DOMESTIC POLICY OBJECTIVES AND THE MULTILATERAL TRADE ORDER: LESSONS FROM THE PAST*

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1. INTRODUCTION

Trade issues are rarely discussed in isolation from other policy issues. The conference that led to the Havana charter for an International Trade Organization (ITO) was the United Nations Conference on Trade *and Employment*. Chapter II of the charter assigned to the ITO the task of resolving the most pressing economic problems of the late 1940s, including attaining full employment, eliminating *balance-of-payments disequilibria*, action against *inflationary or deflationary pressures*, and promoting *fair labor standards*. Chapter III committed the ITO's members to cooperation on economic development and reconstruction, and chapters III and V established the ITO as a forum for negotiating agreements on technology transfer, foreign investment, double taxation, and restrictive business practices, as well as commodity agreements (ICITO 1948).

While the Havana charter was never adopted, its chapter on commercial policy survived in the form of the GATT. Linkages taken over into the original GATT concerned *balance-of-payments disequilibria* and *competition*, to which a linkage between trade and *development* was subsequently added. Under the WTO, commitments on trade in goods have now been linked with

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commitments on *intellectual property rights* through an integrated dispute settlement mechanism.

When the Uruguay Round was brought to a close in April 1994 at the Marrakesh ministerial, the list of linkages with trade proposed by various speakers included *environmental policies, internationally recognized labor standards, competition policy, company law, foreign investment, immigration policies, development, political stability, and alleviation of poverty* (GATT Document MTN, TNC/45 [MIN], 12). Only one of these proposals was accepted: the Decision on Trade and Environment provides for the WTO to continue the work of the GATT on environment (GATT 1994, 469). Efforts to link trade with labor standards did not succeed at the WTO ministerial meeting in Singapore in December 1996, but two working groups were established to study the relationship between trade and *investment* and the intersection between trade and *competition*, respectively.

As the preceding paragraphs demonstrate, linkages between trade and other policy areas have long been a feature of the multilateral trade order, and recent events suggest an intensification of the trend. The pursuit of domestic policy objectives through the multilateral trade order raises fundamental issues for the newly established WTO. Will such linkages be beneficial or harmful to the young institution? Will the attainment of domestic policy objectives be furthered or frustrated by their integration into the world trade order? Will regimes established in disparate policy areas mutually reinforce or weaken each other when interacting in a single treaty with an integrated enforcement mechanism?

This paper attempts to shed light on these questions by examining the experience of the GATT with the linkages made between trade and balance-of-payments matters, development policies, and objectives of antitrust policies. This paper argues that the integration of these subject matters into the multilateral trade order undermined *both* the trade order *and* the attainment of the objectives in those nontrade policy areas. At least two important lessons can be drawn from this experience: first, the pursuit of domestic policy objectives through trade policy instruments is not judicable and therefore leads to a de-legalization of international trade relations; and second, exemptions from trade policy disciplines designed to permit the pursuit of domestic policy objectives attract protectionist forces that eventually subject that objective to their ends. The application of these lessons to the trade and environment linkage is considered in detail.

2. The Pursuit of Domestic Policy Objectives through the GATT

2.1. Trade and Monetary Policies

Within nations, trade policy and monetary policy are conducted in isolation. Trade policies are basically structural policies determined by legislators for long periods of time, while monetary policies are conducted on a daily basis by central banks, often politically independent of the executive and legislative branches. Trade and monetary policies are generally implemented with different instruments: trade policies with tariffs, quotas, and similar measures; monetary policies with interventions in the exchange and money markets.

The architects of the postwar economic system nevertheless considered that it was necessary to link these two policy areas. GATT contracting parties were permitted to impose import restrictions for the purpose of correcting a balance-of-payments deficit; in other words, to use trade policy instruments to achieve monetary objectives. According to article XII of the GATT, which applies to all WTO members, and section B of article XVIII, which applies only to developing countries (GATT 1994, 501, 512), a WTO member may impose import restrictions to safeguard its external financial position provided the restrictions do not exceed those necessary to prevent a serious decline, or achieve a reasonable increase, in its monetary reserves. The restrictions need not be withdrawn even if a change in monetary policies would make them unnecessary.

The 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes of the GATT contracting parties recognized that "trade measures are in general an inefficient means to maintain or restore balance-of-payments equilibrium" (GATT 1978-79, 205). This statement is regarded by most economists as a truism. Since the fundamental cause for a balance-of-payments deficit is normally an excess of domestic consumption over domestic production, the solution lies in most cases in restrictive fiscal and monetary policies that help reduce the overall level of consumption. Imposing import controls on particular products will influence the *pattern* of domestic consumption but cannot have any predictable and durable impact on the overall *level* of domestic consumption. Like devaluations, import controls change the prices of internationally traded products, but only for

imports and not exports, and therefore constitute at best "half a devaluation" (GATT 1983, 16).

In practice, the trade measures imposes under articles XII and XVII:B of the GATT have not been applied across the board to all imports and have thus distorted the price relationships not only between imports and exports but between different categories of imports. Such distortions inevitably entail additional inefficiencies, widening the gap between domestic production and consumption. For these reasons, the only predictable consequence of an import restriction imposed under the GATT's balance-of-payments provisions is a worsening of the balance-of-payments deficit.

What practical use did the GATT contracting parties make of the balance-of-payments provision? In the immediate postwar period, they were mainly invoked by European countries struggling to achieve the convertibility of their currencies. In the 1960s, when convertibility had been achieved, many European countries, eschewing devaluations, used the provision to justify import restrictions designed to maintain the exchange value of their currencies. In 1971, the United States invoked article XII to justify an import surcharge imposed to force its trading partners to accept a revaluation of their currencies in relation to the dollar. Since the replacement of the International Monetary Fund's (IMF) par value system by a system of flexible exchange rates in the early 1970s, industrialized countries ceased almost completely to invoke the GATT's balance-of-payments provisions (Roessler 1975).

These provisions then became the almost exclusive preserve of the developing counties, which invoked them, often for decades or longer, as a legal justification for their import substitution policies. By doing so, developing countries avoided the procedural strictures of GATT article XVII:A and C, which were meant to be the legal basis for restrictive import measures imposed for development purposes. As import substitution policies became less popular and the pressure on the more advanced developing countries to liberalize grew, they began to disinvoke voluntarily the balance-of-payments provisions. In 1995 and 1996, seven WTO members ceased to apply article XVII:B or gave undertakings to disinvoke it. In early 1997 the IMF found that India did not have a balance-of-payments problem justifying an invocation of article XVII:B. The only members still consulting in the WTO Committee on Balance-of-Payments Restrictions

(BOP Committee) are Bangladesh, Hungary, Nigeria, Pakistan, Sri Lanka, and Tunisia. Of these countries, all except Hungary have invoked article XVIII:B since their accession to the GATT.[1]

The determination as to what constitutes a serious decline or a reasonable increase in reserves is made by the BOP Committee on the basis of a determination by the IMF. According to article XV:2 of the GATT, the IMF's views on this matter must be accepted by the WTO (GATT 1994, 507). Under the current monetary system, however, the IMF faces an impossible task. The level of import controls necessary to resolve the reserve problem depends on the level of the exchange rate: the greater the devaluation, the less protection will be required to safeguard the external financial position. In the past, the IMF's par value system dictated the choice of the exchange rate, namely the exchange rate agreed with the IMF, but under the current monetary system, the choice of any exchange rate by the IMF would be arbitrary. If it chooses the exchange rate that prevails after the introduction of the import restrictions, its determination would only reflect what the market has already decided and automatically sanction the level of import controls actually applied. If it chooses the exchange rate that would be required to eliminate the need for the restrictions, it would effectively eliminate the right under articles XII and XVIII:B to impose restrictions. In short, the criteria that determine the level of restrictions have not been capable of rational application for more than two decades—except for the determination that a country has no balance-of-payments problems and therefore the level of restrictions should be zero—but the GATT, and now the WTO, have nevertheless not adopted any other criteria.

The linkage between trade and monetary matters has helped neither the GATT nor the IMF in the pursuit of their basic objectives. The right of all WTO members to impose import restrictions in the event of a balance-of-payments deficit creates significant legal uncertainty in international trade relations, and nourishes the illusion that import controls can reduce a deficit. It is disquieting that the United States could now, consistent with its WTO obligations and section 122 of its Trade Act of 1974, impose a surcharge on a wide range on its imports, or that China could, once it becomes a WTO member, withdraw all the market-

[1] Information supplied by the WTO Secretariat.

access commitments now painfully being negotiated in the process of its accession to the WTO simply by writing a letter to the director general of the WTO. In practice, the use of balance-of-payments provision by developing countries deprived them of the possibility to invoke GATT disciplines to ward off domestic protectionist pressures. The restrictions originally imposed in a payments crisis often created their own pressure groups, making their subsequent removal politically difficult or impossible. As a result, the countries disinvoking the balance-of-payments provisions generally required long transition periods to phase out the restrictions.

From the perspective of the monetary order, the balance-of-payments provisions of the GATT have also not had a favorable effect. Article IV:1 of the Articles of Agreement of the IMF states that "the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries" (IMF 1978, 6). However, the GATT balance-of-payments provisions allowed governments to postpone devaluations and therefore to mask the most visible sign of fiscal or monetary mismanagement. By helping governments postpone the political consequences of mismanagement, these provisions created a permanent moral hazard for governments, undermining the smooth operation of the international monetary system.

The right of GATT contracting parties to impose IMF-sanctioned trade controls in payments crises originally served to promote the goals of convertibility and of exchange rate stability, considered by the architects of the postwar international economic order to be of a higher priority than trade liberalization. Now the convertibility of the major currencies has been achieved and exchange rate stability as such has ceased to be a goal of the IMF. Nevertheless the IMF insisted throughout the Uruguay Round on the maintenance of GATT's balance-of-payments provisions and even on their extension to the General Agreement of Trade in Services (GATS).[2] One explanation is that the balance-of-payments provisions give the IMF the possibility to approve trade measures that permit its members in payments crises to use their scarce financial resources to reimburse their debts rather

[2] See the Declaration on the Relationship of the World Trade Organization with the International Monetary Fund (GATT 1994, 447), and articles XI and XII of the GATS (GATT 1994, 337).

than to pay for additional imports. The provisions sought by the IMF thus give it the competence to approve measures designed to protect its own financial interests and those of its members.

The response to the above observations might be that the link between trade and monetary matters is a fact of political life, without which the world trade order would not be politically realistic. In reply, it could be pointed out that the world trade order should not pave the way to disaster but react appropriately when it occurs. Debt crises are also a political fact of life, but the creation of a formal legal framework for the rescheduling of debts has been wisely avoided. Rather than granting WTO members an almost unconditional right to impose trade controls for decades merely because of a payments deficit, the WTO should grant ad hoc time-bound waivers when grave crises arise, on conditions tailored to the circumstances of the case. The explicit and permanent linkage between trade and monetary matters incorporated in 1947 into the GATT has neither an economic rationale nor a political rationale and serves neither the purpose of the world trade order nor that of the international monetary system.

2.2. *Trade and Development Policies*

The central theme of international economic diplomacy in the 1960s and 1970s was third world development. The Charter on the Economic Rights and Duties of States, adopted by the United Nations in 1974, made all aspects of international economic cooperation subservient to the goal of development (General Assembly resolution 3281 [XXIX] of 12 December 1974). In the GATT decision on "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries" (GATT 1978-79, 203), the principle of nonreciprocity in trade negotiations between developed and developing countries was recognized, developed countries were permitted to accord tariff preferences to developing countries under the Generalized System of Preferences (GSP), and developing countries were accorded the right to exchange preferences among themselves in the name of collective autonomy.

Today, the new international economic order is long forgotten, and the charter lies in the wastepaper basket of history. Declining tariffs eroded the commercial attraction of the GSP, and it never achieved its ethical mission—to create greater equality among nations—because the benefits were concentrated on a small

group of highly advanced developing countries. The principle of nonreciprocity had on balance a negative impact on trade liberalization: rather than inducing developed countries to liberalize unilaterally imports in sectors of export interest to the developing countries, such as textiles and agriculture, the principle provided developing countries with a justification for refusing to make market-access commitments and to sign the agreements on nontariff measures concluded in the Tokyo Round. As a result of the principle of nonreciprocity, developing countries were deprived of the main benefit of GATT membership, namely the exposure to a system of rules and procedures that help correct the protectionist bias in trade policymaking, and of the benefits of adherence to codes of good government practice incorporated in the Tokyo Round agreements (Hudec 1987). The cause of development was manifestly not served by releasing developing countries from their GATT obligations.

The trade and development linkage eliminated the rule of law in north-south trade relations. The most-favored-nation rule was removed, but no other rule of conduct was put in its place. The beneficiaries of the principle of differential treatment were never defined. The GSP permits the donor countries to unilaterally determine the beneficiaries and to withdraw the preferences at any time, which led developed countries to impose numerous conditions on the grant of the preferences. Thus, the main preference donors, the United States and the European Community, each make GSP benefits conditional on the adoption of certain labor standards, cooperation in drug control, and many other policy conditions.[3] The nonreciprocal nature of the preferences thus

[3] Under Title V of the United States Trade Act of 1974, a developing country cannot receive preferences if inter alia the country expropriates or otherwise seizes control of property owned by a U.S. citizen, including patents, trademarks, and copyrights; repudiates an agreement with a U.S. citizen; imposes taxes or other excations with respect to property of a U.S. citizen; refuses to cooperate with the United States to prevent narcotic drugs from entering the United States unlawfully; aids or abets any individual or group that has committed an act of international terrorism; denies its workers internationally recognized rights, including acceptable minimum wages; refrains from enforcing arbitral awards; is a member of the Organization of Petroleum Exporting Countries.

Under article 3:2, 7, 8, and 9 of Council Regulation (EC) 3281/94 of 19 December 1994 (Official Journal of the European Communities, 31 December 1994, no. L 348/1), the European Community makes GSP benefits available to countries that conduct a campaign to combat drugs; apply the conventions of the International Labor Organization on the freedom of association, on the

turned out to be an illusion: rather than reciprocating in the field of trade, the developing countries were forced to make concessions in other policy areas without receiving legally guaranteed benefits in return. The new law of north-south relations consisted essentially of clauses enabling, but not obliging, developed countries to accord trade advantages under unilaterally determined conditions. What was hailed by some authors as "a new law of development" (Hubbard 1979, 92) consisted essentially of rules delegalizing trade relations between developed and developing countries.

The historical failure of the GATT in this area was the absence of an appropriate response to the genuine problems that low-income states may have had in applying GATT principles. For instance, certain countries with a fiscal infrastructure insufficient to raise revenue through domestic taxes could have been given the right to levy import duties for revenue purposes. Instead, the GATT responded to the broad political demands of the Group of 77, a coalition spanning the richest and poorest developing countries with no common trade interests. This group was able to formulate only the demand to exempt all of its membership form the rules of the GATT, and make them all eligible for GSP. None of the instruments the GATT adopted in response to the demands of the developing countries was therefore targeted to the real and definable problems of these states and to those of the poorest among them.

2.3. Trade and Competition Policies

At present, the only provision in the WTO agreements that links trade with competition is article VI of the GATT, which declares that dumping "is to be condemned if it causes or threatens material injury to an established industry" (GATT 1994, 493) and permits the levying of duties to offset such dumping.

Dumping and antidumping have been extensively analyzed in the literature on imperfect competition. At their origin, anti-

protection of the right to organize and bargain collectively, and on the minimum age for admission to employment; apply standards relating to the sustainable management of forests; do not practice any form of forced labor; do not manifest shortcomings in customs controls on export or transit of drugs; comply with international conventions on money laundering; do not engage in unfair trading practices, such as discrimination against the European Community, comply with market-access obligations under the WTO agreements.

dumping provisions in the international trade agreements were intended to protect competition against anticompetitive practices, and in particular to combat predatory pricing (Hindley and Messerlin 1996). The general conclusion is that predatory pricing is only in exceptional situations a rational strategy of companies locked in battle for control of a market and that, in most cases, the antidumping provisions have been used in circumstances in which predatory pricing cannot occur. Thus, it was found that "most antidumping cases involve products with a considerable number of producers at the global level, none of whom has a dominant share of global output" (Hinkley and Messerlin 1996, 21). As a result, there is no economic rationale for the vast majority of antidumping cases.

Even on the assumption that predatory pricing may occur and will need to be suppressed by governments to safeguard competition, there would still not be any justification for special rules that differentiate between domestic and imported products. Article III, the GATT's national treatment provision, and article XX:d of the GATT's general exceptions allow WTO members to apply their competition policies equally to all sources of predatory pricing and to take in respect of imported products all measures necessary to secure compliance with those policies. The only function of the WTO antidumping provisions is therefore to permit WTO members to apply to imported products competition rules that are more onerous than those applied domestically.

Article VI of the GATT is supplemented by the WTO Agreement on Implementation of Article VI of the GATT 1994 (Antidumping Agreement), which regulates the application of antidumping measures at the national level in great detail. Such an agreement fosters the illusion that the rule of law applies in this area. In fact, however, the agreement leaves WTO members with an extremely wide range of discretion in determining whether injurious dumping has occurred, and its article XVII:6 explicitly exempts the exercise of this discretion from a full review by WTO panels and the WTO Appellate Body (GATT 1994, 193). The exercise of the right to take antidumping measures is consequently not submitted to judicable criteria and effective multilateral control, notwithstanding the plethora of WTO rules on their application.

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documented, however, the provisions became a safe harbor for projectionist domestic interests (Hindley and Messerlin 1996). Once GATT contracting parties were permitted to deviate from the basic trade policy principles, ostensibly to pursue competition policy objectives, the political forces that these principles are to control overwhelmed the competition policy objectives. There is nearly unanimity in the academic world now that the WTO's rules on antidumping operate to protect competitors rather than competition and consequently have acquired a rational that is the complete opposite of the one they were originally meant to serve.

3. The Trade and Environment Link: Will History Repeat Itself?

The trade and environment debate raises issues and submits the principles of the world trade order to scrutiny from a new perspective. However, there are elements in the proposals to integrate environmental concerns into the multilateral trade order that so strongly resemble aspects of the unsuccessful linkages made between trade and other policy matters that a repetition of past mistakes is to be feared.

Technically, there is no conflict between environmental policies and trade policies. The rules of the WTO do not prescribe or prevent the attainment of any domestic policy goal in the field of the environment. They are merely "negative" rules prohibiting policies that distinguish, openly or in disguise, between products and services or service suppliers as to their origin or destination. Such distinctions are, however, normally not necessary to attain domestic environmental policy goals (Roessler 1996b). Why then do so many environmental organizations consider WTO law as a threat to domestic environmental legislation?

Their opposition is based on the fear that many laws furthering environmental and other public interests may only be adopted with elements that are contrary to WTO law. The legal constraints imposed by WTO membership create in their view obstacles to the formation of domestic political coalitions between sectoral interests pursuing protectionist aims and public-interest groups pursuing environmental goals, and the rulings of the WTO panels put into jeopardy existing domestic laws furthering legitimate domestic policy objectives for which there is, politically, no prospect of a WTO-consistent solution. As Ralph Nader stated in his testimony before the U.S. Senate Finance

Committee on the results of the Uruguay Round (16 March 1994, photocopy): "Raw log export bans are one of the most trade restrictive means to attain the goal of conserving our nation's forests. Yet, after years of debate, raw log bans were the only politically feasible approach because they accommodated the interest of providing alternative lumber processing jobs to those who would no longer be cutting down forests. Laws with such mixed economic and social purposes, of which there are many, would likely fall before challenge under the World Trade Organization's rules."

Ralph Nader is no doubt right. And many other illustrations can be provided to substantiate his point. Take the case, for instance, of the introduction of a new clean-air standard for gasoline. Such a standard, by itself, can of course be introduced for all gasoline without any legal constraints under WTO law. A problem of WTO consistency would arise, however, if the domestic political constraints are such that a new standard would secure a parliamentary majority only if domestic gasoline is exempted from the standard for five years or, to put the issue in political-economy terms, if the cost of reducing pollution is initially borne only by nonvoting producers abroad. That discrimination would be inconsistent with the GATT's national treatment provisions of article III and would most likely not be justifiable under the GATT's public policy exceptions of article XX. The five-year exemption violating the GATT 1994 would thus not be *technically necessary* to implement a higher environmental standard (it would in fact reduce the new standard's environmental impact during the transition period), but would be *politically necessary* to adopt the higher standard.

Another example illustrating Nader's point is the phase-out mechanism for chlorofluorocarbons (CFCs) included in the 1987 Montreal Protocol on Substances That Deplete the Ozone Layer. In theory, the phase-out of CFCs could have been achieved through internal measures consistent with the national treatment principle, for instance, a system of sales licenses. However, such a system would have imposed only burdens on the producers of the chemicals and would probably not have won their support. The mechanism that was instead adopted provides for quantitative limits on the production of CFCs in the members, combined with a ban on imports from nonmembers, with the result that the consumption of CFCs is reduced. Under this mechanism, the decline in the domestic supply of CFCs combined with the import

controls generated rents for the domestic producers during the phase-out period, and the scheme therefore won their support. The import controls were thus not technically required to protect the ozone layer, but were politically necessary to win the support of the producers of ozone-depleting chemicals (Enders and Porges 1992).

How can the dilemma of groups pursuing environmental goals be accommodated in the WTO law? One approach would be to add a provision to the GATT 1994 permitting discriminatory trade measures if a legitimate domestic policy goal would not be politically attainable without that measure. However, such a "political necessity" clause would establish a license for unprincipled policymaking, and the market-access rights under the WTO agreements would therefore be submitted to the vagaries of the domestic political process of the WTO members. A provision with these functions, however drafted, would not mark a line between international trade interests and domestic policy constraints, and would therefore be incompatible with the rule of law in international trade relations (Roessler 1996a).

Environmental groups have also been concerned that a WTO member is, under the principle of unconditional most-favored-nation treatment, unable to offset through trade measures the economic consequences of the differences between its environmental policies and those of other WTO members. This concern is reflected in the following statement by Ralph Nader (16 March 1994):

> U.S. corporations long ago learned how to pit states against each other in a "race to the bottom"—to provide the most permissive corporate charters, lower wages, pollution standards, and taxes. Often it is the federal government's role to require states to meet higher federal standards. . . . There is no overarching "lift up" jurisdiction on the world stage. . . . The Uruguay Round is crafted to enable corporations to play this game at the global level, to pit country against country in a race to see who can set the lowest wage levels, the lowest environmental standards, the lowest consumer safety standards. Notice this downward bias—nations do not violate the GATT rules by pursuing too weak consumer, labor . . . and environmental standards. . . . Any . . . demand that corporations

> pay their fair share of taxes, provide a decent standard of living to their employees or limit their pollution of the air, water and land will be met with the refrain, "You can't burden us like that. If you do, we won't be able to compete. We'll have to close down and move to a country that offers us a more hospitable business climate."

The theoretical literature on interjurisdictional competition indicates that the problem described by Ralph Nader is largely a reflection of a desirable competition among jurisdictions and not a race to the bottom (Wilson 1996). Given that jurisdictions can be assumed to choose environmental quality to maximize the welfare of residents, they have no incentive to offer firms exemptions from taxes required to cover costs to the environment even when competing for scarce capital. However, second-best situations—unavailability of policy instruments or distortions in market structure or both—may give rise to the adoption of inefficiently low or *too high* standards; again, a case-by-case analysis is necessary.

Furthermore, if the race-to-the-bottom argument is accepted, it would apply not only to environmental policies but to all policies that affect the location of industries, including tax and subsidy policies, the provision of infrastructure, and production regulation of all kinds. Eliminating a race to the bottom only in the area of environmental policies would merely displace the race into other policy areas, for example in workers' safety. At the end of this process, there would no longer be local jurisdictions within federal states, and states would have to cede their policy autonomy to international authorities (Revesz 1992).

What would be the consequence of a new general rule in the WTO legal system that would permit WTO members to apply import taxes and restrictions designed to offset the competitive advantages that differences in environmental and other regulations accord to producers abroad?[4] With such a rule, the law of

[4] There is no provision in the WTO agreement that permits trade restrictions specifically designed to offset differences in domestic policies. WTO members may impose countervailing duties on products that benefit from a domestic production subsidy. However, a countervailing duty may be imposed even if the importing contracting party also accord a subsidy. Two WTO members granting the same fiscal advantages to their steel industries may impose (and frequently impose in practice) countervailing duties on the steel products exported to each other. The countervailing-duty provisions of the

the WTO would provide legal security only for the products and services traded between pairs of countries with identical domestic production regulations. This would be contrary to the principle of comparative advantage according to which nations are to exploit their differences, which are often reflected in their regulations (Bhagwati 1996). Moreover, the unconditional most-favored-nation principle would be lost, and with it the peace-engendering impact of that principle. With a general rule that permits WTO members to eliminate the external effects of the differences between them, the WTO legal system could therefore no longer fulfill its functions.

One legal method to take into account the domestic political constraints of WTO members and the fear of a race-to-the-bottom effect of trade liberalization would be to permit them to individually vary their market-access commitments in accordance with those constraints. That method is already available. The market-access commitments under the WTO agreements are made by product (GATT), by sector (GATS), or by entity (Agreement on Government Procurement). The schedules of commitments of WTO members therefore vary significantly. Moreover, WTO members are entitled to renegotiate their commitments. Both during the process of negotiating the commitments and after their acceptance, WTO members thus have the possibility to adjust their trade obligations in accordance with their domestic political constraints and the external impact of their policies. However, this adjustment takes place at the time when market-opening commitments are negotiated or after a renegotiation based on reciprocity, and therefore maintains the balance of rights and obligations among members.

From the perspective of WTO law, the issue is thus not whether domestic policy constraints should be taken into account or whether trade liberalization entails a healthy competition

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WTO are therefore not provisions permitting measures designed to offset policy divergences, but are provisions permitting the protection of import-competing industries contingent upon the protection of an exporting industry in another country. This observation can also be made in respect of the provision of the GATT that exempts mea ures related to the products of prison labor from the obligations under the GATT (article XX:e). It is true that the domestic policies of another WTO member trigger in this case the right to impose import controls, but that right may be exercised independently of the prison-labor regulations of the contracting party imposing the import control. A WTO member could consequently permit the sale of products produced in domestic prisons while restricting the sale of those made in foreign prisons.

among jurisdictions or a destructive race to the bottom. Given the right of each member to adjust its market-access commitments to its perception of these issues, the real issue is whether WTO members should be able to react to the external repercussions of their own domestic policy choices by unilaterally withdrawing their market-access commitments or whether they should be able to do so only by renegotiating their commitments. A multilateral trade order based on the rule of law cannot but be based on the principle of renegotiation.

There are many proposals to use the market-access opportunities created by the obligations assumed under the WTO agreements as bargaining chips to induce other countries to change their environmental policies, and the withdrawal of these opportunities as sanctions against countries that do not cooperate in the protection of the environment. Thus, Steve Charnovitz (1993, 282) wrote:

> How can an agreement on minimum standards be achieved among a hundred countries with different values and resources? One approach is to devise a clever mix of carrots and sticks from a diverse enough issue garden to allow a cross-fertilization of concerns. The goal is not only to obtain an agreement, but also to maintain its stability. The carrots are the basic tool. Because countries face different economic trade-offs . . . an assistance mechanism can be developed to enable gainers to compensate losers and rich nations to "bribe" poor ones. This assistance could be in the form of financial aid or technology transfer . . . , or it could be trade concessions.

The proposal to use the world trade order as a source of carrots and sticks for the pursuit of environmental objectives is based on three illusions. The first is generated by the image of "carrots and sticks." "Carrot" suggests that you give something of value to you; "stick" suggests that you inflict pain without hurting yourself. However, such sticks do not exist in international economic relations. Here, nations can hurt others only by hurting themselves at the same time; a trade sanction inflicts costs both on the imposing nation and on the target nation, and the cost for the former can sometimes exceed that of the latter. The choice is thus not, as the image suggests, between costly subsidies and costless

trade sanctions, but between subsidies that transfer resources from one nation to another and trade sanctions that destroy the resources of both (GATT 1991).

If the image of carrots and sticks has such currency in the trade and environment debate, it is probably because the costs of trade sanctions are generally so thinly spread across populations that they arouse little political opposition and are therefore not taken into account in the public debate. This is probably also the reason that a trade sanction seems to be the only stick seriously considered in the trade and environment literature even though the arsenal of economic sanctions contains many more sticks, such as the interruption of financial relations, telecommunications, transport services, and so forth. These other types of economic sanctions may be just as effective in obtaining commitments from other nations to cooperate in the protection of the environment as trade sanctions; however, they will cause concentrated and easily visible effects for a small group of producers and will therefore engender greater political opposition. If one has concluded that sanctions are required to achieve a negotiating goal, one still needs to decide that among the sanctions available the trade sanction is the most efficient one. The public choice on that issue, however, is likely to be distorted by the bias that distorts the public choice on trade policies generally. The focus of the trade and environment debate on trade sanctions, rather than economic sanctions generally, is an indirect reflection of this bias.

The second illusion is that the goals of trade liberalization and environmental protection can be obtained simultaneously in a single negotiation. In a reciprocity-based negotiation in the WTO, a nation will not obtain in return for its market-access commitment an equivalent market-access commitment *and* commitments in another policy area; it will obtain only one or the other and will therefore have to decide which of the two objectives to pursue. To propose that a multilateral negotiation cover market access issues *and* a raising of environmental standards is therefore to propose that nations with high environmental standards pursue their trade interests *or* their environmental interests.

The third illusion is that the trade and environment link is a one-way street toward better environmental protection. In any system in which the results of reciprocity negotiations are enforced through a right to retaliation, an issue linkage becomes a two-way street: if market access and the protection of endangered species were to be successfully linked in WTO negotiations, trade

concessions could be withdrawn in response to the failure to protect an endangered species *and* vice versa. If environmentalists seek in the WTO the "trade weapon" to further environmental goals, they must therefore accept that other nations obtain the "environmental weapon" to defend their trade interests. However, it is totally inappropriate to make commitments on such essential matters as the protection of endangered species, where the withdrawal from obligations may have irreversible effects, dependent on the ups and downs of commercial policies. The main purpose of international bargaining is to create regimes, systems of rules and procedures making governmental actions more predictable. Each of these regimes cannot furnish predictability if it is constantly exposed to the need to adjust to a breakdown in other regimes. That is true for both the international trade order and international environmental law.

The inherent limitations of the cross-retaliation principle were recognized by the negotiators of the WTO agreements. Initially, the United States, mainly with its interest in protecting worldwide intellectual property rights in mind, proposed that there be an unbridled right of cross-retaliation under the WTO dispute settlement procedures. However, it subsequently revised its position to the effect that retaliation across sectors should be resorted to only if retaliation within the sector was not practical or effective. This change reflected the fear of the United States' banking sector that cross-retaliation resulting from failures to observe obligations in the field of trade in goods might upset the delicate balances of interest between nations in the field of financial services. Article 22:3 of the Dispute Settlement Understanding (DSU) therefore now contains eight subparagraphs which, while maintaining the principle of cross-retaliation, define meticulously the circumstances under which a WTO member may retaliate across sectors and the elements of the Uruguay Round package that constitute individual sectors, segregating—of course—financial services as a separate sector (GATT 1994, 423). If environmental groups did not have the illusion of the one-way street, they would, just like the U.S. banking community, make every effort to ensure that their important cause is not throw into the crab basket of trade policymaking.

4. CONCLUSION

What do the linkages between trade and domestic policy objectives reviewed in this paper have in common? In each case, the linkage led to the creation of new rules permitting governments to depart from basic principles of the world trade order without, however, establishing effective new disciplines constraining the exercise of the resulting discretion. The reason was that the new rules enabled governments to pursue monetary, development, and competition policies with second-best policy instruments, and, as economic theory has amply demonstrated, one cannot define in the abstract ad in advance under what circumstances the choice of the wrong instrument for the right policy raises welfare. Only a case-by-case analysis is appropriate in this situation. No generally applicable, abstract rule is therefore conceivable that would distinguish between permissible and forbidden second-best policies on economic efficiency grounds.

The choice of the second-best policy instrument was permitted essentially for political reasons, that is, to exempt from GATT disciplines the trade policy measures of governments politically unable to pursue their monetary, development, or competition policies with more direct and efficient policy instruments. However, a GATT rule that defines the domestic political circumstances that would justify the resort to a second-best policy instrument is impossible to craft. For instance, in the case of balance-of-payments policies implemented through trade measure, such a rule would have to provide for something like the following: "A WTO member incurring a serious balance-of-payments deficit may, instead of devaluing its currency, impose an import surcharge if it demonstrates that its government would, if it were to devalue, lose the next election/be toppled by riots/encounter serious problems in containing wage demands." It is obvious that such a rule would not be seriously considered even though it would precisely reflect the political purpose of the GATT's balance-of-payments exception. A fundamental lesson that can be drawn from the GATT's links with monetary, development, and competition policies is that, upon entering the realm of the second-best, the realm of the rule of law is left, and any such link therefore entails a delegalization of international trade relations.

Each of the linkages reviewed above was made to harness the instruments of trade policy for domestic policy objectives. In all three cases, however, the protectionist forces freed by the elimina-

tion of the trade policy disciplines seized the occasion and overwhelmed the domestic policy objective. Thus, the antidumping provisions, originally designed to protect competition, now operate exclusively to protect competitors. Another conclusion that can therefore be drawn from the experience under the GATT is that, if domestic policy objectives are not pursued in a trade-neutral manner, they attract protectionist interests that will tend to undermine the attainment of these objectives. As a result neither the world trade order nor the causes such linkages were meant to serve benefited from the link.

Many of the proposals to pursue environmental objectives through the multi-lateral trade order have features that resemble those of past failed linkages between trade policy instruments and domestic policy objectives. Again proposals are made that would permit the use of trade measures in the pursuit of policy objectives that cannot be attained efficiently with trade policy instruments. And, again, the hoped-for cross-fertilization is likely to turn into cross-contamination. The fundamental illusion that prompts these proposals is that the link between environmental policies and trade policies is a one-way street and that it is therefore possible to use the political pressures behind trade policy instruments for one's policy objectives without in turn being subjected to these pressures. In fact, however, that linkage, as the previous linkages of its kind, is likely to turn into a disservice to the important cause it is meant to advance.

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