ET aculteit der Economische Wetenschappen en Econometrie

05348

1993
076

Serie Research Memoranda

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Research Memorandum 1993-76

December 1993

vrije Universiteit *amsterdam*

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Summary: *The paper considers whether International Commodity-Related Environmental Agreements are consistent with the GATT system of trade rules. A number of aspects are considered: use of import tariffs; applicability of waivers; trade sanctions against free riders; international standards on production process and methods; ecolabelling; preferential tariffs for commodities produced with environmentally preferable technologies; and the use of environmental subsidies. It is found that the two main variants of these commodity-specific environmental agreements are compatible with GATT rules. The issue of trade sanctions against free riders of multilateral environmental agreements remains a grey zone on which the GATT system is still ambiguous, and where future clarification is required.*

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05348

Introduction

The aim of this paper is to investigate how International Commodity-Related Environmental Agreements could fit into the GATT system, and where sources of possible conflicts with the current GATT provisions could arise. In doing so, we are interested in the economic implications rather than in the juridical finesses.

This report forms part of a wider project on the appropriateness and feasibility of International Commodity-Related Environmental Agreements (ICREAs) as instruments to accomplish internalisation of environmental externalities in the user price of primary export commodities. Since ICREAs are intergovernmental agreements which relate strongly to international trade and affect - or even contain - trade regulation, it is necessary to consider their consistency with the GATT framework. This issue could be important for two reasons. Firstly for ICREA members, because hierarchy may exist between their obligations due to participation in the GATT and their obligations in an ICREA. And secondly, because non-members of ICREAs could challenge certain implications of ICREAs which they consider to be incompatible with multilateral trade arrangements of the GATT.

After a brief section on ICREAs, the background idea on which they are based, and on the way in which they may operate,[1] we shall consider several latent friction points between ICREAs and a number of important elements of the GATT system.

The paper was written while the Uruguay Round was still continuing, so that alterations and amendments to earlier GATT rules were not yet definitive. In order to look forward to the potential changes accomplished by a successful Uruguay Round we used the draft agreement ('Dunkel text').[2]

International Commodity-Related Environmental Agreements

Production of primary commodities in developing countries often causes or exacerbates degradation of the natural environment in the producing regions (Kox, Van der Tak & De Vries 1993). Sometimes commodity production causes irreparable ecological damage, like exhaustion of unrenewable natural resources. Prevention or neutralisation of such ecological damage requires measures which tend to increase unit production costs. According to the OECD's Polluter Pays Princi-

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1) These issues have been treated more extensively elsewhere, for instance Kox & Linnemann (1993); Kox (1991).

2) In the preparation of the paper very useful insights were derived from an interview held at GATT with mr. R. Eglin (Director, Technical Barriers to Trade & Trade and Environment Division) on November 29th 1993. The interpretation and remaining errors in this paper are completely the responsibility of the author, of course.

ple, the producer must be made to pay for the negative externalities he inflicts on others. In competitive markets a generic increase in production costs causes higher product prices, which are ultimately to be paid by the final consumers. Thus, in such markets the Polluter Pays Principle equates the User Pays Principle. From an environmental point of view two advantages are accomplished by this form of internalisation of environmental externalities in costs and prices. Squandering of scarce natural resources by producers diminishes and consumers are confronted with the 'real' costs of their consumption. It is obvious that some central authority is needed to make this system work.

In world markets for primary commodities there is no single central authority which can impose internalisation of externalities. Export commodities are produced by producers which fall under the jurisdiction of sovereign national governments. The latter must be willing and able to impose environmental policy upon their domestic producers. The economic situation, and especially the degree of socio-economic development, are major factors which affect domestic policy priorities in commodity-producing countries. In developing countries with low per capita income levels issues like food security problems, poverty abatement, debt servicing problems and constructing an industrial infrastructure, may have even higher priority ranking than environmental preservation. Moreover, LDC government apparatuses may not have developed the administrative ability to deal with the complexities of ecological monitoring and environmental policy implementation. They are often under pressure to secure enough foreign exchange earnings to finance their imports and service their debt obligations. The consequence is that many developing country governments, though considering abatement of the negative environmental effects of primary commodity production as a valuable target in itself, regard this as too much of a luxury in their present economic situation. The capacity of individual LDCs to take care of the ecological degradation caused by the production of primary export commodities thus depends on: (1) their economic conditions, and (2) the administrative and technological abilities of their government apparatus. For this reason the 1992 UNCED summit in Rio de Janeiro called for financial and technological support of developed countries to enable LDC governments in implementing environmental policies. There are good reasons to do so, since it is clear that various forms of environmental degradation in developing countries do not stop at national borders. Traditional distinctions between 'national' and 'transnational' environmental externalities get blurred when a longer time horizon is used. Due to cumulation, environmental degradation problems which are initially treated as 'local' or 'national' issues, may become transnational or even global problems. A number of - initially local - environmental problems have already reached the status of becoming worldwide issues for scientific and political concern: the diminishing 'green lung' capacity of tropical rain forests; perforation of the ozone layer; global warming; dwindling of species; pollution of oceans.

Apart from the UNCED targets, another background idea of International Commodity-Related Environmental Agreements is that is must be possible to realise the 'Polluter Pays' and 'User Pays' principle for *specific* primary commodities which are traded in world markets. This represents a step from a 'development aid approach' in international environmental cooperation to a more market-based approach. To make this step it is necessary to remove a major obstacle that prevents internalisation with regard to primary commodities, namely the disincentive created by cut-throat competition in many international commodity markets. Because of the fierceness of international competition in commodity markets where many developing countries with similar foreign exchange needs operate, producers stick to ecologically unsustainable production methods for the simple reasons that these methods are commercially cheaper. Ecologically sustainable production of primary commodities often requires the use of other production methods and/or supplementary investments in protection of the natural environment in the production areas. An individual exporting country cannot recoup the costs associated to this 'technology switch' by simply raising its export supply price. The consequence would merely be that the country prices itself out of the market, and that other exporting countries will take over its market share. Importing countries can often easily switch from one import source to another, because primary commodities are rather homogeneous products. In commodity markets where less developed countries (LDC) are important exporters there is another reason for fierce competition. Many of them are highly dependent on a small number of primary export commodities for secure foreign exchange earnings which they need to maintain their import capacity and debt servicing capacity. This commodity dependence is the reason why, contrary to economics textbooks, these exporters react on falling world market prices by increasing rather than decreasing their export volume. Due to this market structure, *individual* export countries face a high price elasticity of demand. The same is often not true for total or world exports. The price elasticity of *total* import demand for LDC primary commodities is typically rather low, often in the range of - 0.10 to - 0.35, as many commodity market studies have found.

Looking at this situation from an environmental economics perspective, commodity prices and costs for consumers are persistently too low. Foreign consumers in importing countries are implicitly subsidised at the expense of a welfare loss (depleted natural resources) in exporting countries. Given this difference between individual and total price elasticity of imports, there is an obvious opportunity for a co-operative, multilateral approach to realise internalisation of additional environmental costs in the price and import costs of primary commodities. This is the aim of commodity-specific environmental agreements.

International Commodity-Related Environmental Agreements or ICREAs pertain to the internalisation of ecological costs in the price of a specific primary commodity. Several variants of such

agreements can be used, depending on the nature of the commodity involved, prevailing production conditions, the structure of production costs, and the structure of the market. We here deal with three variants of which the GATT compatibility will be reviewed:

A. A standard-setting ICREA (ICREA type *A*). This is an agreement between countries to use common standards with regard to production technologies. Such standards can be formulated positively or negatively. In a positive formulation the agreement defines the set of production technologies and production methods that producers are entitled to use in the participating countries. In a negative formulation, the agreement defines the set of technologies and production methods which shall *not* be used in the production of the commodity. Positively formulated standards could form a disincentive to technological innovation. Therefore, a negative formulation is more likely. One could for instance agree to phase out certain types of production methods which are agreed upon as being ecologically destructive.[1)] If all important producers co-operate like in a cartel, 'average world-wide' production costs of the commodity will increase. Ultimately, world market prices adjust to these additional costs. Internalisation will be then be achieved in the 'average' country and those countries which are even more cost-effective in applying the production standards.

B. An ICREA with financial compensation mechanism (type *B*). This agreement is a rather open and flexible instrument to promote internalisation of environmental costs. This flexibility may required when environmental effects of commodity production differs sharply between countries and types of producers, or when environmental priorities differ between governments. The agreement creates a compensation fund on which exporting countries may draw for financing projects and programmes to make the production of the commodity more environmentally sound. The ICREA Fund is also important when a switch to more ecologically preferable production techniques requires considerable pre-investment and pre-financing.
The Fund can, *inter alia*, be fed by an import levy charged at border-crossing in importing countries, especially the developed OECD countries.[2)] Governments of exporting LDCs get drawing rights on the fund, according to an agreed distribution code. The agreement further includes broadly formulated guidelines on the type of project and programmes which are eligible for funding or soft loans from the ICREA Fund. Governments of exporting countries submit the funding proposals. The

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1) While such an agreement would create an international ecological minimum standard with regard to a specific commodity, it would leave the freedom for individual governments to apply more strict standards in their own country.

2) Other forms of financing can be used as well, like funds from ODA budgets or general government budgets (e.g. a part of value added tax on imported commodities), or contributions from multilateral funds like the GEF or a future Climate Fund.

Secretariat undertakes periodic monitoring to ensure effective use of the funds. Remittance of funds can be made conditional upon the effectiveness of use which has been made of prior fund transfers.

C. A standard-setting ICREA with trade preferences (type *C*). This type of agreement is similar to the first one (type *A*), but is supplemented with a positive incentive in the form of trade preferences for participating LDC exporters. In order to maintain discipline among exporters in a standard-setting ICREA, it will be very helpful if importing countries create positive incentives for compliance to the goals of the agreement. To achieve this the agreement is extended with a system of environmental labelling. Environmental labelling means the use of labels in order to inform buyers that a labelled product is produced in a way that meets certain predetermined ecological standards. If primary commodities with the ecolabel get preferential import tariff treatment, this creates a positive incentive to maintain discipline in the agreement. To guarantee the credibility of the ecolabel some monitoring and verification procedures need to be agreed upon on, e.g. in combination with a dispute settlement procedure. Because OECD import tariffs on raw materials tend to be very low, the exact form of trade preferences might comprise other commodities as well, including processed commodities.

It is a common trait of all three types of ICREAs that they offer positive rather than negative sanctions for participation by LDC exporters, and that they fully respect the sovereignty of governments in exporting countries with regard to environmental policy. Moreover, they offer the possibility to reconcile environmental targets with the exporting country's foreign exchange and budget constraints. ICREAs are environmental agreements rather than old-style commodity agreements, which aimed at commodity price stabilisation. At the same time, they must be distinguished from other multilateral environmental agreements because of their commodity-specific character.

Let us now investigate whether, or to which extent, International Commodity-Related Environmental Agreements are compatible with the GATT system of trade rules. The following aspects will be considered: (a) use of import tariffs to finance the ICREA Fund; (b) applicability of GATT waivers; (c) trade sanctions against free riders; (d) international standards on production process and methods; (c) ecolabelling for primary commodities; (e) preferential tariffs for commodities produced with environmentally preferable technologies; and (f) the Subsidies Code and environmental subsidies.

Use of import levies for financing purposes

A main objective of the General Agreement on Tariffs and Trade was and is the liberalisation of international trade by reciprocal limitation of import tariffs and other trade barriers. Such reciprocal concessions were achieved by multilateral negotiation rounds, involving many commodities and therefore package deal negotiations. With regard to import tariffs it resulted in maximum tariff levels ('bindings') per trade item, listed in a multi-volume annex to the text of the General Agreement. Contracting parties of the GATT are treaty obligated to keep their tariffs levels below this binding. If they grant tariff preferences *below* this binding, then normally such preferences are made available to all other GATT contracting parties via the 'most-favoured nation' (MFN) principle of the General Agreement. After several negotiation rounds the overall tariff levels on most unprocessed primary commodities have been reduced to zero or slightly above zero, while processed commodities still face substantial tariff escalation. Table 1 shows MFN tariff levels on selected unprocessed commodities since the Tokyo Round which ended in 1979.

Table 1: *MFN tariffs[a] on tropical products in selected countries, 1984 (Per cent ad valorem)*

Product	EEC	Japan	USA
Coffee (raw, unroasted)	6.5	0.0	0.0
Tea (in bulk)	0.0	10.2	0.0
Cocoa (beans)	3.0	0.0	0.0
Oilseeds (unprocessed)	0.3	0.9	0.2
Tobacco (unmanufactured)	30.0 b)	0.0	15.9
Natural rubber (unprocessed)	0.9	0.0	0.7
Jute (raw)	0.0	0.0	0.0
Tropical wood (in the rough)	0.4	0.2	0.8
Rice (unmilled)	12.0	0.0	4.3
Tropical fruits (fresh,dried)	9.9	12.3	13.5
Sisal, hennequen (raw)	0.0	0.0	0.0

Notes: a) simple averages of MFN duty rates applied at the tariff-line level in 1984. b) Estimated. Source: Computed by UNCTAD from GATT Tariff Study 1984 computer files. UNCTAD, Problems of protectionism and structural adjustment, TD/B/1160/Add.1, Geneva 1988.

In International Commodity-Related Environmental Agreements of 'type *B*' import levies can used to finance the ICREA Fund. At first sight one might object that introduction of such import tariffs contradicts the principles of the GATT, because it (re-)erects new trade barriers. This argument is incorrect. Firstly, these tariffs are not created as trade barriers to protect domestic industries or trade sectors. Certainly in the case of several tropical products, the import commodities do not even compete with domestic sectors. Secondly, the import tariffs result from an international agreement in which the potentially damaged export countries (or at least a large share of them) participate on a voluntary basis. Finally, because the funds collected in this way are channeled back to the export-

ing countries to finance commodity-specific environmental projects.

A remaining, more practical question is how the relevant tariff bindings can be 'unbound'. The General Agreement on Tariffs and Trade offers two possibilities for this: 'unbinding' as a temporary measure (articles XII, XIX) or as a permanent withdrawal of a concession (article XXVIII). The temporary option under article XII only applies in extreme situations where a country's monetary reserves shrink below safe limits. Article XIX forms the main temporary safeguard mechanism in the GATT system. It offers participating countries an escape clause to apply, on a temporary basis, tariff or non-tariff barriers that respond to imports which are deemed to harm the importing country's economy or domestic competing industries. In the case of an ICREA this situation does not occur. Moreover, the further conditions upon which applicability of article XIX depends, are such that this temporary escape clause deserves no further attention.[1] More relevant in the case of an ICREA is article XXVIII which creates the possibility of changing a tariff binding on a permanent basis. It allows contracting parties to withdraw their concessions at any time, provided they grant 'compensation' and 'renegotiation rights' to other contracting parties.[2] A guiding principle in the renegotiations can be that importing countries offer compensation for the (small) effect that tariffs will have on import volumes due to price elasticity of demand. To offset this demand effect exporting countries can be granted tariff concessions on, for instance, processed or manufactured commodities. Most commodity-exporting countries would very much welcome such a step. The costs of such tariff compensations for the granting countries can remain modest.

The conclusion is that tariffs as part of a 'transfer type' ICREA can be compatible with GATT rules when the tariff redescheduling option of article XXVIII is used. The renegotiation process may take some time, but it forms a real option. Of course, the tariff scheme should be implemented in a way that satisfies 'normal' GATT requirements (non-discrimination, national treatment, transparency and proportionality).

1) First it must be shown that imports of a product are increasing either absolutely or relatively, and such increase must be a causal result of (a) 'unforeseen developments' and (b) GATT obligations. Second, it must also be shown that domestic producers of competitive products are seriously injured or threatened with serious injury, and that this injury or threat is caused by the increased imports. If both conditions apply, an importing nation is entitled to suspend the relevant GATT obligation in respect to such a product for the time necessary to prevent or remedy the injury, after consultation of the exporting nations (GATT 1986: 36-37; Jackson 1992: 154-165).

2) Literally, the text of art. XXVIII.2 reads: "In such negotiations and agreement, which may include provision for compensatory adjustment with respect to other products, the contracting partners concerned shall endeavour to maintain a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in this Agreement prior to such negotiations" (GATT 1986: 47).

Applicability of GATT waivers

Article XX of the General Agreement mentions ten general exemptions or 'waivers' which allow member countries to take measures which deviate from the provisions in the rest of the agreement.[1)] Three of these waivers are potentially important with regard to ICREAs.

Exemptions *(b)* and *(g)* formulate in fact the conditions under which domestic environmental policy measures are allowed, even if they affect international trade. They refer, respectively, to measures "necessary to protect human, animal or plant life or health", and measures "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption". There is increasing international support for the view that these exemptions constitute a relatively explicit basis for balancing environmental and trade interests, provided that these provisions are not interpreted in a way that circumscribes national discretion in setting environmental policies.[2)] Future revisions of article XX could, however, provide clarification with regard to this interpretation.
An important remaining issue relates to the geographical scope of the exemptions. Though exemptions *XXb* and *XXg* form in the first place a legal basis for trade-affecting national policies, they could as well serve as a legal basis for measures taken in the context of an international environmental agreement. The location of the object of such environment-protecting measures is not specified (Reinstein 1992: 114). Such an interpretation certainly holds for *XXb* and perhaps also for *XXg*. This has direct importance for International Commodity-Related Environmental Agreements. They are intergovernmental agreements with no other objective than to "protect human, animal or plant life or health" and/or "exhaustible natural resources" in some of its member states. Therefore, it is hard to see any a priori reason why ICREAs should not qualify for one or both of these exceptions to the general GATT provisions. If this interpretation would appear to be correct, the use of import tariffs to finance the compensation fund does not even need the aforementioned use of time-consuming tariff renegotiations under article XXVIII.

The third waiver which could be relevant for ICREAs is the exemption mentioned in *XXh*. It opens the possibility that trade-related measures "undertaken in pursuance of obligations under any intergovernmental commodity agreement" are exempted from the general GATT rules. To qualify for

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1) The headnote to the article formulates, however, that application of the waiver is subject to the conditions that the measures adopted under them, do not constitute a 'disguised restriction on international trade', or a means of 'arbitrary or unjustifiable discrimination between countries where the same conditions prevail'. Trade disputes on environmental regulations could, according to Reinstein (1992: 114) be brought to the Standards Code, which is not covered by the exception in Article XXb.

2) Cf. Charnovitz (1991,1992); Repetto (1993: 7-10); Verbruggen (1992: 60); GATT (1993b).

this waiver the international commodity agreement itself must meet a certain standard. The agreement must: (a) conform to criteria which are submitted to the contracting parties of GATT, and which are not disapproved by them; or (b) itself be submitted to the contracting parties and not be disapproved by them; or (c) conform to the principles approved by an ECOSOC resolution in 1947. The latter criterion stems from the interpretative note to article *XXh*. It originates from the history of the General Agreement, which was originally designed to become the International Trade Organisation (ITO). From the earliest proposals, the ITO Charter included a chapter (VI) permitting international commodity agreements to use (some) quantitative restrictions, and allowing them (some) divergence from the non-discrimination principle. When the idea of an ITO was aborted and 'provisionally' replaced by the General Agreement, the ECOSOC Resolution in 1947 nevertheless established a link to the ITO draft chapter on international commodity agreements, so that agreements which conformed the principles laid down in the latter chapter would be allowed a qualified exemption from the GATT rules (GATT 1993a). The waiver for commodity agreements has never been used up to now. No complaints on existing commodity agreements have ever been filed. Nor have any of the latter been submitted to the GATT parties for approval.

Though environmental aspects were certainly not envisaged when this waiver was created, it could perhaps be activated for ICREAs. The International Commodity-Related Environmental Agreements are agreements with some market regulatory elements. It is doubtful whether they would comply with all criteria set by the ECOSOC Resolution.[1] It means that they must be submitted to the GATT parties or the future Multilateral Trade Organisation for approval. This is a time-consuming procedure in which opposition from non-participants of the ICREA could block approval.

So, although this waiver of *XXh* relates more specifically to commodity-specific agreements than both the aforementioned waivers, its application is unprecedented and bound to rules which imply that it will only be a relevant option if there is broad country participance to the International Commodity-Related Environmental Agreement.

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1) The 'ECOSOC criteria' imply that the international commodity agreement had to: (1) be open initially to all members on equal terms; (2) provide for adequate participation whose interest was in the importation or consumption of a commodity; (3) accord fair treatment to (ITO) members who did not participate; and (4) provide full transparancy with regard to their negotiation and administration. Moreover, before being allowed to control commodity markets via price regulation, production regulation, quantitative control of exports or imports, at least one of two (additional) preconditions should exist, related to the abatement of unemployment and the existence of large stock overhangs in markets where small producers accounted for a substantial portion of total output (GATT 1993a).

International standards on production processes and production methods

An agreed-upon set of standards with regard to the production process of a commodity forms the main instrument to accomplish internalization in a 'type *A*' ICREA. No matter if the standards are formulated positively or negatively, they always relate to process and production methods (PPM in GATT language) rather than to the commodity product itself. Because they do not relate to inherent qualities of the product itself, PPM standards for imported goods easily develop into attempts of a government to give its domestic environmental priorities an extraterritorial leverage. Technical standards and regulations for imported goods can form effective non-tariff barriers to trade.

During the Tokyo Round of GATT an Agreement on Technical Barriers to Trade - the 'Standards Code' - was negotiated in order to curb arbitrary use of technical barriers to trade (GATT 1979). The Standards Code was extended and amended under the Uruguay Round. In the draft agreement of 1991 environmental policy motives are explicitly mentioned as legitimate objectives,[1)] but their implementation in the form of technical regulations and PPM standards for imported goods is only allowed when these regulations and standards:

(1) equally relate to 'like' domestic products and do not discriminate between import origins,

(2) form no unnecessary obstacles to trade (proportionality), and

(3) are based on broadly accepted and transparant international standards, like for instance ISO standards.

The existence of an ICREA is *not automatically* a sufficient condition with regard to the third condition. If a non-member exporting country is confronted with PPM standards and considers them to be non-tariff barriers to trade, it can file a complaint under the GATT. It is difficult to tell in advance what the outcome of a dispute settlement panel would be.

Problems with PPM standards are likely to be much smaller or even absent, when such standards are used by the exporting countries instead of the importing countries. It is part of the national sovereignty of exporting countries to apply what measures they deem necessary to preserve their environment, and to harmonise such measures as part on an intergovernmental agreement (ICREA). To ensure that importing countries cannot claim that PPM standards for export products

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1) cf. Article 2 of the draft agreement on 'preparation, adoption and application of technical regulations by central government bodies' (GATT Secretariat 1991: G2-G3).

are trade-restrictive,[1] the exporters should ensure that the standards do not discriminate between products for exports and products for the domestic market. A further factor to support such common standards by commodity-exporting countries would be to make them transparent, e.g. by notifying the regulations to the International Standard Organisation in Geneva.

A conclusion here is that mandatory PPM standards with regard to primary commodities may be incompatible with GATT when they are imposed by *importing* countries, and the more so when competing domestic sectors are treated more favourably. A preferable and appropriate approach is that such standards are agreed and implemented by the *exporting* countries themselves. There will certainly be no conflict with GATT rules when the exporting countries ensure non-discrimination between domestic-oriented and export-oriented commodities, and when the ICREA standards are notified to ISO.

Ecolabelling for primary commodities

Environmental labelling or ecolabelling means the use of labels in order to inform consumers that a labelled product is environmentally more friendly than other products in the same category. The criteria for awarding the ecolabel predominantly refer to life cycle analysis of the products and put strong emphasis on the way the product has been produced.[2] Because of the latter ecolabels are related to PPM standards. An important difference, however, is that ecolabels are voluntary rather than mandatory. They inform consumers that the product meets a few specific environmental criteria and threshold levels. The background idea is that ecolabels render the product a higher status, that consumers will be willing to pay a higher price for the labelled products (niche market), and that general product standards in a market will be raised to include more environmental aspects. It is for the latter reason that developing countries worry that ecolabels may become non-tariffary barriers to trade, when their export product has to compete with domestic products in the import country.

Most existing ecolabels refer to manufactured products. By the end of 1993 more than four hundred environmental technical regulations with trade impacts had been notified under the Agreement on Technical Barriers to Trade. They cover, *inter alia,* domestic sales and use restrictions on hazardous

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1) The EC threatened to do so with regard to the Indonesian export ban on unprocessed tropical timber. The Indonesian government mentioned forest conservation as one of its arguments for this measure. Japan did the same when the USA imposed restrictions on unprocessed log exports from its Pacific North Western forests as part of a strategy to reduce harvesting rates to protect the habitat of a rare bird species (Northern spotted owl). In both cases the domestic timber industries were not or only in a positive sense influenced by the government measures. For a discussion of these measures, see for instance Arden-Clarke (1993).

2) Cf. Jha and Zarrilli (1993); Jha, Vossenaar & Zarrilli (1993); OECD (1991b).

products, environmental packaging, marking and labelling requirements, and waste disposal regulations. Only very few of them related to primary commodities. Nevertheless, efforts to apply ecolabels to primary commodities are increasing at present. They are being considered for sustainably produced tropical timber,[1] cotton, coffee, jute and cocoa. It may be doubted whether ecolabelling schemes will ever cover considerable parts of international trade in primary commodities, because of inherent problems with regard to certification and verification. However, to the extent that ecolabelling contributes to a higher willingness-to-pay for commodities produced by environmentally preferable technologies, such schemes could be actively promoted and strengthened in the context of ICREAs. Especially in standard-setting ICREAs, the use of ecolabels may be a complementary element which could allow preferential treatment by commodity-importing countries.

Under the current GATT, the current Agreement on Technical Barriers to Trade, and under the amendments envisaged in the 'Dunkel draft agreement', the use of ecolabelling schemes for import products is permitted if such schemes meet a number of criteria. These criteria are that the labelling scheme:[2]

- equally applies to domestically produced and imported 'like' products;
- does not represent unnecessary obstacles to international trade;
- is presented in a transparent and accessible manner, inter alia by notifying the underlying standards to ISO in Geneva;
- is based on standards that take production conditions and production methods in other coun tries into account;
- with regard to the preparation and application of technical standards and conformity assessment procedures, takes account of the special development, financial and trade needs of de veloping countries;
- is based on standards on which, during a period of at least two months before their adoption, interested parties in foreign countries have been able to submit their comments;
- is, to the extent possible, based on international standards.

A conclusion with regard to ecolabelling schemes, if they were to be incorporated into ICREAs, are very well compatible with current and future GATT rules, provided that some requirements are met. GATT rules stress the importance of international above national ecolabelling standards, and International Commodity-Related Environmental Agreements would intrinsically contribute to the development of such standards for a specific commodity.

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1) With regard to timber such ideas are being developed by ITTO, the ASEAN timber exporters, and the German 'Projekt Tropenwald' initiated by the German forestry and timber industry (cf. Jha, Vossenaar & Zarrilli 1993: 7).

2) Cf. Gatt Secretariat (1991: G1-G27) and Jha, Vossenaar & Zarrilli (1993: 12-15).

Trade sanctions against free riders

The effectiveness and coherence of international environmental agreements can be undermined when free ridership occurs on an important scale. Firstly because free riders artificially gain competitiveness and market share, because the participating countries incur additional production costs, and secondly because the free riders receive environmental benefits without having paid for it. Several recent international environmental agreements, like CITES, Basel Convention and the Montreal Protocol, incorporate the use of trade sanctions against free riders (cf. Enders & Porges 1992: 138-140). These agreements require parties to apply more restrictive trade provisions to non-parties than to parties. Some 17 of the more than 150 multilateral environmental agreements contain trade provisions of any kind (GATT 1992: 45-47).

The issue of trade sanctions in multilateral environmental agreements has led to a lively debate in and outside the GATT. None of the signatories of the General Agreement on Tariffs and Trade has so far officially complained on the trade sanctions incorporated in multilateral environmental agreements. Many observers expect that if a dispute settlement panel would now be convened on the issue, it would consider the measures at odds with the non-discrimination principle. Another line of thinking is that such trade sanctions are allowed under the general exemptions article (XX) of the General Agreement. Reinstein (1992) for instance stresses that the negotiators of the Montreal Protocol considered the trade sanctions in this protocol to be in accordance with the headnote of the exemptions article. The latter states that the application of the waiver should not present arbitrary and unjustified discrimination between countries *'where the same conditions prevail'*. The CFC negotiators found that countries which 'free ride' on multinational agreements, do not comply to behavioral guidelines with broad international support, and thereby artificially gain international competitiveness and market share, cannot be considered countries 'where the same conditions prevail'.

An important discussion element in the GATT Group on Environmental Measures and International Trade is that a country's government can have good reasons for not joining an international environmental agreement. This may be because of controversial scientific evidence, differences in national risk assessment, differences in the capability to adhere to certain environmental standards (cost aspect), and different absorption capacities of its environment. Therefore, persuasion and positive incentives for participation should precede the use of trade sanctions.

If trade sanctions are to be used for the attainment of environmental objectives, certain rules and principles should apply, and these are listed in Agenda 21 of UNCED summit in Rio de Janeiro. The measures should respect the principle of non-discrimination, should be the least trade-restrictive possible, transparent, and give special consideration to the special conditions and developmen-

tal requirements of developing countries as the latter move towards internationally-agreed environmental objectives (e.g Zutshi 1993: 16). Some countries voice the opinion that a future revision of the exemptions article should explicitly include a separate clause on trade sanctions in multilateral environmental agreements (cf. GATT 1993b). To achieve this a two-thirds majority of votes, and more than half the signatories must support this proposal (GATT 1992: 25-26). Such a procedure will only succeed when most of the major countries endorse the waiver. Until this has happened and no official complaints have been deposited, the issue of trade sanctions in environmental agreements remains a grey zone.

The issue of free ridership is also relevant with regard to ICREAs. It may arise due to non-compliance by member countries, or due to non-participance of important commodity-exporting or commodity-importing countries. In the latter case international parallel markets come into existence. These have proved to be an undermining element for prior international commodity agreements, like the International Coffee Agreement. The effectiveness of a 'transfer type' ICREA will be negatively affected when important commodity-importing countries refuse to share the financial burden of producing the commodities with environmentally preferable production methods.
It seems wise from a GATT point of view to avoid trade sanctions against non-members or non-complying members of an ICREA as far as possible. Positive incentives, persuasion and co-operative international solutions should be used to the extent possible to prevent free ridership and to stimulate participation. Participation and compliance by exporting countries in a transfer type ICREAs is stimulated by the positive incentive of financial compensation and/or technology transfer. Participation of importing countries would be stimulated if a differentiated export supply price could be agreed and maintained, with non-member importers paying a higher price. Trade sanctions should be the instrument of last resort and their design should meet a number of minimum criteria which are listed above.

Preferential tariffs for commodities produced with environmentally preferable technologies

A main element of 'type C' ICREAs are preferential import tariffs for primary commodities which originate from ICREA member countries and which have been produced according to certain environmentally preferable production methods. This can conflict with GATT rules for two main reasons. Firstly, preferential tariff treatment forms a department from the MFN principle, and secondly, this preferential treatment is based on PPM standards rather than on product standards. The latter issue has already been dealt with in this paper and we elaborate on the first issue.

Using preferential tariff treatment for products which have been produced according to some specified PPM standards, is very likely to be in conflict with GATT rules. The 'most-favoured-nation' (MFN) principle is a main element of the GATT system of trade rules (e.g. Jackson 1992: 133-148). It is formulated in the very first article of the General Agreement. The MFN obligation calls for each contracting party to grant every other contracting party the most favourable treatment which it grants to any country with respect to imports and exports of products, that is that no ('most-favoured') country should receive a preferential treatment. In practice, several exceptions from the MFN treatment have developed over the last decades. Under the aegis of UNCTAD a 'generalised system of trade preferences' for developing countries has developed. It had a redistribution background and allowed OECD countries to reduce tariff levels on developing country manufactured exports *below* their MFN rates.[1] The Lomé Conventions of the EC granted also preferential tariff treatment to some fifty developing countries, which also departed from MFN principles of the GATT. The same holds for the Caribbean Basin Initiative of 1983, by which the USA granted preferences to a number of countries in the Caribbean basin. After 1983, the USA increasingly adopted an 'ad hoc' approach of granting or withdrawing the MFN status of its trading partners (e.g. in its relations with the EC, Mexico, Japan, China and the East-Asian NICs) in order to punish or reward certain regimes and policies.
The conclusion is that in practice the MFN principle has been seriously eroded over the last two decades. It remains to be seen whether the MFN system will be restored as a result of the Uruguay Round. There is increasing doubt whether the preferential tariff treatment of developing countries achieved the original UNCTAD objectives of trade creation, and whether their exemption of applying the MFN principle to their own imports didn't do their economies more bad than good in terms of efficiency and access to world markets (e.g. Hudec 1987).

ICREAs should be so designed that they cause the least conflict with current GATT rules.Preferential tariff treatment for primary commodities whose production methods satisfied certain PPM standards, in principle infringes on two important GATT principles (MFN, equal treatment to 'like' products). Therefore, this variant of International Commodity-Related Environmental Agreements is definitely less attractive from a GATT point of view.
Even though the MFN principle has in practice been eroded on many occasions, there is no reason to create new anomalies if they can be avoided. The PPM problem could be avoided by applying these standards in the exporting countries rather than in the importing member countries of an

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1) The effect of these 'generalised' tariff concessions has been limited, because preferential imports were subject to quota, because many important goods (like textiles, clothing, processed agricultural products, leather) were excluded from the schemes, and because the preference scheme contained escape clauses which allowed the granting country to withdraw the concessions when they caused 'market disruption' (cf. Winters 1991: 172-175; Jackson 1992: 275-282).

ICREA. Moreover, if possible, commodities produced according to the agreed PPM standards, could voluntarily qualify for an ecolabel, supported by the ICREA members, which would justify differential tariff treatment and/or price differentiation. Avoiding the MFN problem in 'type C' ICREAs is, however, much more difficult, and this forms a good reason for considering this ICREA variant as the least attractive option.

The Subsidies Code and environmental subsidies

The last element of the GATT rules that we will deal with, are the regulations on subsidies. Subsidies, like tariffs, can cause price and trade distortions. This is the reason why the GATT from its inception paid attention to the use of subsidies in international trade. During the Tokyo Round (1979) further agreement was reached on this issue, which materialised in the 'Subsidies Code'. The code has been signed by most important OECD countries, but many developing GATT parties are not (yet) among its signatories. Crucial in the GATT approach towards subsidies is the distinction between general producer subsidies and export subsidies (Jackson 1992: 249-251).

General producer subsidies are issue-oriented and are granted for the benefit of products regardless of whether those products are exported or not. Here the principles of national treatment and national sovereignty apply. Such general producer subsidies cannot be challenged under the GATT. Nevertheless, they may affect international trade by directly or indirectly stimulating more exports or reducing imports. Therefore, governments are asked to notify these subsidies to other contracting parties of the GATT, describing extent and nature of the subsidy, its estimated effect on exports or imports, and the circumstances making subsidisation necessary. The Subsidies Code further specifies a code of conduct for member governments to minimise the negative trade consequences of general producer subsidies on other countries.

Export subsidies, contrary to general producer subsidies, are specifically granted to products when they are exported. They intentionally affect international trade conditions, and may cause harmful commercial effects in other countries. Such subsidies can be challenged under the GATT. Article XVIB specifically mentions that contracting parties should seek to avoid the use of export subsidies for primary commodities in a manner that results in having 'more than an equitable share of world export trade in that product' (GATT 1986: 27).

The relevance of these provisions is that environmental subsidies for producers are perfectly compatible with the GATT, provided that they are applied as part as of an integrated national programme that does not discriminate between trade destinations, and that does not create unnec-

essary commercial injury to other signatories.[1] Till now none of the GATT parties has ever challenged the legitimacy of another signatory's domestic environmental subsidy programme. In the 'Dunkel draft treaty' for the Uruguay Round it is explicitly stated that environmental subsidies in agriculture shall be exempt from the subsidy reduction commitments in the rest of the agreement, if such payments (including payments in kind):[2]

a) are "part of a clearly-defined government environmental or conservation programme";

b) "be dependent on the fulfillment of specific conditions under the government programme, including conditions related to production methods and inputs"; and

c) the amount of payment is "limited to the extra costs or loss of income involved in complying with the government programme".

It must be very well possible to create domestic environmental programmes, funded (at least partly) by ICREA transfers, within the limits set by these GATT criteria.

Conclusion

The existing GATT rules, provided that they are not interpreted in a way that unnecessarily curtails national discretion in designing environmental policies, offer ample opportunity for the formulation of national environmental policy measures. Nevertheless, it is for two reasons important that trade-affecting environmental measures are testable and accountable in the light of internationals trade rules. Firstly, because it is important that 'green' arguments are used to cover up 'ordinary' trade protectionism. And secondly, because, national measures may affect international trade in an unnecessarily restrictive way. A central message from the UNCED conference in Rio was that trade and environment policies should be mutually supportive. Agenda 21 explicitly stated that the accomplishment of "an open, equitable, secure, non-discriminatory and predictable multilateral trading system" would represent a large step in this direction. Behavioral rules for international trade, as specified in the General Agreement, have an important value of their own because they guide national trade procedures, offer possibilities for dispute settlement and contribute to prevention of archaic trade wars.

Thus, it is important to establish that the GATT rules do not in themselves form a stumbling block for adequate environmental policy formulation. In the case of environmental problems with an international (trade) dimension GATT has a clear preference for multilateral solutions and positive

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1) This latter condition is specified in the Subsidies Code, but its application is far from easy and still under debate. See for instance Jackson (1986: 259-273).

2) Derived from Annex 2 ("Domestic support: the basis for exemption from the reduction commitments") to the concept "Uruguay Round Agreement on Agriculture" (Gatt Secretariat 1991: L.18).

incentives for participation in such multilateral solutions. R. Eglin (1992: 96) of the GATT expressed this in the following way: "The more international environmental problems can be resolved multilaterally, the less chance there is of the problems degenerating into a source of trade friction for GATT. And it would appear more appropriate for environmental agreements to be backed up by financial compensation agreements and technological transfers, where these are necessary to encourage full participation, rather than using trade weapons to force countries into courses of action that are not of their own choosing". We fully subscribe to this opinion, but having said that, it should be acknowledged that cases may arise in which national decisions of limited numbers of countries to 'free ride' on multilateral solutions to international environmental problems, may effectively undermine such solutions. In such cases, and after offers of positive incentives for participation have failed, it will be difficult to avoid political sanctions and economic sanctions with regard to trade, finance and investment. Accentuation and elaboration of GATT rules for such situations will be necessary in future amendments of the General Agreement.

The paper looked at the GATT-compatibility of three main variants of International Commodity-Related Environmental Agreements. If was found that the *standard-setting variant (type A)* will be incompatible with existing trade rules when mandatory PPM standards are implemented by commodity-importing countries. Exporting countries are free to apply such standards in the context of an international agreement. If the standard-setting ICREA variant is extended with an ecolabelling scheme, this must be applied on a voluntary basis and not unilaterally imposed by importing countries. If certain GATT requirements with regard to ecolabelling schemes are met, it could form a useful addition to standard-setting ICREAs.
The *transfer type variant (type B)* of International Commodity-Related Environmental Agreements is consistent with GATT provisions. Using import tariffs for financing a compensation fund makes it necessary to apply the tariff rescheduling option incorporated in article *XXVIII* of the General Agreement. This could even be avoided when the general 'waivers' of articles *XXb,g* apply, and indeed, there are good reasons that ICREAs qualify for these waivers. The GATT waiver for international commodity agreements (article *XXh*) has never been used so far, and its application for ICREAs seems only possible when the latter agreements have a broad country participance.
The *preferential tariffs variant (type C)* of ICREAs is the less preferable variant from a GATT point of view. Granting preferential trade access for commodities produced according to some agreed PPM standards is at odds with the most-favoured-nation' principle of the General Agreement. Moreover, the application of PPM standards by importing countries is likely to cause problems with the non-discrimination principle for 'like' products.

As a general conclusion we can say that 'type A' and 'type B' ICREAs both can be designed in such a way that they are perfectly compatible with existing GATT rules.

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