: national jurisdictions should uphold international standards, national competition agencies should work more closely together, and the disciplines of competition law should be introduced into the World Trade Organisation (WTO). Codes of conduct for *transnational corporations* should be developed jointly by international institutions, national governments and industry. The Uruguay Round agreement on *intellectual property rights* should be modified to ensure that it becomes of greater value to poorer countries.

Despite continuing poverty and hardship in the developing world, the developed countries maintain systematic trade barriers against their goods. The removal of these barriers will benefit all countries, as long as action is also taken to tackle the structural disadvantages suffered by the poorest. EU *preferential trading agreements* should be rationalised so that exports from the least developed countries face lower or zero tariffs, with no rules of origin or quota restrictions. The industrialised countries should move faster to reduce *agricultural price and production support*, and the phase-out of the protectionist *Multi-Fibre Arrangement* should be accelerated for imports from the least developed countries. Trade, aid and debt policies need to act together to promote development. The practice of *tying aid* to purchases from the donor country (in which the UK is a major offender) reduces the value of aid and should be ended. The *Aid and Trade Provision* should similarly

be scrapped. Aid should expand investment opportunities in developing countries and improve export and marketing skills.

We support and encourage the work of the International Labour Organisation in raising *global labour standards*. *The current GATT clause permitting discrimination against products produced with prison labour should be extended to cover forced labour*. We oppose, however, any further extension to labour conditions in general, as this would undercut the comparative advantage most developing countries enjoy from cheap labour. Increased wealth resulting from trade liberalisation should enable standards to be raised, a process which should be encouraged by the ILO's voluntary approach and by promoting trading and investment links with companies with high standards. Richer countries should cooperate with developing countries in helping them enforce labour standards which they have themselves set.

Trade impacts both positively and negatively on the environment. It helps to ensure that resources are used efficiently and encourages the spread of environmental technology; but a failure to internalise the environmental costs of economic activity means that trade magnifies unsustainable behaviour, accentuating global problems of pollution and resource depletion. *A 'sustainability clause' should be added to the GATT, setting out agreed principles of environmental policy against which trade measures can be judged and an appropriate balance struck*; a presumption of compatibility with international environmental treaties should be created. The GATT clause permitting countries to discriminate against environmentally harmful products should be extended to permit trade measures against products produced by *processes* which cause significant transboundary or global pollution. The compatibility of GATT with international agreements on *animal welfare* should be firmly established.

The WTO itself is in need of reform. It should forge closer links with global institutions, and disputes panels should cease to operate the GATT legal code in isolation of other sources of international law. Institutional transparency should be increased, public perspectives should be adequately represented, and the post of Advocate General created to represent the public interest in trade matters.

The implementation of our proposals for reform will be more effective in a world of strong and vigorous *international institutions*. We advocate a strengthening of the United Nations system, a review of the structure and operations of the IMF and the World Bank, and the creation of a powerful Global Environmental Organisation. *Fifty years after many of these bodies were first created, it is time for another Bretton Woods conference, a comprehensive review and reform of the structure and operations of global institutions, to help achieve the aims of prosperity, sustainability and interdependence which the development of the system of international trade offers the twenty-first century*.

The Liberal Democrat Approach

1.0.1 The rapid expansion of international trade and the globalisation of economic activity have been important characteristics of the postwar world. Merchandise trade (primary commodities and manufactured products) has grown thirteen-fold since 1950, to a total value of over four trillion dollars. 25 years ago one eighth of world product was traded; now the proportion is a fifth.

1.0.2 One of the principal reasons for this expansion has been the reductions in tariffs coordinated through the General Agreement on Tariffs and Trade (GATT). Industrialised countries' tariffs on manufactured goods have fallen from about 50% in 1948 to an average of 6.5% in 1994, and are set to fall to an average of 3.7% under the latest agreements. First adopted in 1947, GATT has been augmented through successive rounds of international negotiation, of which the Uruguay Round completed in 1994 was the eighth. More ambitious and longer drawn out than its predecessors, the conclusion of the Round signalled the transformation of the GATT as an institution into a permanent rules-based body, the World Trade Organisation (WTO), which came into being on 1 January 1995.

1.0.3 The original GATT agreement in fact formed only a part of a far more ambitious plan for an International Trade Organisation (ITO). Brainchild of the Liberal John Maynard Keynes, the ITO was to form the third leg of the tripod of global economic institutions created at the 1944 Bretton Woods conference to guide and encourage postwar economic reconstruction. Yet only the first two - the International Monetary Fund and the International Bank for Reconstruction and Development (the World Bank) - were set up; US fears of loss of national sovereignty led to the abandonment of the plans for the ITO. The

provisional GATT agreement remained and in effect became permanent. It is at least arguable that the creation of the ITO at that time would have avoided many of the problems subsequently experienced in the international trade arena.

1.1 The Impact of Trade

1.1.1 Increased opportunities for trade provide great potential human benefits, both economic and political:

- On the economic side, the creation of new markets on a global scale can expand export opportunities and consumer choice, thereby contributing to economic growth. As countries get richer they become better able to address their social and environmental problems.
- Politically, trade helps to build relationships between peoples and governments. The economic integration of Western Europe has contributed to the creation of the political, cultural and institutional links between its constituent nations that have given the best prospects for enduring peace the region has ever known. More broadly, growing world trade provides an important stimulus for the gradual evolution of global institutions through which global problems can be tackled effectively and peacefully.

1.1.2 These potential benefits of trade, however, need to be pursued with due recognition of the less positive effects that can arise from the operation of market forces in general, and their globalisation in particular:

- So far the proceeds from global economic growth have been distributed very unequally, resulting in a substantial

widening of the divide between the world's rich and poor. In 1960, the richest fifth of the world's population had 30 times more wealth than the poorest fifth; by 1990, they had 60 times more. Many developing economies have not been able to diversify economically, remaining dependent on a small number of exports liable to wide fluctuations in prices, with accompanying economic and political disturbance.

- The expanding global market, lacking institutions for effective regulatory control, together with these huge disparities in wealth, have created new opportunities for large countries and large corporations to abuse their economic power. The sharpening of competitive pressures within the globalised economy has led to turmoil within national economies, and disruption to individuals and communities faced with the need to adapt to new conditions. Cultures that cannot thus adapt are disappearing.
- The continuing failure to make markets responsive to environmental costs means that the worldwide increase in economic activity has been environmentally unsustainable, creating major problems of global pollution and overexploitation of natural resources.

1.1.3 It should not be expected, however, that these problems can be addressed through unilaterally imposed protectionism, which generally has a very poor record. There are many examples of protectionism that benefits inefficient domestic elites at the expense of consumers, taxpayers and less-favoured domestic enterprises, that subsidises environmental destruction as well as economic inefficiency, that discriminates against poorer countries and makes it more difficult for them to diversify their economies and add value to their resources.

1.1.4 It is more important for Britain than for most countries that the right balance between the the benefits and the costs of expanding trade is struck in an orderly international institutional framework. Rich in human capital but lacking in many crucial natural resources, the development of the

British economy has been critically dependent on international trade. Today, exports account for 25% of GDP, a much larger proportion than in the US (11%) or in Japan (10%). Britain's openness to international markets is reflected both in the level of overseas direct investment in the UK (the third largest in the world, accounting for 40% of exports, and 17% of employment, in manufacturing) and the stock of overseas investment by British companies (the second largest in the world). Within the European Union - where responsibility for international trade policy is exercised on behalf of member states - Britain has helped to ensure that an open trading policy has prevailed over protectionist tendencies.

1.1.5 This is the background against which this policy paper has been written and in which the Liberal Democrat approach to international trade has been assessed. The global economy of the 1990s bears little relation to the postwar world into which the GATT was born. The transformation of the GATT into the new World Trade Organisation offers a crucial opportunity to build on GATT's achievements in a way that is appropriate to current realities and tackles current problems.

1.2 Interdependence and Internationalism

1.2.1 The historic attachment of the Liberal Party to free trade is well known. It was both economically and politically motivated, deriving in the nineteenth century from the Liberals' identification with manufacturing and business interests (as opposed to the Conservatives with the land and agriculture). It made good economic sense to seek free markets for what was at the time the largest trading nation in the world.

1.2.2 Politically Liberals looked to free trade as the agency which would promote internationalism and end war. "*For the disbanding of great armies and the promotion of peace,*" wrote the radical John Bright, "*I rely on the abolition of tariffs, on the brotherhood of the nations resulting from free trade in the products of industry.*" Free trade was not an end in itself. It fostered international

cooperation and was therefore an instrument for peace as well as for economic prosperity.

1.2.3 Liberal Democrats today share these aims. “*We look forward to a world,*” states the preamble to the Party’s constitution, “*in which all people share the same basic rights, in which they live together in peace and in which their different cultures will be able to develop freely We promote international action based on a recognition of the interdependence of all the world’s peoples and responsible stewardship of the earth and its resources.*”

1.2.4 Our aims for the global society and the global economy can be summarised as follows:

- The evolution of supranational and global institutions through which international and global problems can be resolved effectively.
- The encouragement of cooperation and interdependence amongst peoples and countries, through trading links as well as through political, cultural and institutional ties.
- The promotion of prosperity across the globe, especially amongst the poorest people and the poorest countries.
- The establishment of economies and societies which are environmentally sustainable.

1.2.5 An open and rules-based system of international trade, founded on principles of multilateral cooperation and non-discrimination, has a crucial role to play in achieving these aims.

1.3 International Trade

1.3.1 The freedom for people and companies to trade is an important freedom. It has positive effects beyond the benefits of the exchange to the parties concerned, allowing economies to utilise resources efficiently, fostering the spread of knowledge and technology, promoting dynamic economies and workforces and furthering the development of international

cooperation and effective global institutions. Liberal Democrats therefore argue for the removal of barriers to this freedom to trade.

1.3.2 But we also recognise the negative impact of trade in some circumstances. The freedom to trade is not, and cannot be, absolute. At the national level it is well recognised that market forces need to be guided and regulated, so that other important freedoms and values may be safeguarded or promoted. The same is true internationally, especially in the globalising markets of the 1990s.

1.3.3 International trade needs to be based on a clear framework of rules deriving from the principles of multilateral cooperation and non-discrimination. This framework must define the basis on which competition will take place and ensure that all can compete on equal terms. This is the best safeguard of the position of small countries and companies. It also allows disputes to be settled through negotiation and not through conflict or unilateral imposition by the stronger party.

What is needed are clear rules and standards for a trading system that promotes both open markets and a trading practice that respects human rights and environmental sustainability

1.3.4 The articles of GATT, and now of the WTO, provide much of the necessary basis for the international trading system. But they are in need of some significant reforms - in areas such as competition safeguards, the position of poorer countries, labour standards and environmental protection - so that the trading system can be appropriate for the globalised economy of the twenty-first century, providing the widest possible human benefit and paying special attention to the needs of the least well off. These reforms are detailed in subsequent chapters.

1.3.5 At the present there are two great threats to the maintenance of an orderly and

fair trading system and to the enactment of these necessary reforms. The first derives from those who advocate a completely deregulated international economy, in which all power to control any aspect of trade is abandoned to an unbridled market and market operators. Yet all commerce, international or otherwise, is subject to some form of regulation, with (usually) good reason. In the protection of the local and global environment, for instance, government action to alter the parameters within which the market operates is essential, since otherwise natural resources - such as the atmosphere - are underpriced and overexploited. (Regulation of this kind often *creates* markets, as it has in waste management, for example, or pollution control technology.) We argue for the progressive removal of discriminatory and unnecessary barriers to trade, but not at the expense of the aims we have set out above.

1.3.6 The other threat stems from those who reject a multilateral, non-discriminatory, rules-based trading system in favour of national or regional protectionism and bilateral *ad hoc* trading agreements. It must be clearly stated that there is no evidence that such protectionism will safeguard Western jobs or living standards, or promote environmental sustainability, or foster the development of poor countries, or promote international cooperation, or achieve any of the other worthy

objectives which are sometimes invoked to justify it. Rather, it is likely to have quite the opposite effects.

1.3.7 There is a real danger at present that these two threats will feed off each other. The over-zealous pursuit of the further opening of world markets regardless of adjustment costs or such needs as environmental protection may spark off precisely that protectionism which not only fails to address those needs but impoverishes economies, both domestic and foreign, in the process.

1.3.8 What is needed are clear rules and standards for a trading system that promotes both open markets and a trading practice that respects universal human rights and environmental sustainability. With some amendment, the rules of the GATT provide a good basis for such a system, while the foundation of the WTO affords the international community a rare opportunity to make the necessary reforms. This paper sets out how Liberal Democrats address this task, pursuing objectives of prosperity, sustainability and international cooperation through negotiated multilateralism and non-discrimination.

Completing the Uruguay Round

2.0.1 The Uruguay Round was a complex and wide-ranging set of negotiations. Amongst its major elements were significant reductions in levels of tariffs on manufactured goods; agreement (for the first time) on bringing the agricultural sector significantly within multilateral trading rules; a phase-out of the protectionist Multi-Fibre Arrangement; the establishment of an international framework for services and for intellectual property rights; clearer rules on anti-dumping, subsidies, technical barriers to trade, and public procurement; and, perhaps most important, the creation of the World Trade Organisation with revised procedures, including a more sophisticated system of dispute resolution.

2.0.2 On a number of aspects, the Uruguay Round Final Act simply lays out the framework for further negotiations. This is particularly true, for example, of trade in services, including financial services and telecommunications, two areas of particular importance to the UK. At the time Liberal Democrats welcomed the conclusion of the Uruguay Round negotiations. We now urge the UK Government, acting through the EU, to press for the rapid implementation of its agreements and the speedy conclusion of its further talks. If rapid progress is not made, there is a serious risk that the liberalising forward movement produced by the successful conclusion of the Round will be lost. Unilateral actions, such as the recent US - Japan dispute, could become more common, to the detriment of the trading system as a whole.

2.0.3 We also urge action on trade liberalisation beyond the Uruguay Round agreements. This includes further reductions in tariffs, continued assaults on non-tariff barriers (such as quotas or 'rules of origin' regulations), and the removal of subsidies in

areas such as agriculture and energy.

2.0.4 The interaction of the new arrangements with the developing world, with labour standards and with the global environment are examined in separate chapters below. Chapter Six deals with the new institutional arrangements. Here we consider other aspects of particular concern in the post-Uruguay Round trading system. (The provision of finance for trade, and proposals for the taxation of international currency transactions, although important topics, are not considered here, as they raise issues well beyond this paper's remit.)

2.1 Competition and Transnational Corporations

2.1.1 Transnational corporations (TNCs) are in many ways at the forefront of the development of a truly international society, demonstrating how behaviour can be organised at a global level. Investment by TNCs is the key to many developing countries' futures. Their transnational nature, however, means that they can escape national regulation - on tax, on competition, on the environment, or on social policy - by shifting between national jurisdictions. Global markets can encourage private monopolies, especially if these are supported by internationally enforceable intellectual property rights (see Section 2.2).

2.1.2 Liberal Democrats believe that TNCs' enjoyment of the benefits of the global economy should be balanced by an acceptance of their responsibility not to exploit individuals, countries or natural resources. At issue is the creation of a framework of international law strong enough to hold TNCs to account, just as national companies are held to account by national legislation. Ultimately this will require

the development of strong and effective global institutions enforcing a global competition policy for the operations of TNCs.

2.1.3 Yet there are steps that can be taken even without this. First, national jurisdiction can be developed to defend international standards; US citizens, for example, can be prosecuted in US courts for offering bribes, even if this takes place overseas (while UK companies are currently allowed to offset overseas bribes against UK tax). Second, national competition and anti-trust agencies can improve their links with each other, sharing information and experience in the enforcement of existing law. Third, the disciplines of competition law can be introduced into the WTO, a process which is already being examined within the EU.

We urge action on trade liberalisation beyond the Uruguay Round agreements

2.1.4 Finally, TNC codes of conduct should be developed jointly by governments, international institutions and industry. These could cover, for example, transparency in TNC operations (disclosure of accounts, environmental liabilities, etc), best practice in employment conditions, training and transfer of technology to host country nationals, and so on (see 3.2.4). We recognise and encourage the recent work of the World Business Council for Sustainable Development, and other industrial organisations, in drawing up such codes, and favour the principle of mutual recognition of codes of conduct drawn up by different countries.

2.2 Intellectual Property Rights

2.2.1 Intellectual property rights (IPR) range from trademarks and design rights to patents and copyrights. They are effectively monopolies granted by national legal systems, but they are justified by the stimulus which results to research and development of new products, technologies and systems. Since the trade-off between the incentive to invent and

the effects of the restrictions on trade which IPR implies varies between countries and between different stages of development, there is little rationale for the imposition of uniform conditions for intellectual property internationally. On the other hand, piracy of intellectual property embodied in computer software, for example, or compact discs, has grown to alarming proportions, particularly in countries such as China.

2.2.2 IPR were covered by the Uruguay Round principally at the instigation of the industrialised countries, as a *quid pro quo* for the 'concessions' granted to developing countries on matters such as textiles and agriculture. As it stands, however, the trade-related IPR (TRIPS) agreement, which ultimately obliges all countries to implement reciprocal IPR protection is of limited value to poorer countries. We therefore support:

- An acceleration in the reductions in trade barriers of interest to developing countries, such as textiles and agriculture, which notionally corresponded to the TRIPS agreement in the Uruguay Round negotiations.
- The establishment by the UK and other EU governments of the programme of incentives for promoting and encouraging technology transfer to least developed countries called for in the TRIPS agreement.

2.2.3 In addition, in further developing the TRIPS agreement, we:

- Support the principle of exhaustion of IPR by first sale (which already exists in the EU), whereby royalties only have to be paid once; without this developing countries will be prevented from selling abroad even if they have complied with full IPR conditions in their own country.
- Believe that ethical considerations should be taken into account in the review of patenting plant forms and gene sequences, and acknowledge developing countries' role in protecting biodiversity (see also Federal Green Paper 29, *The Challenge of Genetic Engineering* (1993)).

2.3 Regional Trading Blocs

2.3.1 An important characteristic of the the global economy in recent years has been the development of regional trading blocs - including the North American Free Trade Agreement, the Association of South East Asian Nations, the Asian Free Trade Area, the Asia-Pacific Economic Community and the Mercosur trading agreement in South America. Recently calls have been made for the establishment of an EU-NAFTA free trade area.

2.3.2 Regional trading blocs such as these can act to stimulate trade, and may provide useful lessons for the world trading system (in developments such as the environmental side agreement of NAFTA, for example). However, they can also divert trade from countries outside the trading area, may develop into closed political power blocs, and are always likely to exclude the poorest countries, including most of those in Africa. Liberal Democrats therefore support their development only inasmuch as they encourage the evolution of a genuinely global system of trade through the WTO.

Trade and Development

3.0.1 Trade is just as vital to the developing as it is to the developed countries. Indeed, trade has transformed the developing world, and in particular the ‘tigers’ of East Asia and Mexico, the latest recruit to the OECD. Yet at the same time other developing countries, particularly in Africa, have seen their terms of trade collapse, mainly because of falls in commodity prices. The share in world trade of sub-Saharan Africa has fallen to a third of its 1960 level.

3.0.2 Despite continuing poverty and hardship in much of the developing world, the developed countries maintain systematic trade barriers against their goods - though successive GATT rounds have helped to reduce them. These range from non-tariff barriers such as the network of textile quotas known as the Multi-Fibre Arrangement (MFA) to the practice of ‘tariff escalation’ by which developing countries face substantially higher tariffs against manufactured and processed goods than they do against primary products. This effectively restricts their export opportunities to commodities and raw materials (often subject to wide variations in prices), denies them their comparative advantage of cheap labour, and forces them to over-exploit their natural resources. Even where developing countries benefit from preferential tariffs, these may be subject to quotas or rules of origin restrictions.

3.0.3 Such barriers to trade are in no-one’s long term interest. Countries denied the opportunity to earn foreign exchange both remain poor and injure developed countries, since they cannot afford to import goods. The continued need for overseas aid is witness to the failure of trade; barriers to textiles and clothing alone cost developing countries an estimated £35 billion a year in lost trade, a sum equal to the total of Western development aid.

3.0.4 Liberal Democrats believe that all countries, developing as much as developed,

can potentially gain from trade liberalisation. Indeed, many developing countries, with limited and shrinking access to natural resources (even ones as basic as water, increasingly in short supply in many Middle Eastern and Central Asian countries) must trade to survive. But equally we recognise that the poorer developing countries, suffering from major structural disadvantages including a lack of access to capital and technology, inadequate infrastructure, export and marketing skills, and currency convertibility and debt problems, are poorly placed to benefit. Special measures are therefore justified.

3.0.5 Liberal Democrat policy on international development was set out in full in Federal Green Papers 15, *Shared Earth* (1990) and 25, *Beyond the Nation State* (1992), and is shortly due for updating. Here we address only those aspects of development which relate to international trade. Proposals set out elsewhere in this paper, such as the need for a global competition policy (see Section 2.1), or an enhanced Global Environment Facility (see 5.1.4) will also benefit poorer countries.

3.1 Improving the GATT Deal

3.1.1 The GATT principle of ‘special and differential’ treatment for developing countries has been in place for many years. The Uruguay Round, however, has reduced these concessions; at the end of a transitional period, developing countries (other than the least developed) will be expected to adopt most of the same disciplines as richer countries. In return for this, the special needs of developing countries should be accorded more emphasis than they have been so far. This should include an attack on tariff escalation and an enhancement of supplementary or compensatory financial arrangements, such as the IMF’s Compensatory and Contingency Facility, or the EU’s Stabex and Sysmin funds,

designed to help countries dependent on a limited range of commodities.

3.1.2 Developing countries currently benefit from a range of preferential tariff regimes, such as those included in the Lomé Convention, an agreement between the European Union and developing countries in Africa, the Caribbean and Pacific (generally former European colonies) and the various Generalised System of Preferences (GSP) systems operated by the main industrialised countries. Our ultimate objective is the reduction and removal of all tariff and non-tariff barriers to trade. Until this is achieved, however, the structural disadvantages from which the least developed countries suffer (see 3.0.4) justify preferential treatment. This should include:

- Lower or zero tariffs for imports from the poorest countries.
- The abolition of rules of origin and quota restrictions on such goods.
- The rationalisation of the various EU preferential systems, including Lomé and the GSP.

3.1.3 We recognise that the EU is already making progress towards these goals, but urge it to move further and faster, in particular in reducing protection for so-called 'sensitive sectors' for the benefit of the poorest countries. Action should also be taken to ensure that the least developed countries are able to exploit these preferential agreements and expand their trade with the industrialised world (see 3.2.4).

3.1.4 Of equal importance is the further limitation of agricultural support in developed countries, beyond that agreed in the Uruguay Round. The substantial subsidies for agriculture common throughout the industrialised world undermine developing country food producers and should be phased out. Support for rural communities in industrialised countries should be delivered through direct payments for environmental and social objectives rather than through price or production support (see Liberal Democrat Policy Paper 5, *Reclaiming the Countryside* (1994)).

3.1.5 Textiles and clothing is one of the sectors in which developing countries enjoy a comparative advantage, but these are the goods against which the industrial countries maintain the highest barriers. Under the Uruguay Round agreements, the MFA (which as well as costing developing countries £35 billion a year, raises prices to consumers in the developed world by about 5%) will finally be phased out over a ten year period. The phase out is not even, however; the developed countries plan to lift 50% of the quotas only in the very last year, 2005. There is substantial scope for much more generous action; quotas on the poorest, least developed, countries should be lifted earlier and faster.

3.1.6 Some of the poorest countries will be net losers from the Uruguay Round in the short term, as food prices rise and commodity prices fall; they do not have the industrial base to benefit from tariff reductions on industrial goods (though their agricultural sectors will be encouraged by higher returns to farmers). Some of the gains from trade which the richer countries will enjoy should be recycled to these countries, through development aid, international debt relief and assistance for export diversification and intra-regional trade. The WTO's Committee on Trade and Development should publish an annual report on proposals and progress in developing the trading strengths of such countries.

3.2 Making Policies Coherent

3.2.1 Aid, debt and trade policies have not always worked together. Aid has been used to build up textile industries which then cannot export under the MFA; or to support agriculture which is then destroyed by subsidised dumping. High levels of international indebtedness often force countries to concentrate on producing hard currency-earning exports at the expense of long term development needs and to the detriment of their natural resource assets. The previous section has indicated ways in which aid and trade can be used together to promote development; aid and debt relief are also needed to help developing countries overcome those structural disadvantages which prevent them enjoying the potential gains from international trade

3.2.2 The practice of ‘tying’ aid to purchases from the donor country is a major example of unhelpful linkage. As the 1993 OECD Development Cooperation Report noted, “*tied aid procurement can mean that recipients pay on average 15% above prevailing prices and for goods that may not correspond to development priorities.*” Yet in 1991 72% of all British bilateral aid was tied, compared to the OECD average of 33%. If the British government wishes to assist UK industrial exports, then such assistance should be justified on these grounds and not be taken from the development budget at the expense of poor countries - and in practice British industry had done relatively well in competing for purchases from *untied* aid. The practice of tying British aid should be ended, and Britain should argue for an end to tied aid throughout the OECD.

3.2.3 The Aid and Trade Provision (ATP), which gives a small number of British companies subsidies to compete for contracts in developing countries, is a particularly pernicious example of tied aid. Accounting for 9% of UK bilateral aid in 1993, ATP lay behind the Pergau Dam scandal, in which the aid budget paid for a hydroelectric project which generated electricity at a higher cost than its alternatives, imposing additional costs on Malaysian consumers. A UK Government study of ATP found that not only was it of less value to developing countries than other bilateral project aid, but that it was also notably unsuccessful in generating business for British industry. This abuse of the aid programme should be stopped immediately: ATP should be scrapped.

3.2.4 More development assistance should be devoted to improving investment opportunities in developing countries. Often these are not realised simply because of a lack of knowledge and technical expertise. The UN Conference on Trade and Development, UNCTAD’s, efforts to provide market information to developing countries should be strengthened and extended, as should the Commonwealth Development Corporation’s investment programme. Similarly, although transnational corporations are valuable sources of capital, host countries may not always get the best deal available out of them (over agreements on transfer of technology, training of local workers, and so on) through lack of experience. Technical assistance, such as that provided by the Commonwealth Secretariat to developing country negotiators, should be supported and expanded.

3.2.5 Finally, greater coordination is called for amongst the array of international bodies with responsibilities for development - including the UN Commission on Sustainable Development, UNCTAD, the UN Development Programme and the UN International Children’s Fund (UNICEF), the ILO, IMF and the World Bank - together with donor governments and NGOs, working together with developing countries to tackle their structural disadvantages. A great deal can be achieved without building entirely new institutions but through better coordinating existing ones. Intergovernmental panel processes, beginning informally and graduating into integrated policy-making structures, have had a measure of success in, for example, the area of climate change, and could be expanded (see 6.1.7).

Trade and Labour Standards

4.0.1 The interaction of trade and labour standards has been recognised for over a century; the first treaty to prohibit the import of slaves was drawn up in 1889-90. In 1919 the International Labour Organisation was created, and has subsequently assisted in the establishment of some 174 conventions setting various international standards of employment. The ILO has developed an effective monitoring system, underpinned by its tripartite structure of governments, employers and unions. Labour standards have undoubtedly been raised in many countries.

4.0.2 Liberal Democrats wish to see this work continue. Britain should follow the example of other EU countries, with Parliamentary consideration of ILO proposals and much wider public awareness and debate. The ILO should establish a closer working relationship with other international institutions. It could make a useful input to the discussions of the WTO Committees on Trade and Environment (helping, along with other bodies such as the International Standardisation Organisation, to inform debate on international product standards) and Trade and Development. It should assist the work of the development agencies in helping developing countries adapt to the impact of trade liberalisation.

4.0.3 Article XX of GATT ('General Exceptions') contains a clause allowing WTO members to discriminate against products produced with prison labour. Suggestions have been made that this approach should be extended to labour conditions in general - eg that discrimination should be permitted against products made with child labour, for instance, or in conditions of health and safety which would not be permitted in the developed world.

4.0.4 There are great difficulties, however, in imposing standards on countries from outside, as distinct from giving them practical help and encouragement through the ILO and development assistance. Most developing countries rely heavily on cheap labour and would regard the use of trade measures aimed against this as discriminatory, weakening their major advantage in international markets. In the main, we therefore look for the improvement of standards to the continuation and reinforcement of the ILO's voluntary approach, backed by technical assistance as well as international instruments. Increased wealth resulting from trade liberalisation should make it easier for governments in developing countries to take up the responsibility of adopting and enforcing high standards.

We look for the improvement of standards to the continuation and reinforcement of the ILO's voluntary approach

4.0.5 Nevertheless, there are grounds for widening the scope of GATT's current exceptions clause. Although countries must themselves decide the labour standards they desire, we believe that participation in that decision is a basic human right. The clause should therefore be extended to allow discrimination against products produced with *forced* labour. This represents an extension of the current clause to include slave and bonded, as well as prison, labour, and would cover many cases, for instance, of child labour. This new provision would, of course, be subject to the normal procedure of appeal under the WTO disputes resolution procedure; WTO panels should have recourse to international

agreements outside the GATT system in deciding its applicability (see further in 6.1.2).

4.0.6 Often the problem is not one of low standards so much as lack of enforcement. The richer countries can assist developing countries to uphold the minimum standards which they themselves decide, where this assistance is requested. Bi- and multilateral extradition and enforcement agreements should be drawn up and promoted so that employers cannot evade the standards to which they should be subject.

4.0.7 In addition to such international action, improved labour standards can be promoted by non-governmental bodies. This includes encouragement for the establishment of trading links with companies which maintain good standards, publicity for cases where standards are grossly deficient, and the development of ethical investment policies. Development programmes and codes of conduct for transnational corporations (see 2.1.4) should similarly encourage the adoption and maintenance of high standards.

Trade and Environment

5.0.1 Trade impacts both positively and negatively on the environment. It helps to ensure that resources are used efficiently, it can help generate the wealth necessary for environmental improvement, and it can encourage the spread of environmental technology. On the other hand, since much activity in modern economies is environmentally unsustainable, trade can act to magnify this behaviour and accentuate the problems of pollution and resource depletion.

5.0.2 These problems are at base caused by a failure to internalise the environmental costs and benefits of economic activity. The consumption of coal, for example, involves the release of carbon dioxide, sulphur dioxide and other air pollutants, with accompanying damage to the local and global environment. The cost of this damage is not, however, reflected in the price of coal, with the result that more coal is consumed than the environmental optimum and society as a whole, rather than the producers and purchasers of the coal, bears the costs. (Subsidies, common in many countries, make the problem even worse.)

5.0.3 Policy Paper 8, *Agenda for Sustainability* (1994), sets out Liberal Democrat proposals for internalising these costs and ensuring that polluters pay the cost of the pollution they cause. Measures to be taken include the taxation of environmentally damaging activities (for instance energy taxation), and the removal of distortionary subsidies. Even on a national basis, however, this will be a long process, and action to curb global environmental degradation cannot wait until it is complete - if it ever is - at a global level.

5.0.4 These problems have been exacerbated, however, by the way in which the GATT has been used. Disputes panels have progressively narrowed the interpretation of the GATT agreements in the pursuit of ever more rigid trade rules, to the detriment of the

environment. Despite the evidence, they have acted as though there is no linkage between trade and the environment, arguing that environmental problems should be solved through the negotiation of international treaties and that GATT law should be applied as though the issue did not exist.

5.0.5 Urgent reforms of the GATT system are therefore necessary. We call for a new 'sustainability clause' to be added to the GATT setting out agreed principles of environmental policy - such as the Polluter Pays Principle and the Precautionary Principle - against which trade measures can be judged. This is similar to the contents of Article 130 r, s, and t of the Treaty of Rome, which enables EU institutions to pursue both trade liberalisation and environmental sustainability as objectives. As the EU has shown, conflict between these two objectives can be resolved successfully, striking a balance appropriate to the particular circumstances.

5.0.6 We believe that WTO structures are flexible enough to provide this on the global scale - but they are currently inhibited by an unbalanced body of law in the GATT agreements. The types of measures which the new clause should permit are examined below. We are aware of the danger of abuse of these procedures by protectionist interests. That is why we have been careful to specify precisely the conditions under which the various measures could be taken; and they are all intended to operate, of course, under the multilateral WTO system.

5.1 Multilateral Environmental Agreements

5.1.1 Global environmental problems are clearly best tackled through the negotiation of multilateral environmental agreements (MEAs); international agreement is clearly preferable to unilateral action. Yet on the face

of it the GATT itself would appear to conflict with MEAs which contain trade measures. This is a small but important group, including, for example, the Montreal Protocol on the control of ozone-depleting substances. Often regarded as a model for future MEAs, the Protocol's inclusion of a clause permitting parties to ban imports of controlled substances from non-parties is thought to have been crucial to its success in attracting support and adherence.

5.1.2 Yet under the GATT such discrimination between members is not permitted. GATT panels' tendency to restrict themselves merely to narrow points of GATT law and isolate themselves from any other source of international law has led to a genuine fear of conflict between the GATT and MEAs. Other trade agreements, however, such as NAFTA, do not follow this path, explicitly recognising the primacy of particular MEAs.

5.1.3 This problem must be resolved, and an appropriate balance struck between the objectives of trade liberalisation and environmental protection. Disputes panels established under the new WTO need to recognise the validity of other sources of international law, including existing and future MEAs. The new GATT sustainability clause should clarify this relationship, establishing a presumption of compatibility with MEAs.

5.1.4 Many MEAs recognise the different capabilities of developed and developing countries. The former are responsible for almost all the global pollution caused so far, and are of course in a better position to implement abatement measures. A vital component of a global strategy for environmental sustainability must be the transfer of resources and technology to developing countries to enable them to follow a more sustainable path of development than that adopted historically by the industrialised countries. This was the rationale for the creation of the Global Environment Facility in 1991. While fully supporting its establishment, we call for an urgent increase in its resourcing.

5.1.5 By their nature, however, MEAs are often difficult and time-consuming to negotiate and implement - as the current attempts to draw up an effective convention on climate

change show. The GATT system therefore needs to be amended to permit trade measures to be taken, in carefully defined circumstances, in pursuit of the objective of sustainability. We regard this not as a substitute for MEAs, but as a last resort - and, hopefully, as an incentive to devise a multilateral approach. The key amendment that needs to be made relates to the production methods by which goods are produced.

5.2 Process and Production Methods

5.2.1 Recent GATT panel decisions have differentiated between products on the basis of what they are and on how they are produced ('process and production methods', or PPMs). Countries are permitted to take trade measures - import bans, for example, or the levying of duties - against products which are harmful to the importing country's environment, as long as the same product is treated equally whether it is produced by domestic or overseas producers. GATT panels have ruled, however, that such action is *not* permitted on the basis of PPMs.

5.2.2 The logic of this decision is that PPMs are highly country-specific: the same process may cause different degrees of environmental damage in different countries, depending on population density, land area, levels of historic pollution, and so on. Rich country standards of environmental protection are often quite inappropriate to poorer countries. Yet where pollution is transboundary or affects the 'global commons' (the oceans, the atmosphere, species which roam the globe, etc), this differentiation is more difficult to justify: carbon dioxide released in Africa, for instance, causes just as much global warming as carbon dioxide emitted from Europe. Indeed, it is probably true that most serious problems of pollution arise from processes and not from products - for instance, in the use of energy in industry and agriculture. The panels' decisions are therefore wrong in principle and are likely to lead to the ratcheting down of standards of environmental protection worldwide.

5.2.3 However, it seems likely that the panels' decisions were reached primarily as a result of their dislike of unilateral action, since

at present there are no agreed international standards for most PPMs. We understand and share this dislike, and where possible minimum standards for production processes should be agreed internationally - though, as we have pointed out, this may often require the recognition that different standards may be appropriate for countries at different levels of development. But until this happens there is no justification for banning trade measures against PPMs and not against products: what is needed is a set of carefully defined and predictable criteria which must be fulfilled before action can be taken.

5.2.4 We therefore propose that the GATT should be amended to permit trade measures on the basis of PPMs where:

1. The environmental damage caused is transboundary or global, and is significant and difficult or impossible to reverse.
- The measures taken are nondiscriminatory as between foreign and domestic producers.
 - Due notice (eg 12 months) of intention to introduce trade measures is given, and a WTO mediation procedure is invoked in the interim.
 - The measures taken are proportionate to the damage caused; market-based measures (labelling, taxes, etc), which are in general more efficient, are preferable to outright bans or quotas.

Forming part of the GATT, this new provision would be subject to the normal procedure of appeal under the WTO disputes resolution procedure.

5.3 Animal Welfare

5.3.1 One specific problem related to environmental concerns is the interaction of the GATT and legislation on animal welfare. Concerns have been raised that GATT law could be used to challenge established animal welfare legislation, such as the EU law banning imports of fur caught in leghold traps, or regulations governing slaughtering or rearing procedures for farm animals (a ban on imports of veal raised in veal crates, for example, would probably be illegal under GATT).

5.3.2 Liberal Democrat policies on animal protection are set out in Federal Green Paper 27, *A Matter of Conscience* (1992). It is essential, we believe, to ensure that the system of international trade does not undermine the policies included there. At the same time, we do not wish to create barriers to trade which harm developing countries; voluntary rather than coercive measures must be pursued (see also 4.0.4). In common with our approach in Section 5.1, therefore, a presumption of compatibility needs to be firmly established between GATT and multilateral agreements on animal welfare standards. At the same time, the topics of animal protection and welfare should be introduced into the remit of the WTO Committee on Trade and Environment, providing an international forum in which to discuss and develop them.

Institutional Reform

6.0.1 All the proposals set out in this paper rely for their implementation on the existence of strong and effective international institutions. The greater interdependence of countries which trade promotes - and which we welcome - must rely heavily on the observance of international rules and regulations, monitored and enforced by effective international institutions. National enforcement alone is no longer adequate. We therefore repeat the Liberal Democrat commitment - set out in full in Federal Green Paper 25, *Beyond the Nation State (1992)* - to a strengthened United Nations system and to the reform of global economic institutions.

6.1 The World Trade Organisation

6.1.1 The World Trade Organisation's major problem is that it was created 50 years too late. Had it come into being with the IMF and World Bank, as was envisaged (see Chapter One), it would have developed as an integrated part of the system and not as the detached body it has become. In order to function effectively in today's world, it needs to forge much stronger links with other global institutions, including in particular those dealing with economic, developmental and environmental issues.

6.1.2 This problem is seen at its most acute in the GATT disputes procedure. Despite many opportunities to do so, GATT disputes panels have paid no attention to other bodies of international law but have treated the GATT legal system as though it were a hermetically sealed code. As we saw in Chapter Five, this has created obstacles to the achievement of environmental sustainability. The new WTO disputes panels - already an improvement on the old GATT model - should abandon this hopelessly naive position, recognise that trade policy is inextricably interlinked with other

areas of international policy, and draw on appropriate sources outside the GATT system (eg multilateral environmental agreements) in reaching decisions. The pool from which panel members are drawn (currently restricted largely to trade experts) should be widened, and panels should be required to consult a range of expert opinion on the cases they consider.

6.1.3 In addition, the WTO system is unnecessarily secretive and impervious to public scrutiny and participation, a characteristic which is deeply damaging to the cause of trade liberalisation. The public should have access as of right to all documents prepared in connection with dispute resolution cases, as well as panel reports, official reports, negotiating texts, papers related to WTO institutional matters, and notices of dispute challenges. Disclosure should be restricted only to safeguard proprietary business information or national security.

6.1.4 As Liberal Democrats first proposed in 1993 (in *Making Europe Work for Us*), public perspectives should be adequately represented in WTO meetings and disputes procedures. As is common in many international institutions, WTO Committees should be open to (non-voting) participation by non-governmental organisations (NGOs). The dispute settlement system, including the appeal stage, should allow for *amicus* interventions by NGOs or international bodies (eg UN agencies) with a demonstrated interest in the outcome of the case.

6.1.5 The post of Advocate General should be created within the WTO, modelled on the same office in the European Court of Justice. Its purpose would be to represent the public interest in the disputes procedure. Such an office could help synthesise, evaluate and report on arguments made by disputing parties, and process information and requests for standing presented by interested individuals and NGOs. In the long run, as the WTO and its legal system develops, the Advocate General

may form the route through which individuals, corporations and NGOs themselves could initiate challenges to trade measures taken by WTO members.

6.1.6 Efforts should be made to create greater linkage between the WTO and other parts of the UN system. In particular, the WTO should prepare regular (and openly available) reports on the development and impact of world trade for the UN Secretary General and General Assembly, its Committee on Economic and Social Rights and the Commission on Sustainable Development.

6.1.7 The WTO's own internal structure needs to be improved. The Committee on Trade and Environment, currently only an ad hoc body, should be made permanent. It should hold occasional joint meetings with the so far inactive WTO Committee on Trade and Development on key matters of concern to developing countries. We support recent calls for the establishment of an Intergovernmental Panel on Trade and Environment (modelled on the successful Intergovernmental Panel on Climate Change) to create a forum within which governments and NGOs can meet and exchange information and views, and draw up reports, on the relevant issues. The Global Environment Facility, although severely under-resourced, provides a good example of the kind of institution which we aim to build, bringing together financial and environment experts from both governments and NGOs (see also 5.1.4).

6.2 International Institutions

6.2.1 As we set out in *Beyond the Nation State*, the structure of international economic institutions is in urgent need of review and reform to meet modern needs - including in particular action on the problem of debt, the integration of criteria of environmental sustainability in decision-making and encouragement for regional cooperation. The structure, subscriptions, objectives and methods of operation of the IMF and the World Bank - including the possibility of merger -

should be considered. The two bodies should concentrate on lending linked to economic reform and the creation of basic institutions, with the devolution of the role of project financing to the regional development banks. More specific proposals for reform, and for the greater coordination of development agencies, will be included in our forthcoming paper on development policy.

6.2.2 As Chapter Five has shown, much of the current failure to link the objectives of trade liberalisation and environmental sustainability stems from a severe imbalance in the system of international institutions. The WTO is a relatively strong organisation implementing a detailed and effective body of law. There is no real counter to this on the environmental side, either in terms of institutions or international law. We therefore call for the transformation of the UN Environment Programme into a Global Environmental Organisation, taking responsibility for coordinating the work of the secretariats administering the various MEAs (on climate change, ozone depletion, trade in endangered species, and so on). This new organisation would possess the responsibilities, resources and influence to balance those of the WTO.

6.2.3 The network of international economic institutions created at the Bretton Woods conference at the end of World War Two underpinned postwar economic recovery, averting the international recession and retreat to protectionism which followed World War One. Fifty years later, in entirely different circumstances, facing new challenges and new threats, and with the creation of a new and major world body in the World Trade Organisation, it is high time for another Bretton Woods, a comprehensive review and reform of the structure and operations of global institutions. In this way the world community can achieve the aims of prosperity, sustainability and interdependence which the development of the system of international trade offers the twenty-first century.

This Paper has been approved for debate by the Federal Conference by the Federal Policy Committee under the terms of Article 6.4 of the Federal Constitution. Within the policy-making procedure of the Liberal Democrats, the Federal Party determines the policy of the Party in those areas which might reasonably be expected to fall within the remit of the federal institutions in the context of a federal United Kingdom. The Party in England, the Scottish Liberal Democrats and the Welsh Liberal Democrats determine the policy of the Party on all other issues, except that any or all of them may confer this power upon the Federal Party in any specified area or areas. If approved by Conference, this paper will form the policy of the Federal Party.

Many of the policy papers published by the Liberal Democrats imply modifications to existing government public expenditure priorities. We recognise that it may not be possible to achieve all these proposals in the lifetime of one Parliament. We intend to publish a costings programme, setting out our priorities across all policy areas, closer to the next general election.

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