

Post Uruguay Round Issues for Asian Developing Countries

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Abstract

This paper looks at some of the emerging issues since the conclusion of the Uruguay Round (UR) in the world trading system from the perspective of developing countries in Asia. Two important issues are the linking of trade and the environment, and the proposed "social clause" to the WTO charter relating to labor standards. The author suggests that developing countries should resist the linking of market access to performance in nontrade-related areas and, in particular, the inclusion of the social clause. Concern is raised that the commitment to the phaseout of the Multi-Fibre Arrangement (MFA) might be reneged and MFA recreated in effect through antidumping and safeguard measures. Potential problems with the UR agreement on these measures and the dispute settlement mechanism are presented. Institutional reforms in developing countries related to global integration and issues of transparency and corruption are addressed. A brief discussion of the potential danger for the WTO from proliferating preferential regional trading arrangements follows. Finally, the implications of the global trading system of recent us legislation are touched upon. Remarks on the proposal to negotiate a multilateral investment code under the aegis of the WTO conclude the paper.

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The Final Act embodying all the multilateral and plurilateral agreements of the Uruguay Round (UR) of Multilateral Trade Negotiations (MTN), the latest, eighth, and most ambitious of a series of such negotiations under the auspices of the General Agreement on Tariffs and Trade (GATT), was signed on 15 April 1995 in Marrakesh, Morocco by ministers representing 124 governments and the European Community. These agreements extended, multilateral rules and disciplines to trade in services, trade related aspects of intellectual property rights, and investment measures. They also brought trade in agriculture and textiles back to the GATT. The Final Act included the decision to establish a formal organization called the World Trade Organization (WTO) "to provide the common institutional framework for the conduct of trade relations among its members in matters related to the (Uruguay Round) agreements" (GATT 1994, 6). The ministerial representatives affirmed in their declaration that "the establishment of the World Trade Organization (WTO) ushers in a new era of global economic cooperation, reflecting the widespread desire to operate in a fairer and more open multilateral trading system for the benefit and welfare of their peoples" (GATT 1994, iv).

The WTO, which subsumed the GATT, came formally into being on 1 January 1995. As of 26 July 1996, it had 123 members and 29 more were negotiating to join (WTO 1996a, 16). A ministerial conference of representatives of all the members of the WTO is its decision making body. It has to meet at least once in two years. The first ministerial conference is scheduled to meet in Singapore in December 1996. In his fourth annual Sylvia Ostry lecture, Renato Ruggiero, WTO Director-General described the achievements of the WTO during its first 18 months of existence as "a picture of light and shadow, of commitments implemented and others which remain still unfinished business" (WTO 1996b, 4). While a good start has been made in the implementation of the UR agreements, he rightly stressed that there was no room for complacency.

Among the pictures of light is the functioning of the more effective and credible (compared to that of the GATT) dispute settlement mechanism (DSM) of the WTO. Since the start of the WTO, 50 complaints (18 initiated by the US) came before the Dispute Settlement Body (DSB), and ten or so disputes have been settled at the stage of mutual consultation among disputants. Regrettably, the US, while proclaiming its intention to bring its auto parts dispute with Japan before WTO's DSM, in fact failed to do so. Fortunately, that dispute was settled by the two parties, and even more significantly, the US has taken the complaint of Kodak of US against Fuji of Japan regarding the latter's practices in the Japanese market to the DSB. Also, the US has decided to accept the ruling on its appeal to the Appellate Body of the DSM, upholding the finding of the panel that investigated Venezuela's complaint about US standards for reformulated and conventional gasoline. Unlike the situation that prevailed under GATT, several developing countries have chosen to take their complaints against some developed countries to the DSB of WTO. All these augur well for the DSM of WTO.

The "shadows" to which Ruggiero referred are the four sectors on which there was a commitment to continue negotiations after the conclusion of the UR: financial services, movement of natural persons (i.e., those who provide services), basic telecommunications, and maritime transport. In July 1995, the negotiations on financial services ended with partial success, viz. an agreement without the participation of the US. As in all such GATT-WTO negotiations, each participant makes an "offer" or "concession" of measures liberalizing access to its market. The US found the package of offers made by others unsatisfactory, and decided to withdraw its offer and not to submit any offer on future access to its market. The telecommunications negotiations adjourned on 30 April 1996 without a final agreement, again because the US found the offers of others unsatisfactory. Negotiations are to resume in 1997 starting from results achieved as of 30 April 1996. The US decision came at the final days of negotiations and is seen by many as the result of lobbying by Motorola. With respect to maritime transport, the US did not even make an initial offer and the negotiations have been postponed to year 2000.¹ As to be expected

¹ It is no surprise that domestic political considerations, particularly with a presidential election in 1996, had a lot to do with this outcome. According to David Sanger (*New York Times* 8 October 1996, 1), "It took six years and endless arm-twisting for American trade negotiators to persuade Japan, Republic of Korea and nearly every European nation to end one of the biggest forms of corporate welfare in the world: billions of dollars in

from the WTO Director-General, Ruggiero chose not to view these cases as outright failures, since, in his view, their remaining unsettled at the end of the UR must mean that “they must be considered hardest cases. It is thus no wonder if they could not be settled in one further attempt”! (WTO 1996b, 4). Whether these “shadows” should be viewed as temporary setbacks or whether they constitute the first cracks that will eventually undermine five decades of steady progress since the end of the Second World War on the road toward an open, free, and multilateral trading system, remains to be seen. It is also the case that some developing countries feel that they are not ready to open their markets to international competition in these areas and might welcome the delay, though, in the long run, they are also likely to be losers if there is no agreement.

Lawrence et al. (1996) argue that the sharp differentiation between domestic and international policies related to the barriers at the borders of a country (e.g., tariffs, quotas, and exchange rates) made sense when the barriers at the border were high. The exercise of sovereignty over domestic policies without regard for effects on other nations did not then lead to serious conflicts. Thus, MTN for the reduction of at-the-border barriers could take place, and agreements were reached while leaving domestic policies pretty much alone, except for the requirement of national treatment, viz. that once a foreign good or enterprise entered the barriers, it was not discriminated against relative to its domestic counterpart in the application of domestic policies.

Eight rounds of MTN have virtually eliminated barriers at the border for most goods in industrialized countries. Since the 1980s, many developing countries have also been engaged in a process of opening up their economies and reforming their structures. The debt crisis of the early 1980s, that was in large part associated with syndicated loans from commercial banks, seems to have become a distant memory. There has since been a phenomenal growth in flows of direct and portfolio investment from foreign investors into developing countries, with private flows vastly exceeding official capital flows (bilateral and multilateral in the early 1990s). Syndicated commercial bank lending has virtually disappeared. There were three other relevant developments, two economic and one political. The economic ones were the increasing concern around the world over environmental degradation (particularly of the atmosphere and the seas) and the revolution in communication and information technology. The political development of great consequence was the collapse of the Soviet Union and its satellites as well as the trend toward multiparty elections and democracy, not only in Russia and Eastern Europe, but also in the developing world.

With border barriers virtually dismantled and capital markets getting integrated, the possible spillover effects of domestic policies, such as those relating to market structure (i.e., antimonopoly policies, environmental protection, financial sector policies, etc.) have come to the fore in the international arena; with demands at a maximum for harmonization across countries of specific domestic policies at a minimum for an agreement, for example, on a “core” set of thresholds with respect to labor, environmental, or product standards. Significantly and ominously, there are proposals linking access to world markets to the meeting of core thresholds; in other words, for the use of trade sanctions against countries failing to meet the thresholds.

Lawrence et al. (1996) set the alternatives before policymakers in rather dramatic terms:

As the twentieth century comes to a close, three roads to the economic future lie before economic policymakers. They can rely on the historical policies of reducing at-the-border trade barriers, the agenda of shallow integration. They can seek to harmonize and reconcile national differences, the agenda of deeper integration. Or they can reverse

government subsidies for shipbuilders. The subsidies, American shipbuilders said, were making it impossible for them to compete and could cost thousands of jobs in shipyards from Maine to California. But nearly two years after the deal was struck, and just as most subsidies were supposed to be cut off, the entire deal unraveled when Democrats and Republicans in Congress, only weeks from the election, realized that the United States would also have to cut off its subsidies for American shipbuilders.”

previous liberalization and reassert national autonomy. Which road today's leaders choose will shape the world in which their children and grandchildren live (p. 104),

They identify three possible scenarios. In the first, which they term as "a world of the invisible hand", harmonization of domestic policies will come about through market pressures in a world that is well integrated with respect to trade, financial, and technology flows. The second scenario of "global fragmentation" is the obverse of global integration—it is a world in which the trend toward dismantling of barriers at the border is reversed and, in fact, such barriers are reerected. The third scenario termed "imperial harmonization" is one in which the economic superpowers such as the U8 or the European Union force harmonization on the less powerful nations of the world.

Lawrence et al. stress the desirability of achieving a global community of nations that in their view "balances openness, diversity, and cohesion". They argue that openness promotes competition, diversity encourages innovation and experimentation and ensures that varying national conditions and preferences are not ignored, while cohesion builds trust in one another as well as in international institutions. They suggest that a world of nation states organized around *functional, regional, and global coordinating clubs* will achieve such a balance. A functional club would be organized around single or related issues such as trade policy, antimonopoly policy, and environmental and labor standards. Regional clubs will simultaneously deal with several functional areas that are of interest to countries in a region. Finally, one or more international clubs or a club of clubs will coordinate functional and regional clubs, initiate new clubs, promote interaction, and settle disputes among clubs.

While the characterization of Lawrence et al. in terms of a "trinity" of future options of policymakers, a "trinity" of possible scenarios of the future evolution of the global economy, and a "trinity" of clubs as possible solutions to emerging global problems may be overly dramatic and even simplistic in some respects, it nonetheless serves the useful purpose of highlighting the seriousness of some of the emerging issues. In what follows, I will look at these issues and also add others not discussed by Lawrence et al. from the perspective of developing countries of Asia. The second section is devoted to the proposal to include a "social clause" relating to labor standards in the charter of the WTO. The issue of trade and the environment, on which a committee of the WTO is already in existence and functioning, is the topic of the third section. The fourth section airs concerns whether the Uruguay Round commitment to phaseout of the notorious Multi-Fibre Arrangement, governing the trade in textiles and clothing by the year 2005, will in fact be kept, and even if it is in a formal sense, whether in effect its restrictive features will be recreated through the use of WTO-consistent antidumping (ADM) and safeguard measures (8M). The fifth section critically looks at some potential problems with the UR agreement on ADM and 8M as well as with the D8M. The sixth section briefly addresses institutional reforms in developing countries aimed at maximizing benefits from global integration and, in particular, issues relating to transparency and corruption which are emerging as targets for *international* action. The seventh section briefly discusses the potential danger for the future of the WTO from proliferating preferential regional trading arrangements. The paper also touches on the disturbing implications for the global trading system of some recent legislation (the Helms-Burton and D'Amato Acts) of the US. Brief remarks on the proposal to negotiate a multilateral investment code under the aegis of the WTO conclude the paper.

Proposed Social Clause in the Charter of the WTO

The demand that the charter of the WTO should include a "social clause" that would allow restrictions to be placed on import of *products* originating from countries not complying with a specified set of minimum labor standards was raised by the US and France *after* the painful and lengthy negotiations of the Uruguay Round had been completed, almost holding the negotiated agreement hostage. The agreement was signed, but not without an understanding that the topic of labor standards could be discussed by the preparatory committee for the WTO. The minimum standards "typically

include freedom of association, collective bargaining, prohibition of forced labor, elimination of exploitative child labor and non-discrimination” (Krueger 1996, 1).

It is becoming clear, according to Ruggiero, that the issues of labor standards, environment, and employment “will be the big three issues, as will the integration of developing countries into the trading system” at the first Ministerial Meeting in December 1996 of WTO *International Herald Tribune* 29 July 1996, 11). Even though Australia, Japan, and ASEAN nations have already expressed their opposition to the discussion of issues which are not specifically related to trade such as corruption and social clauses, US Secretary of State Warren Christopher has gone on record at the July 1996 meeting of ASEAN that the relationship between trade and labor standards would be one of Washington’s priorities besides the issue of illicit payments (i.e., corruption) at the Singapore meeting

The deceptively appealing notion that lower labor standards in a country relative to its trading partners confers it an unfair competitive advantage was already present in the charter of the International Trade Organization (ITO) negotiated by participant countries in Havana in 1948. Article 7 of the ITO stated that “The members recognize that unfair labor conditions, particularly in the production for export, create difficulties in international trade, and accordingly, each member shall take whatever action may be appropriate and feasible to eliminate such conditions within its territory” (Wilcox 1949, 233). The ITO did not come into being and the GATT treaty came to be applied through its Protocol of Provisional Application. Except for prohibition of trade goods made with prison labor, the articles of GATT did not deal with labor standards. Various administrations in the US, Democrat and Republican, have proposed the inclusion of a labor standards article in the GATT, unsuccessfully as it turned out, during several rounds of multilateral trade negotiations. Similar proposals have been made by political parties in national parliaments in several European countries and also in the European Parliament.

The Employment, Labor and Social Affairs Committee and the Trade Committee of the Organization for Economic Cooperation and Development (OECD) undertook a Joint Study on Trade, Employment and Labor Standards at the request of the ministers of member governments of OECD. A summary of the report (OECD 1996) points out that

Since the end of the Uruguay Round, the issue of trade and labor standards has come to the forefront of the policy agenda. The protracted rise in unemployment in many OECD countries and in wage inequality in some countries has led some observers to look for external explanations, including claims of *unfair* trade practices associated with competition from firms that allegedly base their comparative advantage on *low labor* standards (p. 3, emphasis added).

Rodrik (1996) states that such claims may be justified.²

It should be noted that the words “unfair”, “exploitative”, and “forced” are repeatedly invoked, though not defined with any operational precision, by most participants in the debate on labor standards. The OECD report refers to the argument that some labor standards not only reflect basic human rights and that all countries in the world should therefore adhere to them, but also observance of these standards can stimulate economic development and, therefore, is in the interest of all workers and countries. What is more, observance could neutralize protectionist pressures, thus securing support for free trade. If this argument were to be true, other than for reasons of market or political failure, such labor standards would be observed everywhere! Indeed, the International Labor Organization (ILO), founded as long ago as the

² He argues that “some of the concerns that labor groups in advanced countries have over low labor standards in the developing world are justified “ “ Such standards can appropriately become a matter for trade policy when they are viewed as *unfair and exploitative* by a wide segment of society in the importing country .., the interests of the developing countries are better served by acknowledging the sources of resistance to some of their exports-and working around them-than by blithely repeating the free-trade mantra” (Rodrik 1996, 4; emphasis added).

conclusion of the First World War, has over the past 75 years adopted a series of conventions which set international labor standards.³

Nine of the ILO conventions are particularly relevant from the perspective of labor standards. These relate to freedom of association such as right to organize (No. 87) and collective bargaining (No. 98); forced labor (No. 29) and its abolition (No. 105); nondiscrimination in employment and occupation (No. 111) and its remuneration (No. 100); employment policy (No. 122); minimum age of employment (No. 138); and tripartite (i.e., workers, employers, and government consultation) (No. 144). Interestingly, not only OECD countries other than the US have ratified most of the nine conventions, but those two on freedom of association and forced labor and nondiscrimination have been ratified by all but a handful of countries who are members of ILO.

The US is not only leading the campaign to include a social clause in the WTO, but has reportedly threatened to block agreement on the draft declaration to be adopted by trade ministers at their forthcoming Singapore meeting in December 1996 because the current text of the draft does not contain a reference to workers' rights (*Financial Times* 1996f, 6). The Council of Economic Advisers (CEA) to the US President has advanced a sweeping claim of universality and eternity for what they deem to be core labor standards viz. "freedom of association, the right to organize and bargain collectively, freedom from forced labor, and a minimum age for employment of children" (CEA 1995, 250) by arguing that they represent "fundamental human and democratic rights in the work place, rights that should prevail in *all societies whatever their level of development*" (CEA 1995, 250). Ironically, the US has ratified only two of the nine conventions mentioned earlier, those on abolition of forced labor and on tripartite consultation (World Bank 1995, Table A4). According to Charnovitz (1995, 178), the US has not ratified the conventions on freedom of association and the right to organize, nor has it ratified any of the child labor conventions. He points out that the US has in fact been a party to only 12 ILO conventions, including five in recent years, and this is the worst record of any major industrial nation.

One of the few quantitative restrictions on imports that is GATT/WTO consistent is a ban on imports of products produced by prison labor. Indeed, People's Republic of China (PRC) has been accused of exporting such products. If the ban as well as the accusation against PRC are based on the presumption that competitive advantage gained by the use of involuntary prison labor is unfair, then what should one make of the activities of UNICOR, a corporation wholly owned by the US Federal Government and run by the Bureau of Prisons in the US⁴ It operates 100 factories, sells over 150 products including "prescription glasses, safety eyewear, linens, monogrammed towels, executive office furniture, bedroom sets, gloves, brooms and brushes of all kinds, even targets for target practice. They also make cables and electronic component parts for Army tanks, jet fighters, and the Patriot missile." Its gross sales in 1995 was around \$500 million, of which wages paid to prisoners was about \$35 million! According to Schwlab, UNICOR Assistant Director of Corporate Management, prisoners are "not covered by Fair Labor Standards Act, minimum wage laws. They don't get retirement benefits, unemployment compensation, etc. They're workers, but they're not employees." Besides publicly owned UNICOR, private industry has been attracted and allowed to operate within prisons, and as the owner of one such private company agreed, it was a fantastic deal all the way around and he liked "the financial advantages of a prison business, namely, getting to hire the cream of the crop from a pool of cheap prison labor, not to mention the use of ...brand new air-conditioned factory space, rent free." The cost advantage, of UNICOR and any private business operating with prison labor should be obvious. Yet, as the narrator of the story put it, without realizing the absurdity of the economic reasoning involved,

³ Some of the ILO conventions of the past reflect a dirigiste mindset and are counterproductive. They are not relevant and should perhaps be repealed.

⁴ The description of the activities of UNICOR and the quotations in this paragraph are taken from the transcript of the program "60 Minutes" broadcast by CBS on 20 October 1996. (Transcript prepared by Burrelle's Information Services, Box 7, Livingstone, N.J.)

Back in 1934, when Congress created UNICOR, it restricted its sales to one and only one customer, the federal government. The reason: to prevent UNICOR's cheap prison labor from undercutting private industry in the commercial marketplace. But Congress also armed UNICOR with one big advantage: It gets first crack at the government's business, even at the expense of private companies competing for the same work.

Clearly, the effect of any sale to government by UNICOR displaces what another producer, *domestic* or *foreign*, would have made! It is irrelevant that UNICOR is not allowed to export or sell to the domestic private sector. Yet those in the US and the OECD, who accuse less developed countries with lower labor standards than their own as engaging in social dumping, fail to see that the operation of UNICOR has the same effect!

Proposals for a social clause often include a reference to the ILO.⁵ An ILO Working Party on the Social Dimension of the Liberalisation of World Trade reached a consensus that it should not pursue the question of trade sanctions and that any discussion of the link between international trade and social standards, through a sanction-based social clause, should be suspended. Instead, consistent with ILO's long tradition, the Working Party decided to look at ways to promote core labor standards through encouragement, support, and assistance and the means to strengthen ILO's effectiveness in achieving this task. This makes eminent sense.

Clearly, if there is no universal agreement on a minimum labor standard or set of standards, from the fact that the prevailing labor standards in one society happen to be lower than those of another, it does not follow that the former is engaging in "unfair" practices or is "exploiting" its labor. This is the crux of the issue and not whether individuals "may have preferences not only over outcomes (their 'consumption bundles') but over the processes through which these outcomes are generated (Rodrik 1996, 32). No economist, whether a specialist in trade or not, ever denied that individuals have ethical or moral values. However, ~one would claim that one set of values could be deemed superior to another. As such, to the extent preference over processes is an expression of such values, lack of recognition of such preferences is certainly not "the gap that separates labor advocates from trade economists" (Rodrik 1996, 32). What separates the two is the lack of recognition by some labor advocates, first, of the legitimacy of the *differences in values* that often lead to differences in labor standards across societies. Second, they tend to underplay the possibility that consumers, by signalling through their market actions rather than through actions of their government, bring about changes in prevailing labor standards in theirs as well as in other countries.

Rodrik refers to Sen (1995) in the context of preference over processes. Sen's discussion of processes or procedures critically examines the distinction between consequentialist and deontological reasoning founded on procedural fairness. Dasgupta views procedural fairness as in effect consequentialist because the fairness of a procedure "rests squarely on previous evaluation of its consequences" (Dasgupta 1993, 31). On the other hand, Rawls argues that "pure procedural justice obtains when there is no independent criterion for the right result: instead there is a correct or fair procedure such that the procedure has been followed" (Rawls 1972, 86). It is hard to see how either view is of any relevance to the gap that, in Rodrik's view, separates labor advocates and trade economists.

Generations of students have been taught, correctly, that having an opportunity to exchange what one produces with one's resources for what one consumes through trade is equivalent to adding another

⁵ Such a reference, far from legitimizing the clause or providing a rationale for inclusion in the mandate of WTO, in fact

...puts the Organization at this stage in a difficult situation. First, the ILO has not yet reached a political consensus of its IL constituents to identify clearly a core group of conventions or minimum standards-and of social charter-to be included in a social clause. Second, the ILO's supervisory mechanism is based on persuasion (i.e., on voluntary compliance with freely accepted international obligations) ...The ILO's supervisory mechanism was not designed to apply sanctions of any kind following non-compliance (Maier 1994, 13; emphasis added).

technology to the domestic production technology for transforming one's resources for final consumption. From this self-evident proposition, Rodrik argues that since all governments in principle can, and do, regulate technological choices in domestic production, "the concern over labor standards is just another manifestation of this principle" (Rodrik 1996, 32). Further, "free trade with a lowstandard country would be no different than importing workers abroad and allowing them to work under the same poor conditions" (p. 11). If a country proscribes "sweat shops" at home to prevent the erosion of labor standards elsewhere in the economy, it cannot engage in free trade and import goods produced in "sweat shops" abroad.

These arguments are far from persuasive. First of all, government regulations operate not only with respect to labor standards, but also a whole host of other factors that influence cost of production, such as building codes, zoning laws etc. The Rodrik principle applied to these imply that if a country prohibits certain types of structures (such as buildings that exceed a specified height) or the use of certain types of building materials within its territory, then free trade with, and importing the same product from, a country which does not have such regulations is no different than producing -, the same product at home in a structure that does not meet the regulations. Thus regulations that affect the cost of production of any product at home, in principle, could induce home producers to call for restrictions on imports of the same product. A moment's reflection is enough to convince oneself that this opens the door for attempts to offset comparative advantage of foreign producers by depicting it as arising from lax regulations relative to those prevailing at home.

Second, one has to examine why, in the absence of regulations, competitive market equilibrium standards are likely to be lower. In an economy closed to international trade, if there is no market failure of any kind, and workers freely choose their industry/occupation, in equilibrium the wage structure will reflect available labor standards as well as the differences in them across industries. As such, regulations that raise standards in effect create a disequilibrium and affect comparative costs. This is best seen in the case of some labor standard that is above its market clearing level in the absence of regulations, such as the minimum wage in the organized manufacturing and in the public sector in some developing countries. As long as there is full compliance, clearly there will be an excess supply of labor to the sectors with the set minimum wage and thus a disequilibrium. Of course, by rationing jobs in some fashion, the excess supply is tackled. But the point is that, in the absence of market failure, a regulated minimum wage or labor standard raises the welfare of those who get the job at some cost to the rest of the economy. In this situation, the regulation setting the labor standard is simply a redistributive policy. If it is the *only feasible policy* that achieves a presumably socially desired redistribution, then any competition from imports to the products of the regulated sector will tend to reduce, if not undermine completely, the intended redistribution. In such a case, to maintain the desired redistribution, either import competition has to be restricted through trade barriers or the regulations have to be changed at an additional cost to the rest of the economy. If the economy cannot affect its terms of trade, maintaining the intended redistribution is achieved at the cost of those who consume the products of regulated industry in the former case, and in the latter case, at the cost of all who are not employed in the regulated sectors. The cost of maintaining redistribution in the face of import competition will be lower in the latter case. Thus, if the only purpose of labor standard regulation is domestic redistribution, trade restrictions are not called for.

It is not very difficult to construct theoretical examples of failures in the labor market and of the possibility of multiple equilibria, where the imposition of labor standards could alleviate market failure or move the economy to a Pareto superior equilibrium. But the issue is not one of theory, rather its wide empirical relevance. Establishing the existence of a significant externality *empirically* in a convincing and econometrically sound fashion is more difficult, and hence rarer, than assertions of such existence. Also, it is not enough to show that mandating labor standards would address the failure in labor markets. It has to be shown that there are no other more cost-effective means of addressing such failures. If everything else fails, a resourceful economist can always think up an uninternalized "externality" and the resultant market failure!

Krueger (1996) finds from his linear probability regressions that members of US Congress representing districts with relatively many unskilled workers, who are most likely to compete with child labor, are less likely to support a ban on imports made with child labor. He concludes from this finding that lobbying in industrialized countries for linking market access of developing countries to their observance of labor standards does not necessarily represent disguised protectionism. But, by the same token, it is not necessarily a refutation of the claim that it does. First of all, if a representative did not choose to cosponsor the Child Labor Deterrence Act of 1995, it does not imply his or her lack of support for the legislation, although, to be fair, cosponsoring could be construed as indicating stronger support. Second, since the proportion of eligible voters who actually vote differs across population groups and the less educated and unskilled are less likely to vote, their interests might weigh less heavily in the decision of the representative to cosponsor or not.⁶ Third, and most important, even if one accepts Krueger's econometric analysis as valid, as Krueger himself notes, his regressions suggest that those who support international labor standards are more likely to support protectionist policies more generally and that representatives from districts that have a higher rate of unionization are more likely to be cosponsors.⁷

The facts that support for labor standards in developed countries rests in part on genuine moral grounds or concern of citizens with children's welfare in developing countries, and the belief that "unfair" labor conditions particularly in export production create difficulties in international trade, are long standing, but do not mean that protectionism is not currently the driving force behind the demand for a "social" clause in the charter of the WTO.

First of all, this demand is presently being pushed with great vigor by major developed countries, when imports from developing countries are increasingly penetrating their markets. Second, there is a curious asymmetry in the contents of the proposed clause: they focus almost exclusively on those labor standards which are presumed to be "low" in developing countries and not on those equally plausible ones which are absent in many, but not all, developed countries. The asymmetry is unlikely, if the driving force behind the social clause is some universal moral concern with labor standards. For example, along with the worker's right to unionize and bargain collectively, one might also include the right to be represented in the management of firms, if not a right to a share in the firm's profits. To take another example, it is argued that many developing countries do not enforce their own laws such as those relating to compulsory schooling or labor standards. By the same token many developed countries do not enforce their own laws on drug use as effectively as their resources would allow. Should the resources devoted to law

⁶ Whether or not Krueger's econometric estimates are biased for these reasons depends on the theoretical framework underlying the estimating equation. For example, consider a two-stage decision making by a representative. At the first stage, the representative decides whether he would vote for any legislation that might come up mandating international labor standards. If he decides he would not vote, there is no second stage. If he decides that he would vote, then there is a second stage decision whether he would be proactive and cosponsor such legislation or not. Under some specifications of explanatory variables and distribution of error terms for each decision, a bias could arise in the estimates.

Also under certain circumstances, even politicians who ignore workers' interests might still vote for import restriction. For example, consider a specific factors model in which the capital in industries competing with imports of products from countries with low labor standards is specific to those industries, and suppose a proportion (but not all) of the unskilled labor force is employed in those industries as well. Intensification of import competition in these industries will affect the interests of owners of specific factors adversely, while its effect on the welfare of unskilled labor is ambiguous. Suppose it is adverse. Then even politicians who ignore interests of labor would support import restriction in this case, since it protects the interests capital-specific to these industries.

⁷ It is argued by some that it is extremely unlikely that union members stand to gain from a ban on imports of goods made with child labor because almost all union members do not compete with child labor. However, there is a slippery-slope argument on the other side. If the unions did not take a stand on one labor issue, viz. ban on imports of goods made with child labor, albeit one in which their members may not have a direct interest, their credibility and clout could be weakened on other issues in which their members have a direct interest.

enforcement, and given resource and information constraints, the issue of which laws a government chooses to enforce effectively and which it does not, become matters for *international* negotiations?

The timing of the demand for and contents of the proposed clause, as well as the concern only with enforcement of a particular set of laws, viz. those relating to labor standards, all point to only one conclusion: that protectionist interests have captured the drive for labor standards. It is extremely essential that developing countries together with Australia, Japan and other like-minded industrialized countries take a firm stand at the Singapore Ministerial Meeting against the inclusion of a discussion of labor standards in the agenda.

Of course, excluding labor standards from the ambit of WTO does not mean the issue is neither important nor relevant for international fora. There is already an international forum for discussing it, the ILO. Even the ministers of EU seem to have realized this, when they decided to discuss labor standards at the Singapore Ministerial but only to stress that the ILO was the best forum for this (*Financial Times* 1996c, 4). However, the main reason why the issue is being pushed in the WTO, rather than the ILO, is that while the ILO has no enforcement mechanism for its conventions other than persuasion and technical assistance, in the WTO there is the possibility of the use of trade sanctions as a means of enforcement. Since trade measures are not necessarily the best instruments of enforcement, a far better alternative than including a social clause in the WTO is to seek ways of enhancing the enforcement capabilities of the ILO. Clearly, with substantial overlap in the membership of the two organizations, even without a social clause in the WTO, if a future ILO enforcement mechanism fails, the members of ILO in their dual capacity as members of WTO as well could decide to use trade measures if necessary.

Finally, there is the danger that if the issue of labor standards is not discussed in an appropriate multilateral forum such as the ILO, it will be taken up in other contexts such as bilateral, plurilateral, and regional trade agreements.⁸ For example, as part of the price to get congressional approval in the US of the North American Free Trade agreement, Mexico had to agree to a side agreement on labor and environmental standards. Since the start of the Uruguay Round, there has been a disturbing and unfortunate increase in the number of discriminatory regional trade agreements concluded, as well as proposed. Contrary to the expectation of some, the successful conclusion of the Round did not stop this trend, rather, there is some evidence of acceleration. Many developing countries are already members or eager to become members of such agreements. This eagerness might lead them to accept side agreements on labor standards that are not necessarily in their interest.

Trade and the Environment⁹

It is being frequently argued that fair trade or level playing fields constitute a precondition for free trade and that, therefore, harmonization of domestic policies across trading countries is necessary

⁸ I should also mention here some unilateral actions. GATT allows developed countries to offer preferential access to their markets to developing countries under the Generalized System of Preferences (GSP). The US and EU have conditioned the grant of such preferences to the observance by developing countries of particular labor standards that the US and EU deem important. I should add, however, that whether or not its grant is conditional, GSP is the analogue of "crumbs from the rich man's table" which the developing countries could do well without.

Recently, under intense pressure from the US which imports 60 percent of Bangladeshi garments, and the ILO, a ban on the use of child labor in the Bangladeshi garment industry came into force on 1 November 1996. Under an agreement among Bangladesh Garment Manufacturers and Exporters Association (BGMEA), ILO, and UNICEF, the industry will send 10,000 child workers to school. Each child will receive a stipend of \$8 per month. The ILO, UNICEF, the US Government, and BGMEA will share the cost. Factories will be opened for international inspection and violators of the agreement will be fined. It is unclear whether the stipend merely covers the cost of schooling or it includes compensation for lost income to the child's household. Clearly if it is the former, the incentive for the parents to send the child to school rather than to work elsewhere is much less (*Financial Times* 1996e, 24).

⁹ This section draws on Bhagwati and Srinivasan (1996).

before free trade can be embraced to one's advantage. This argument is nowhere more manifest and compelling in its policy appeal than in the area of environmental standards.

Both the general view that cross-country intra-industry (CCII) harmonization of environmental standards is required if free trade is to be implemented, and the specific proposals currently in vogue to implement this view are therefore in need of analytical scrutiny. In reviewing and assessing the demands for CCII harmonization of environmental standards, it is customary to make a distinction of analytical importance between (i) environmental problems that are intrinsically *domestic* in nature; and (ii) those that are intrinsically *international* in nature because they inherently involve physical spillovers across national borders.

Thus, if India pollutes a lake that is wholly within its borders, that is an intrinsically domestic question. If, however, she pollutes a river that flows into Bangladesh, that is an intrinsically international question. So are the well known problems of acid rain, ozone layer depletion, and global warming. These latter, intrinsically international problems of the environment raise questions that interface with the trade questions both in common and in different ways from the former, intrinsically domestic problems.

It has become commonplace among some environmentalists to assert that this distinction is of no consequence because the intrinsically domestic environmental problems are increasingly seen to have transnational impacts. Science has shown, for instance, that aerosol sprays are not just an environmental nuisance where used; they endanger the planet! But the fact that science seems occasionally to turn local (and partial-equilibrium) environmental impacts into transnational (and general-equilibrium) impacts, is no proof that the former are an empty set. We should not be deterred therefore from using this important conceptual distinction.

It would seem, at first glance, that at least the intrinsically domestic environmental problems should be matters best left to governments, to domestic solutions and within domestic jurisdictions (although transnational, global educational, and lobbying activities by environmental nongovernmental organizations or NGOs are compatible with this solution). If a country's preferred environmental choices and solutions (by way of setting pollution standards and taxes) to intrinsically domestic questions are different from those of another, why should anyone object to the conduct of free trade between the two on the ground that such differences are incompatible with the case for (gains from) free trade? Yet, the fact is that they do.

The objections are directed not merely at free trade, but also at the institutional safeguards and practices at the WTO, which are designed to ensure the proper functioning of an open, multilateral trading system that embodies the principles of free trade. These objections take mainly four forms:

- (a) *Unfair Trade.* If you do something different, and especially if you do what appears to show less concern for the environment than I do in the same industry or sector, this is considered tantamount to lack of "level playing fields" and therefore amounts to "unfair trade" by you. Free trade, according to this doctrine, is then unacceptable as it requires, as a precondition, fair trade.
- (b) *Losing Higher Standards.* Then again, the flip side of the fair trade argument is that environmentalists fear that if free trade occurs with countries having "lower" environmental standards, no matter what the justification is for this situation, the effect will be to lower their own standards. This will follow from the political pressure brought to bear on governments to lower standards to ensure the survival of their industry.
An associated argument is that capital will move to countries with lower standards so that countries will engage in a race to the bottom, each winding up with lower standards than desired to attract capital from each other.
- (c) *Conflicting Ethical Preferences.* Environmentalists also often want to impose their ethical preferences, considered morally superior, on other nations. Free trade in products that offend one's moral sense (either in themselves or because of the way in which they are produced as in the use of purse-seine nets in catching tuna or the leghold traps in hunting for fur) is then considered objectionable because *either* trade in such products should be withheld so as to induce

or coerce acceptance of such preferences *or* such trade should be abandoned, even if it has no effective consequence and might even hurt only oneself, simply because one should have no truck with the devil.

The former argument presumes higher morality on one's part, which should be spread to other nations with lower morality (and with corresponding lack of standards/laws therefore to reflect the higher morality). The latter argument seeks no such morally imperial outreach; it simply wants no part in complicity with lower morality elsewhere via participating in gainful free trade with nations guilty of tolerating such lower morality. In either case, the diversity of standards is considered then to be incompatible with the pursuit of free trade.

- (d) *Institutional Vulnerability of High Standards to Countries with Low Standards Fearing Protectionism.* Then, finally the environmentalists fear that they will lose their high standards, not because market forces under free trade bias the domestic political equilibrium in favor of lower standards or generate a race to the bottom, but because the current institutional arrangements, at the WTO in particular, enable the lowstandard countries to object to, and threaten, the high standards in other countries by claiming protectionist intent or consequences, for instance.¹⁰

Thus, just consider why the first argument concerning the unfair trade of lower CCII standards elsewhere has become such a politically salient issue today. It should suffice to note here that the fear is that competition will be greater if a rival abroad faces lower burdens of environmental regulations; hence the argument follows that this competitive advantage enjoyed by one's foreign rivals is illegitimate and must be countervailed, much like dumping or subsidization is or must be eliminated at the source.

Thus, the former Senator Boren introduced legislation in the US Congress to countervail social dumping allegedly resulting from lower standards abroad, proposing such a measure on that ground that some US manufacturers, such as the carbon and steel alloy industry, spend as much as 250 percent more on environmental controls as a percentage of gross domestic product than producers do in other countries. He saw in this difference an *unfair advantage enjoyed by other nations exploiting the environment and public health for economic gain*.¹¹

Environmental diversity is, contrary to these assertions, perfectly legitimate, and can arise not merely because the environment is differently valued between countries in the sense that the utility function defined on consumption and pollution abatement is not identical and homothetic, but also because of differences in endowments and technology across countries. In fact, even with homothetic preferences, income matters; at the same cost of abatement relative to consumption, a country with ten times the income of another will spend ten times as much on abatement. Forcing the poor country to spend as much on abatement will reduce its welfare substantially. Hence, the common presumption driving harmonization and (alternatively) social dumping-countervailing demands, that others with different CCII standards are illegitimately and unfairly reducing their costs, is untenable.

Nonetheless, these demands are part of a general shift to demand to harmonize a great, and possibly increasing, number of domestic policies: in labor standards, in technology policy etc. With industries everywhere increasingly open to competition, thanks precisely to the postwar success in dismantling trade barriers, with multinationals spreading technology freely across countries through direct investments, and with capital more free than ever to move across countries, producers now face the prospect that their competitive advantage is fragile and that more industries than ever before are footloose. There is therefore much more sensitivity to any advantage that one's rivals abroad may enjoy in world competition, and a propensity therefore to look over their shoulders to find reasons why their advantage is unfair.

¹⁰ The difficulties posed by the WTO for the environmentalists extend to WTO legal procedures, i.e., Dispute Settlement Panel findings, in regard to the ethical preference issue as well.

¹¹ *International Pollution Deterrence Act of 1991*, Statement of Senator David L. Boren, Senate Finance Committee, 25 October 1995.

It can be shown (Bhagwati and Srinivasan 1996), however, that the arguments in favor of free trade and diversity of environmental standards across countries is essentially robust. This follows from a straightforward extension of the proposition that, under standard assumptions ensuring perfect competition in all relevant markets, free trade is globally Pareto optimal. Introduction of environmental externalities (domestic and international) necessitates the use of appropriate taxes, subsidies, and transfers to internalize the externality, but does not call for a departure from free trade to achieve a globally Pareto optimal outcome. Still some policy problems do arise in the context of trans border externalities.

Transborder externalities are generally more complex in character than the ones which arise with purely domestic pollution and more compelling as well. It may be useful, from a policy viewpoint, to distinguish among two cases: (a) a special case where the problem is simplified by assuming a single country that pollutes the other, raising questions of response such as the use of trade barriers by the other; and (b) a general case where the problem is truly global in character. A good example of the former is US transmission of acid rain to Canada; an excellent example of the latter is global warming, to which many countries contribute while all are affected by it (though each in different degrees, and all not negatively).

The case of one-way transmission of pollution and two countries is helpful because it illustrates in a simple way the problem raised by transborder externalities concerning the use of second-best trade instruments by the injured country when the offending country does not implement a first-best solution and uses its jurisdictional autonomy in the spirit of malign neglect. The principal question then is whether a country that is being damaged by pollution from another has the right to impose a trade restraint to affect the exports, hence production, and pollution, of the other country that comes into one's area.

Modifying the WTO rules to explicitly allow for such a possibility arguably makes sense as a second-best solution since the offending party refuses to undertake a first-best solution, provided the usual caveats about satisfying science tests etc. are taken into account.

The problem, of course, is that this type of trade remedy is generally likely to be so weak for problems like acid rain that one may ask, is it worth modifying the WTO to legitimize such trade actions? Thus, take the example of acid rain itself. The generation of acid rain, say in the US, a fraction of which comes across to Canada, is geographically concentrated, of course, at the border whereas the Canadian import tariff on US products produced with electricity would affect all electricity generation in the US. Moreover, the effect on sulfur dioxide generation would be indirect, not direct through a tax on the process of electricity production itself. Then again, only a fraction of the acid rain generation effect would get into the transmission. The tariff instrument would then be extremely weak and the Canadian gain from its use in reducing the loss from the acid rain is outweighed by the reduced gains from trade, i.e., the gains from importing cheaper products from the US. Even apart from this consideration, once a trade policy remedy is contemplated for an environmental problem, it will be advocated for other problems such as alleged human rights violations, endangered species, threats to biodiversity, ad infinitum! It will be seized by all who want protection and this danger of sliding down a slippery slope is real.

The chief policy questions concerning trade policy when global pollution problems are involved instead, as with ozone layer depletion and global warming, take a different turn related to the cooperative-solution-oriented multilateral treaties that are sought to address them. They are essentially tied into noncompliance (defection) by members and free riding by nonmembers. The use of trade sanctions to secure and enforce compliance automatically turns up on the agenda, because any action by a member of a treaty relates to targeted actions (such as reducing chlorofluorocarbons or carbon dioxide emissions) that are a public good (in particular, that the benefits are nonexcludable, so that if I incur the cost and do something, I cannot exclude you from benefiting from it).

At the same time, the problem is compounded because the agreement itself has to be legitimate in the eyes of those accused of free riding or noncompliance. Before those pejorative epithets are applied and punishment prescribed in the form of trade sanctions legitimated at the GATT/WTO, these nations have to be satisfied that the agreement being pressed on them is efficient and, especially, that it is equitable in burden-sharing. Otherwise, nothing prevents the politically powerful (i.e., the rich nations) from devising a treaty that puts an inequitable burden on the politically weak (i.e., the poor nations) and

then using the cloak of a multilateral agreement and a new GATT/WTO legitimacy to impose that burden with the aid of trade sanctions with a clear conscience, invoking the white man's burden to secure the white man's gain.

This is why the policy demand, often made, to alter the GATT/WTO to legitimize trade sanctions to contracting parties who remain outside of a treaty, whenever a plurilateral treaty on a global environmental problem dictates it, is unlikely to be accepted by the poor nations without safeguards to prevent unjust impositions. The spokesmen of the poor countries have been more or less explicit on this issue, with justification. These concerns have been recognized by the rich nations.

Thus, at the Rio Conference of 1992, the Framework Convention on Climate Change set explicit goals under which several rich nations agreed to emission level-reduction targets (returning, more or less, to 1990 levels), whereas the commitments of the poor countries were contingent on the rich nations footing the bill.

Ultimately, burden-sharing by different formulas related to past emissions, current income, current population etc. are inherently arbitrary; they also distribute burdens without regard to efficiency. Economists will argue for burden-sharing dictated by cost minimization across countries, for the earth as a whole: if Brazilian rain forests must be saved to minimize the cost of a targeted reduction in carbon dioxide emissions in the world, while the US keeps guzzling gas because it is too expensive to cut that down, then so be it. But then this efficient cooperative solution must not leave Brazil footing the bill! Efficient solutions, with the compensation and equitable distribution of the gains from the efficient solution, make economic sense.

A step toward them is the idea of having a market in permits again, at the world level: no country may emit carbon dioxide without having bought the necessary permit from a worldwide quota. That would ensure efficiency, whereas the distribution of the proceeds from the sold permits would require a decision reflecting some multilaterally agreed ethical or equity criteria (e.g., the proceeds may be used for refugee resettlement, UN peace keeping operations, aid dispensed to poor nations by UNDP, WHO fight against AIDs, etc.). This type of agreement would have the legitimacy that could then provide the legitimacy in turn for a WTO rule that permits the use of trade sanctions against free riders.

The Phaseout of the Multi-Fibre Arrangement

Trade in textile fibers, textiles, and clothing is very important for developing economies in general and poorer Asian developing economies (ADEs) in particular. The percentage share of merchandise exports accounted for by textiles and clothing for the ADEs was as follows in 1993 or thereabouts (World Bank 1994; 1995, Table 15): Bangladesh 78, Hong Kong 40, India 30, Indonesia 17, Republic of Korea 19, Malaysia 6, Nepal 84, Pakistan 78, Philippines 10, Singapore 4, and Sri Lanka 52. As is by now well known, what started out as a short-term agreement in 1961 mainly to restrain the growth of Japanese exports of cotton textiles soon became a long-term agreement, and by 1974 expanded to include trade in textiles and clothing made with other fibers (natural and manmade). Thus it became the Multi-Fibre Arrangement (MFA) under which each exporting country gets *and* administers a *bilaterally* agreed quota of exports to each market. Over time the MFA had become increasingly restrictive. MFA IV expired at the end of 1994.

The UR agreement envisages the phaseout of MFA in three stages over a period of ten years from 1 January 1995. During each stage, annual growth in the import quotas on those products that are still under restraint will be increased by no less than 16 percent per year over MFA IV in Stage 1 (until 1988), by no less than 25 percent over Stage 1 in Stage 2 (1998-2001), and finally by no less than 27 percent over Stage 2 in Stage 3 (2002-2004). As soon as the agreement comes into force products which accounted for not less than 16 percent of 1990 imports would be integrated into the GATT. At the beginning of Stage 2 (later Stage 3) a further 17 percent (later 18 percent) would be integrated. All the remaining products would be integrated on 1 January 2005. At each of the first three stages, products are

to be chosen from each of the following categories: tops and yarns, fabrics, made-up textile products, and clothing.

The phaseout of MFA is backloaded (in fact, products accounting for as much as 49 percent of the value of 1990 imports could still be under quota restrictions as of the end of the 10-year period, i.e., on 31 December 2004!). The growth in quotas during the transition period would not only yield substantial benefits but could also make lobbying harder for the interest groups opposed to the abolition of MFA. They would have to lobby for an extension of the quota system of MFA *and* for a slowdown in the growth of quotas, a difficult task.¹² The transitional safeguard mechanism that is part of the agreement could be invoked (albeit under restrictive conditions) to slow down the phaseout even further. However, quotas imposed under these safeguards have to be terminated by 1 January 2005. As such they could not be used to extend the MFA. While substantial opportunities for increasing textiles and clothing exports for poorer ADEs, particularly from South Asia, are likely to arise in the coming decade, the political economy of textile protectionism in industrialized countries suggests caution. With a decade to go before the scheduled abolition of MFA, forces opposed to it could indeed gather enough strength to prevent it. There are already some disturbing trends in such a direction.

The US has recently chosen to impose restrictions on imports from India of women's and girls' wool coats and woven shirts under the safeguards provision. These restrictions went into effect in April 1995. The Textiles Monitory Body (TMB) of WTO reviewed the US measures and concluded that with regard to women's and girls' wool coats from India serious damage had not been demonstrated, while in the case of woven shirts and blouses actual threat of serious damage from a substantial increase in imports from India had been demonstrated. In October 1995, India requested the TMB to review the two cases again, and in November 1995 the TMB reaffirmed its earlier findings on both cases. On 27 March 1996, India requested the Dispute Settlement Body (DSB) to establish panels to examine its complaints against US restrictions but the US did not agree to India's requests for panels. The DSB was to meet in April 1996 to consider India's requests (WTO 1996d).

The US restrictions are likely to be the first among many future safeguard actions. Although such actions have to be terminated by 1 January 2005, in the interim the damage to developing countries could be substantial. A failure to live up to the UR commitments in textiles and apparel would be damaging for yet another reason: the developing countries might then revert to their perception that WTO, like GATT, largely subserves the interests of the industrialized countries. Indeed at the Singapore Ministerial, developing countries would be well advised to raise the issue of the pace of implementation of the UR agreement with respect to textiles and apparel. Fortunately, Director-General Ruggiero is aware of the dangers of failing to adhere to the agreed pace of implementation of the phaseout of MF A.¹³

Dispute Settlement Mechanism, Safeguard, and Antidumping Measures

Ruggiero has claimed with considerable justification that thus far WTO's "best achievement is the dispute settlement body, which is working, and which is really the heart of the multilateral trading system ...and the system is being used by developed countries, not just developing countries" (*International Herald Tribune* 29 July 1996, 11). The WTO dispute settlement system

¹² I thank Will Martin for drawing my attention to these aspects of quota growth.

¹³ In a recent talk, Ruggiero said: "...it is not possible to talk seriously about furthering a relationship of mutual confidence with developing countries unless the industrial countries are ready to act courageously in this sector. There is considerable anxiety among textile exporting developing 'countries-who also include some of the least-developed-that the major importers are not always living up to the spirit of the Uruguay Round agreement, whatever their observance of its letter. The developing countries are not seeking to rewrite the rules, but they are concerned to have a second integration phase that is more commercially meaningful, and they are anxious about what the end-loading *or* the commitments will mean in terms of the pressures importing countries face when they finally come to be implemented" (WTO 1996c, 4).

should be a powerful tool for developing countries to enforce the commitments made in the Uruguay Round. The obstacles that remain are largely practical: even with assistance from the Secretariat, initiating the prosecuting of a case will be burdensome for many developing countries, while the existence of disparate economic power may deter complaints against major trading nations; disparate power also continues to make the sanction of retaliation-more readily available than in the past-next to meaningless for many developing countries.

The same powerful, automatic procedures, including the provisions for retaliation, can and will be invoked *against* developing countries (Abbott 1995, 36).

Fortunately Abbott's fears thus far have not materialized. But as he rightly stresses, from the perspective of developing countries, the most important provision in the UR Understanding on Rules and Regulations Governing the Settlement of Disputes may be its Article 23 on "strengthening the multilateral system". It generally requires members of WTO to utilize and abide by rules of WTO's DS when any member seeks a redress of violation of WTO rules by another or of nonviolation nullification or impairment of the benefits it is entitled to under the WTO agreement. This was meant to preclude the use of unilateral procedures, e.g., US actions against several countries, namely India; Republic of Korea; Taipei,China; and Thailand, under Section 301 of the US Trade and Competitiveness Act. As noted earlier, the US took the unilateral route in its auto parts dispute with Japan. India is again on the "watch list" for possible future action under the same Section. Thus unilateral measures like Section 301 which are, as Abbott (1995, 32) rightly suggests, "a throwback to power relations" appear to be part of the trade landscape in spite of Article 23. This issue should be taken up by developing countries at the Singapore Ministerial.

One of the most serious problems with WTO's unified DS procedure, which is in principle applicable to disputes arising under all the multilateral and plurilateral trading agreements, is that it is subject also to DS rules specific to particular agreements such as the Agreement on Implementation of Article VI of GATT relating to Anti-Dumping Measures (ADMs) and Countervailing Duties. The most important article of this agreement, according to Abbott, is its Article 17.6.¹⁴

Abbott draws attention to the possibility of an aggressive interpretation of Article 17.6 by WTO DS panels, under which they could make their own determination (rather than requiring the complainant to demonstrate) of whether the impugned national measure was not based on an "objective and unbiased" evaluation of facts, and also could assert its own interpretation of the relevant article of the ADM code as the only possible one and deem the national measure as improper if it is different from its own. As Abbott rightly cautions, such an interpretation might lead to a crisis in the WTO legal system. In particular, given the openness and automaticity of the DS system, complaints that challenge politically entrenched

¹⁴ This article "... sets forth a unique 'standard of review' for DS panels reviewing national ADMs, as demanded by the US in November 1993.

Under Art. 17.6, a DS panel may review the facts determined by national ADM authorities, but its review must be limited to whether the authorities properly established those facts (an ambiguous phrase not otherwise defined) and whether their evaluation of the facts was 'unbiased and objective.' If these standards are met, the panel may not make different factual findings. The panel is also authorized to interpret the applicable provisions of the ADM Code. If the national authorities adopt a 'permissible' interpretation of the Code, however, the panel must uphold it, even if the panel concludes that a different interpretation is preferable....

Unlike the rest of the Code, which establishes objective rules to govern ADMs, the standard of review attempts to carve out an area of national discretion. Unlike the Understanding, which creates a powerful DS procedure, the standard of review attempts to limit the authority of WTO DS institutions. The standard of review is based on a faulty analogy, to judicial review of administrative decisions within a national legal system. It undercuts an important purpose of a global agreement by opening the door to inconsistent national practices. Finally, it sets a dangerous precedent by introducing a device that allows states to agree to strong rules in principle while retaining the ability to dilute them in practice" (Abbott 1995, 38-9).

programs of powerful states could not be excluded. Such complaints, if sustained by the DSB, might lead these states “to ignore a DS decision or even withdraw from the WTO rather than abandon the programs” (Abbott 1995, 40), thus threatening to undercut the DS system itself.¹⁵

With many developing countries dramatically lowering their high tariff and nontariff barriers, it is natural that their domestic import-competing sectors might be tempted to bring complaints of dumping by their foreign competitors. It may be politically difficult to resist pressures for action under ADM provisions of the WTO agreement. But given the “standard legal review” provision of Article 17.6 it is possible that such AD measures might be found to be WTO-compatible. If this were to occur increasingly, the liberal world trading order of the WTO will be threatened and the developing countries will lose not only by their own use of ADM and, more unfortunately, if such use in part leads to a weakening of WTO. A reconsideration of ADM Code and its relation to WTO’s DS system is urgent.

Institutional Reforms and Corruption

US Secretary of State Christopher said at the Jakarta meeting of the ASEAN in July 1996 that the Singapore Ministerial meeting should confront “the reality of illicit payments” because bribes were costing American companies billions of dollars in lost business.¹⁶ At the annual meetings of the joint Board of Governors of the World Bank and the International Monetary Fund in Washington at the end of September 1996, James Wolfenson, World Bank President, called national leaders of developing member countries to stamp out the “cancer of corruption” and warned that corruption undermined electoral support in developed countries for foreign aid in general and for multilateral lending agencies in particular and “diverts resources from the poor to the rich, increases the cost of running businesses, distorts public expenditures and deters foreign investors” in developing countries (*Financial Times* 1996a, 4). He is reported to have told the governor from Africa that development in their continent was being hampered by corruption, nepotism, and a lack of accountability in government. His counterpart in the IMF, Managing Director Michael Camdessus, apparently agreed in his speech that “countries must demonstrate that they have no tolerance for corruption in any form.” These pronouncements coming close to each other raise the prospect that market access as well as development assistance will be conditioned on “good governance” in a sense specified by the dominant powers in WTO, the World Bank and the IMF.

Christopher had presumably in mind the fact that US law punishes foreign corrupt practices by US companies while other countries do not have such laws, and this places US companies at a disadvantage in the competition for trade and investment in developing countries, particularly with respect to investment in infrastructure. For example, according to Finance Minister P. Chidambaram, India alone requires an investment of \$200 billion in infrastructure in the next five years and in his budget presented to India’s parliament in July 1996, he proposed the creation of a separate government agency to facilitate foreign investment in this sector.

The US government has identified ten “big emerging markets” (BEMs) and designed a strategy for helping US firms to seize opportunities that the markets offer. A study (US Department of Commerce

¹⁵ That this concern is a very serious one is illustrated by the fact that former Senator Robert Dole has proposed, “a WTO Dispute Settlement Review Commission made up of federal judges. The Commission would review final WTO decisions adverse to the US to determine whether the panel or the Appellate Body acted improperly. If the Commission made three affirmative decisions in a five-year period, any member of Congress could initiate an expedited legislative procedure potentially leading to withdrawal from the WTO. Failure to apply Art. 17.6 is an explicit basis for an affirmative decision. The WTO DS institutions will almost certainly try to avoid kicking off the WTO era with such a clear challenge to its most powerful member” (Abbott 1995, 40).

As yet, such a commission has not been established but the proposal has not been withdrawn either.

¹⁶ It would seem that perceived competitive disadvantage of the US vis-a-vis other developed countries in the markets of developing countries, rather than a concern about the deleterious consequences of corruption on developing countries, drives the US demand for a discussion of the issue at the Singapore Ministerial.

1995) by the US government identified the ten BEMs as Argentina; Brazil; ASEAN (now including Vietnam); the Chinese Economic Area (People's Republic of China, Hong Kong, and Taipei, China); India; Mexico; Poland; South Africa; Republic of Korea; and Turkey. The introduction to the BEMs study clearly states that in each of the markets

competition will be fierce. But, because many have important state sectors and because virtually all are focusing heavily on infrastructure projects that demand involvement of local governments US companies will need the US government *at their side to win a fair hearing*. What is more, because of the intensity of foreign competition and the capital demands on these economies, our competitors will be public-private partnerships in which foreign governments are providing concessionary financing and *aggressive advocacy* to support their companies' efforts. If we don't do the same, we will lose not only our chance to succeed in these markets but our chance to remain the world's largest economic leader in the next century" (US Department of Commerce 1995, 18; emphasis added).

The study goes on to identify the role and policies of the US government in promoting US interests in BEMs as follows:

There is an important role for our government to play in helping to stimulate our trade with each of the BEMs. The BEMs are unlike our more traditional trading partners, such as Great Britain or Germany. There are frequently severe barriers to entering these markets, including high tariffs, quotas and protectionist regulatory restrictions. Commercial systems, including full respect for intellectual property rights, smoothly functioning capital markets and open government procurement procedures, are often still developing or lacking altogether. In some of the BEMs, impartial legal systems are missing too. And as noted earlier, the nature of the competition we face in these markets is dramatically different from what we have been used to.

In these markets, therefore, we can and should help American businesses in a variety of ways from securing market access, to providing financing, to supporting US companies seeking to win major projects on deals in which foreign governments are helping their firms or play an important decision-making role in awarding projects (US Department of Commerce 1995, 22).

There is no doubt that other industrialized countries would also mount an aggressive effort to support their companies in the competition for investment and trade in the BEM as well as in other developing countries. It is essential that developing countries create an appropriate mechanism to deal with proposals from foreign companies, particularly those with the implicit or explicit support of their powerful governments behind them.

In this context, some features specific to foreign direct investment in infrastructure have to be kept in mind. Such investments usually involve a sizable chunk of capital, are lumpy, take several years to complete, and whose output is likely to be sold in markets that are regulated. These imply that there are likely to be few potential projects undertaken in a country within any reasonable time horizon, and a consortium, rather than a single investor, might have to be involved in financing a project. Lastly, and most importantly, failing to conclude an agreement to invest and starting project construction can create shortages in the future, since most infrastructural services cannot be imported. The visibility, size, and the fact that only a few projects can be undertaken also imply that intrusion of politics into their choice cannot be easily avoided.

The recent episode relating to the biggest foreign investment ever in India in the state of Maharashtra illustrates many of the problems. The investment by Enron, an American company, to build and operate a power plant costing \$2.8 billion, was approved by the state government then in power and the central government. The investor in effect was guaranteed a rate of return of 16 percent by the central government, and the price at which power was to be sold by the company to the state's electricity loan was also fixed in the contract. The contract was negotiated with Enron alone, and no competitive bidding was called for under India's fast track procedure for negotiations with foreign investors in power projects. This procedure was meant to enlarge electricity generating capacity rapidly so as to fill large anticipated shortfalls in power supply. However, the newly elected state government canceled the contract alleging (so far unproved) bribery by Enron, and also objected to the high price that Enron was to be paid for its supply of power. As the *Economist* (12 August 1995, 25-6) put it, "In the absence of competitive bidding, there was scope for cost-padding and crony capitalism. Accusations of corruption were inevitable, justified or not, and Enron's project bore the brunt, being the biggest of seven such projects, and the first." The *Economist* also reports that the central government has now wisely changed its power policy and decreed competitive bidding for future projects.

Enron and the state government have since renegotiated the terms, with Enron agreeing to scale down the price of power, lower capital costs, and abandon arbitration proceedings that it had initiated. Construction was to resume by August 1996. There is no doubt that, if the project had been abandoned, there will have been a significant shortfall in future power supply, a shortfall that cannot be eliminated since there are no alternative projects that are approved and ready to be implemented. Besides, there is no denying that the episode is likely to inhibit foreign investors, at least temporarily.

It goes without saying that inviting competitive bids, evaluating them, and then awarding a contract in a way that is transparent¹⁷, and precludes collusion and rigging in the bidding process, requires institutional and analytical capabilities that few developing countries are likely to have. While a vigilant and free press and the transparency of procedures would certainly help reduce, if not prevent, political and administrative corruption in the award of contracts, resisting pressure, not often very subtle, by foreign governments is another matter, particularly when the government applying pressure is a powerful one.

In the final analysis, corruption is a serious *domestic* political problem involving not only venality of and illegal transactions by bureaucrats, businessmen, politicians, and individuals, but it often has a connection to the financing of electoral campaigns. It can be addressed only by the *domestic* administrative, judicial and, above all, *political* processes. The President of the World Bank, in the same speech to which reference was made earlier, said as much when he said that the Bank could not intervene in the political affairs of its member countries but could only provide "advice, encouragement and support", for example, by barring companies that engage in "corrupt practices" from Bank financial contracts (*Financial Times* 1996a, 4).

Corruption investigations have recently led to indictments of prominent politicians in several developed (e.g., Italy, Japan) as well as developing (e.g., Brazil, India) countries. This is as it should be. Raising corruption as an issue affecting international competition for discussion in a multinational forum such as the Singapore Ministerial or making loans from multilateral lending agencies conditional on some narrow notion of "good governance" are unlikely to generate the domestic political pressures where none exist for eradicating corruption and could even be counterproductive.

Leaving aside corruption, there are other areas in which domestic institutions have to be reformed if maximum benefit is to be derived by developing countries from global integration. First of all, greater transparency and insulation from the politics of decision making on trade and foreign investment issues should be achieved by establishing *technical and quasijudicial* bodies for making recommendations to the government on them. For example, a Trade and Industry Commission could be entrusted with assessing proposals for foreign investment, relief from import competition, complaints of dumping etc. The

¹⁷ The draft declaration by trade ministers at the Singapore Ministerial reportedly includes a commitment to negotiate an accord on transparency in government procurement. Apparently this was included as a concession to the US which believes transparency will curb corruption (*Financial Times* 1996f).

Commission would hold public hearings in which all affected interests (including foreign interests) will have an opportunity to present their case. Commissioners will be experienced professionals. The conception of Japan's MITI (Ministry of International Trade and Industry) as an omniscient and omnipotent agency that is solely responsible for Japan's rise to economic superpower status has led some to suggest going further and establishing a powerful agency to coordinate decisions of all economic ministries. Whether or not MITI indeed was responsible for Japan's growth, centralization of decisions in a single agency is unlikely to be of help in most developing countries.

The reforms often involve contracting out to the private sector of activities, such as construction of roads and other public works, previously directly executed by the public sector. Such a shift, to be effective, has to ensure that there is adequate competition among private contractors, and appropriate and transparent procedures for evaluation and award of contracts. To take another example, the reform of the financial sector often involves removal of controls on lending and deposit rates, and drastically reduces the volume of directed credit, i.e., credit allocated in such volume and such terms, and to such sectors (or may be even to specified borrowers) as directed by the government. Banks, whether public or private, have little room to choose among alternative lending opportunities when interest rates are controlled, and the volume of funds either appropriated by the government to itself at zero interest through various reserve requirements, or directed by the government to be lent on specified terms, forms an overwhelming proportion of the deposit base. But once the reforms are in place, the banks must acquire the capacity to evaluate the risks and return from alternating lending opportunities, and, particularly over the longer term, the information needed for such an evaluation, and institute procedures for making evaluations routine.

The next example involves creation of research capacity and institutional structures for managing inflows of external capital, particularly of volatile portfolio investment. With the opening up of large economies such as Brazil, People's Republic of China, and India that were earlier closed to foreign investment, the volume of private capital flowing to them has increased. On the one hand, such flows, if not sterilized by the Central Bank, can lead to an appreciation of the exchange rate and a consequent loss of international competitiveness. On the other hand, if they are sterilized (as for example in Brazil), domestic interest rates might rise, attracting even more inflows. Also, servicing the additional domestic debt from sterilization could exacerbate an already weak fiscal situation. Besides, given the substantial volatility of such flows, an adverse shock (*not necessarily* to the "fundamentals" of the economy) could trigger massive outflows. The recent experience of Mexico is instructive in this respect. An appropriate level of exchange reserves along with access to credit to accommodate such outflows would be needed if a disruptive change in the exchange rate is to be avoided. To analyze how much, if any, of the inflows are to be sterilized, and to calculate the "appropriate" level of reserves (and the amount of credit to be held in reserve) are issues that would be challenging even to the best trained and experienced decision makers at the Central Bank. Whether the central bank can sterilize at all in large part depends on the market for government debt. If privately-held stock of public debt is relatively small, and a secondary market for debt is absent, sterilization by the central bank through open market operations is infeasible.

The last example relates to privatization of public enterprises. Some of the enterprises proposed to be privatized often have a significant share of the market for their product or may even be monopolies (for example, the public utilities such as electric power companies). In such cases, or more generally in cases where adequate market competition among private enterprises is unlikely, a framework of regulating the market behavior of private firms has to be established prior to privatization. As mentioned earlier, domestic regulatory policies are likely to move into the areas of international negotiations, under the rubric of competition policies in the next round of MTN under the WTO. Scherer (1994, 92) has already proposed the creation of an International Competition Policy Office within the ambit of the WTO. Developing countries, which already have a regulatory framework or about to design one as part of their reforms, are likely to come under pressure.

An area of economywide and systemic significance in which innovation and reform would be needed in the post-UR world is the legal system and, more broadly, the constitutions of some developing countries. Needless to say, as the role of the market expands and foreign suppliers and investors are

viewed with enthusiasm rather than suspicion, commercial laws have to be streamlined and made transparent. The cost in terms of time and resources needed, not only to meet the legal requirements of setting up an establishment, floating equities, or selling commercial paper in the domestic financial markets etc., but also to settle any commercial disputes, has to be reduced. In some of the so called “transition economies” in which the experience with the market economy is a distant memory and where rights to private ownership of means of production had been abolished long ago, the task of creating an appropriate legal framework is much broader and more complex than in mixed economies of many developing countries.

There are two other sets of laws that need to be examined from the perspective of their potentially being major constraints on the economic liberalization process. These are bankruptcy and labor laws. In some of the larger developing countries (e.g., India) in which the public sector had been assigned a dominant role in the strategy of development and was also expected to be a “model” employer, the laws were designed to make it extremely costly for an enterprise to go bankrupt, in both public and private sectors. Indeed, those private enterprises which were no longer profitable were taken over by the public sector, and run often at greater losses, primarily to ensure the continued employment of their workers. Clearly, privatization cannot go very far in such a context without a reform of bankruptcy laws. Related issues are laws governing the hiring, firing, job security, wages, fringe benefits etc. of workers. Many developing countries have enacted labor laws in imitation of those that are on the statute books of much richer developed countries. These do not reflect the economic realities of their own labor market. A labor-aristocracy consisting of an extremely small proportion of the total labor force employed in the organized manufacturing and the public sector including public administration enjoy the benefits conferred by such laws while the bulk of the labor force has no access to such benefits. It is easy to see that such laws, if enforced, would raise labor costs beyond what they would have been in an equilibrium of the labor market with laws in consonance with the development stage of the country. These have to be drastically amended, if not repealed, for such countries to reap the maximum benefits from a liberalized world market for labor-intensive manufactures in which they are likely to have a comparative advantage.

The effects of the changed global economic environment since many developing countries liberalized their foreign trade and investment and the conclusion of the UR are already evident in many spheres. Two are particularly noteworthy. Flows of portfolio investment (particularly from institutional investors in developed countries) to some developing countries have increased significantly. A scramble is also under way from foreign investors, including multinationals, to get a piece of the huge investment in infrastructure (particularly power transport and telecommunication) that many developing countries (including People’s Republic of China and India) are to undertake. A number of institutional innovations and reforms are needed to ensure that developing countries benefit from such flows and investment and avoid some of the inherent pitfalls.

The innovations needed for enhancing the capacity of the Central Bank to manage the impact of the foreign capital inflows were pointed out earlier. Managing portfolio flows as well as borrowing in world capital markets by domestic firms through the so-called global depository receipts require setting up institutions (if none exist) for regulation of markets for financial securities as well as reforming transactions procedures in such markets. In some developing countries, ostensibly to prevent what is deemed to be destructive speculation and speculative bubbles, formal futures trading is prohibited. Of course, this does not prevent such trading from taking place informally. After having reformed financial markets, established prudential norms, and created appropriate regulatory institutions, the ban on future trading or, for that matter, restriction of the creation and sale of new financial products (including derivatives) has to be evaluated.

Conclusions

The Singapore Ministerial Conference of the WTO's governing body in December 1996 is its first. It is most likely to prove decisive for the future functioning of the WTO and the prospect for the continuation, rather than reversal, of the process of global integration through the multilateral process. There is enough work for the ministers to do to ensure that the implementation of the UR agreement is on track, and to make progress on what was left partially finished in the UR, for them to entertain any new business! Yet, according to the *Financial Times* (1996d), after months of discussions in Geneva, WTO members are at odds over what, if anything, the Singapore Ministerial should achieve. Some trade diplomats apparently fear that the meeting could be embarrassingly short of substance or become a public platform for WTO members' disagreements.

Such an unfortunate outcome cannot be ruled out, given the fact that some powerful members of the WTO, bowing to domestic protectionist pressures, have already announced their intention to bring up for discussion, essentially nontrade-related new issues such as a "social clause" in the mandate of WTO at the meeting. The work of WTO's committee on Trade and Environment will be reviewed at the meeting. It is one thing to say, as Director-General Ruggiero did, that the Committee has made a good start on integrating "environmental concerns into trade policy analysis in the WTO" and in recognizing that "the trade and the trading system have a significant contribution to the promotion of sustainable development" (WTO 1996c, 5), and entirely another to recommend an unfortunate link between market access and performance with respect to environment.

Regarding labor standards, Ruggiero sees the emergence of four areas of common ground:

The respect of core labor standards has been agreed by all Members in the Universal Declaration of Human Rights; All delegations have recognized the primary role of the ILO in international labor issues; The competitive advantage of low-wage countries has not been called into question; and no one has opposed statements by major proponents of the issue that trade sanctions are not envisaged (WTO 1996c, 6).

But he rightly recognizes that it will not be easy

to agree even on a statement based on these four points. Some delegations argue that a reference to these principles could be used by others as a justification for unilateral measures. *Others are asking why, if we are not envisaging trade sanctions and not questioning competitive advantage, we should bring this issue to an organization which deals with trade problems on a contractual basis.* And I must tell you that a sizeable number of delegations strongly oppose any follow-up in the WTO (WTO 1996c, 6; emphasis added),

Given the power realities, unless the developing countries are united and vigilant, the demand for an unfortunate link between market access and performance with respect to labor and environment might yet be put forward at the Singapore Ministerial.

There is also the issue of the proliferation of preferential trading arrangements under which discriminatory trade barriers, based on complex rules of origin that are themselves endogenous responses to protectionist interests, are inherent. Unfortunately, many developing countries are actively engaged in negotiating their membership in one or more such arrangements. However, the recent reaffirmation of their preference for the multilateral approach by the Asian members of APEC at their Osaka meeting in November 1995 is an encouraging sign against this trend. Also, the extension of the North American Free Trade Area further into the Americas, and its enlargement into a Transatlantic Free Trade Area appears to be on hold.

Yet, it is an unfortunate fact that the notion that liberalization of trade, even if it is only on a preferential basis among members of a group of countries, is *always* to be applauded is gaining ground.¹⁸ Ruggiero seems to agree:

The regional liberalizing impulse is not in itself cause for alarm among the upholders of the multilateral system. Regional initiatives can contribute significantly to the development of multilateral rules and commitments; and in *regions* such as Sub-Saharan Africa they may be an essential starting-point for integration of least-developed countries into the wider global economy. At the most basic level the real split is between liberalization, at whatever level, and protectionism. Viewed from this perspective regional and multilateral initiatives should be on the same side, mutually supportive and reinforcing (WTO 1996b, 10).

But he added,

However the sheer size and ambition of recent regional initiatives means we can no longer take this complementarity for granted, if indeed we ever could. We need a clear statement of principles, backed up by firm commitments, to ensure that regional schemes do not act as a centrifugal force, pulling the multilateral system apart.

The answer is to be found, I suggest, in the principle which some of the newer regional groupings have enunciated—Open Regionalism (WTO 1996b, 10).

Ruggiero contrasted two interpretations of Open Regionalism. The first essentially required that any regional preferential trade arrangement be consistent with Article XXIV of GATT, 1994, and the understanding on its interpretation incorporated in the UR agreements on Trade in Goods. In the second,

... the gradual elimination of internal barriers to trade within a regional grouping will be implemented at more or less the same rate and on the same timetable as the lowering of barriers toward nonmembers. This would mean that regional liberalization would in practice as well as in law be generally consistent with the m.f.n. principle (WTO 1996b, 11).

He concluded,

The choice between these alternatives is a critical one; they point to very different outcomes. In the first case, the point at which we would arrive in no more than 20 to 25 years would be a division of the trading world into two or three intercontinental preferential areas, each with its own rules and with free trade inside the area, but with external barriers still existing among the blocs (WTO 1996b, 11).

He clearly expressed his preference for the second, arguing that it

... points toward the gradual *convergence* of regionalism and multilateralism on the basis of shared aims and principles, first and foremost respect of the m.f.n. principle. At the end we would have one free global market with rules and disciplines internationally

¹⁸ Lawrence Summers, US Undersecretary of the Treasury argued in 1991: “Economists should maintain a strong, but rebuttable, presumption in favor of all lateral reductions in trade barriers, whether they be multi-, uni-, bi-, tri-, plurilateral. Global liberalization may be best, but regional liberalization is very likely to be good” (Bhagwati and Krueger 1995, vii).

agreed and applied to all, with the capacity to invoke the respect of the rights and obligations to which all had freely subscribed. In such a world there could and must be a place for China, Russia and all the other candidates to the WTO (WTO 1996b, 11).

Notwithstanding the director-general's favored second interpretation, it seems odd, after all, if regional liberalization is to be extended *on the same timetable* "in practice and in law" to nonmember countries on an MFN basis, that it would be multilateral and not regional. If that is the case, why would any group initiate it on a regional basis in the first place? The concern of the Director-General that mere consistency with Article XXIV is not enough to preclude the possibility of a world of warring trade blocs is well taken. But to avoid such a possibility steps have to be initiated to strengthen the process of review in the WTO of proposed regional agreements.

A committee on regional trade agreements was established by the General Council of the WTO in February 1996. The Committee is to examine 23 proposed agreements presumably for their compatibility with the WTO and the General Agreement on Trade and Services (GATS) and, inter alia, "to consider the systemic implications of such agreements and regional initiatives for the multilateral trading system and the relationship between them, and make appropriate recommendations to the General Council" (WTO 1996a, 10). The Committee met first during 21-22 May 1996, and further meetings are scheduled before the Singapore Ministerial. It is to be seen whether the Committee will have greater success than the Working Parties of the GATT had in the past in examining the compatibility of regional agreements with Article XXIV, and whether it will resist the temptation to put political compulsions above the need to assess the seriousness of the threat posed by such agreement to the principle of nondiscrimination that is the foundation of WTO. Even while awaiting the Committee's report on the systemic implications of regional trade agreements, the developing countries could take the initiative in this regard and come up with their own proposals at the Singapore Ministerial. In any case, they would do well to pause before rushing into any regional PTAs.

There is another issue with potentially very serious implications on the future of the WTO, viz., the Helms-Burton law of the United States under which non-US companies could be sued by private parties in US courts for "trafficking" in those assets confiscated by the Cuban government from them, and the D'Amato Act which targets foreign investors in Iran and Libya. In the first of his televised debates with his opponent Robert Dole in the 1996 presidential elections, President Clinton had this to say about the Helms-Burton and the lawsuits that could be filed under it:

Senator Dole is correct. I did give about six months before effective date of the act before lawsuits can actually be filed, even though they're effective now and can be legally binding, because I want to change Cuba. And the United States needs help from other countries. *Nobody in the world agrees with our policy on Cuba now, but this law can be used as leverage to get other countries to help us to move Cuba to democracy* (*New York Times* 8 October 1996, B9; emphasis added).

It should come as no surprise that the foreign ministers of the European Union have decided to pursue in the WTO their complaints against Helms Burton and anti-Cuba laws and their extraterritorial reach (*Financial Times* 1996b). According to the same report, the US has threatened to invoke the national security exemption permitted under the WTO rules for these laws. The report points out that

If the US sticks to its guns, a WTO disputes panel will have to decide whether it must define the exemption's scope in order to hear the case. Either way, it faces a difficult dilemma. 'If a panel accepted the US argument, it could open the floodgates for defendants in other cases to use national security as an excuse for breaking WTO rules,' said one trade diplomat. That would emasculate the disputes settlement procedures. 'But if a panel found the US defence invalid, it could be accused of over-riding a state's

sovereign right to define its national security interests. Given the current mood of the Congress, that would be playing with fire.'

The developing countries are not directly involved in this dispute. However, if contrary to the belief of some diplomats in Geneva, either the US and EU do not settle their differences before a WTO dispute settlement panel is set up, or if President Clinton chooses not to defuse the dispute in case of reelection, the fallout will surely hurt them, regardless of how the panel resolves the dispute.

Apparently, the draft ministerial declaration at the Singapore meeting calls for work to begin on investment and competition policy, both issues being pushed strongly by the EU (*Financial Times* 1996f). Competition policy involves legal and regulatory frameworks, which, in many developing countries, are rudimentary. In any case, for most developing countries, openness to external trade and competition is the most effective competition policy. It is premature for them to enter into multilateral codes on this issue until they have completed their external trade liberalization.

With respect to investment, the question is whether the members of WTO should create a comprehensive multilateral discipline to govern foreign investment, particularly foreign direct investment (FDI).¹⁹ To assist the members in analyzing the issues involved, the WTO secretariat recently published a report on trade and FDI (WTO 1996e). The report notes the growing importance of FDI as well as its geographical concentration, both in terms of countries of origin and of destination:

- During 1986-89 and again in 1995, outflows of FDI grew much more rapidly than world trade. Over the period 1973-95, the estimated value of annual FDI outflows multiplied twelve times (from \$25 billion to \$315 billion), while the value of merchandise exports multiplied eight and a halftimes (from \$575 billion to \$4,900 billion).
- Sales of foreign affiliates of multinational corporations (MNCs) are estimated to exceed the value of world trade in goods and services (the latter was \$6,100 billion in 1995).
- Intra-firm trade among MNCs is estimated to account for about one-third of world trade, and MNC exports to all other firms for another third, with the remaining one-third accounted for by trade among national (non-MNC) firms.
- Developed countries account for most of the worldwide FDI outflows and inflows, but developing countries are becoming more important as host and home countries.
- The share of the non-OECD countries in worldwide FDI inflows, which decreased in the 1980s, increased from nearly 20 to about 35 percent between 1990 and 1995. However, these flows were highly concentrated, with 10 countries receiving nearly 80 percent of the total (\$78 billion out of \$102 billion).
- Nearly one-third of the 10 leading host economies for FDI during 1985-95 are developing economies. China is in fourth place, with Mexico, Singapore, Malaysia, Argentina, Brazil and Hong Kong also on the list.
- Non-OECD countries accounted for 15 percent of worldwide outflows of FDI in 1995, compared with only 5 percent in the period 1983-87 (WTO 1996e, 52-3).

The fact that there are economic and institutional linkages between trade and investment is well recognized. It is also well-known that not all forms of FDI (e.g., investment that is response to high barriers to imports) are necessarily desirable from the perspective of welfare of citizens of host countries. Besides, restrictive practices by transnational corporations could also hurt. Of course, beneficial effects through technology transfer and expansion of export markets are documented as well. The UR agreement on Trade Related Investment Measures and the General Agreement on Trade in Services both represented multilateral approaches to some aspects of investment. It is fair to say, however, that the perceived need for a framework to protect and promote foreign investment has resulted in a proliferation of bilateral

¹⁹ I thank Jagdish Bhagwati for helpful comments on this issue.

investment treaties (including some among developing countries), regional initiatives as part of preferential trading agreements (e.g., APEC, ASEAN;EU, MERCOSUR, NAFTA), and a few plurilateral agreements (e.g., European Energy Charter Treaty). While bringing order to the possible chaos created by this proliferation, though a comprehensive multilateral treaty is certainly desirable, it is much too soon to initiate negotiations, whether or not they are undertaken under the auspices of the WTO.

The reasons for caution are several. I will mention just two. First of all, in contrast to trade in goods and services, the issue of national sovereignty is involved in a much more direct way in the case of foreign investment. Most developing countries became sovereign only after the end of the Second World War. It is understandable that they are still very sensitive to agreeing to negotiations that might call for them to compromise their sovereignty. However, sensitivity to threats against sovereignty is not unique to developing countries. After all, many in the US Congress consider the WTO's dispute settlement system as posing a threat to US sovereignty. More importantly, the failure of the US to sign or ratify several ILO conventions has been attributed by Charnovitz (1995, 178) to the fear that ratifying a convention could lead to its enforcement by domestic courts, thus superseding any federal or state laws that might be in conflict with the convention. Further, many Americans apparently are reluctant to have US policy reviewed by any international organization.

Second, most of the economic and policy analyses relating to transnational companies and Fill has been done from the perspective of developed countries. Proposed investment codes, such as that being formulated by the OECD, draw on this work. It is natural that issues like right of establishment, transparency, national treatment etc. are viewed from the perspective of easing entry of transnationals. On the other hand, developing countries are rightly concerned about restrictive practices and potential collusive behaviour by transnationals and competition among developing countries to attract them through fiscal incentives. Any proposed code has to address the possible ruinous, race-to-the-bottom competition through subsidies for it to be attractive to developing countries. After all, with respect to goods, trade subsidies (except in agriculture) are against WTO rules. This is not to say of course, that race-to-the-bottom is inevitable, and transnationals will necessarily engage in restrictive practices. Yet, in the absence of a thorough study of various concerns of developing countries, their rushing into negotiations with only codes from organizations of developed countries (e.g., OECD) as negotiating texts would not be advisable. Clearly such a study could be undertaken by a body of experts under the aegis of the Centre for Transnational Corporations in UNCTAD or some other such organization.

I would also note that while active efforts to promote free flow of capital across national borders through an investment code are being made, there is a curious asymmetry when it comes to labor flows. In fact, there is a deafening silence on the part of rich members of WTO when it comes to migration of labor across national borders from poor to rich countries. Clearly, if the concern about low labor standards in poor countries arises from altruism on the part of citizens of rich countries, such citizens could pressure their own governments to lift any restrictions on immigration of workers from countries with poor labor standards. This would be a *direct and far more effective means* of expressing their concerns than relying on the indirect means through linking trade and labor standards in the form of a social clause in the mandate of the WTO. Indeed, there is support for lifting such restrictions on moral-philosophical grounds as in the writings of John Rawls (1993a). He views freedom of movement and freedom of choice of occupation as essential primary goods equivalent to other basic rights and liberties, the entitlement to which is not open to political debate and allocation through the political process. While Rawls was writing about these freedoms in the context of constitutional essentials of a just society, what should be implicit in the very expression of humanitarian concerns about others is a view of the whole human race as one society. As such, a natural extension of Rawls' ideas would treat freedom of movement of humans across artificial political boundaries as a basic human right.²⁰

²⁰ By accepting existing political boundaries, Rawls himself does not make such an extension in his essay on "Law of Peoples" (Rawls 1993b) and is criticized for this failure by Ackerman (1994) who, in his earlier work (Ackerman 1971, 89-95, 256-57), argued that while there may be some grounds for restriction on immigration in

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real-world states, not only should such restrictions be exercised with great care, given the ease with which they may be abused, but also, such restrictions must be accompanied by a massive increase in foreign aid.

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