Free Trade Under Fire

BY DOUG IRWIN

To students suffering through Econ 101, the four dullest words in the English language are “General Agreement on Tariffs and Trade” (the “on” is pretty dull, too). Yet the World Trade Organization, which evolved from the GATT, seems to evoke a very different response. Indeed, to many stranded on the left as the political mainstream drifted right, the WTO symbolizes all that is wrong with global capitalism. ¶ Doug Irwin, who teaches economics at Dartmouth, has spent much of his career demystifying the unintuitive realm of international trade. In *Free Trade Under Fire,* he continues the job, patiently analyzing the logic behind the backlash against open trade in general and against the impact of the WTO in particular. Think of it as the antidote to the opportunism and know-nothingism of the anti-globalism movement. – *Peter Passell*

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When what was called the Uruguay Round of trade negotiations was launched in 1986, the mood was one of guarded optimism – at best. Many observers believed that the General Agreement on Tariffs and Trade was crumbling, and blamed the proliferation of restrictions not covered by trade rules, such as voluntary export restraints. Moreover, countries seemed increasingly unwilling to adhere to existing rules.

Yet when the negotiations were concluded in December 1993, the resulting agreements turned out to be the most successful and comprehensive since the formation of the GATT after World War II. As in previous negotiations, participating countries agreed to reduce tariffs on merchandise. Developed countries reduced tariffs on industrial products (excluding petroleum) by about 40 percent, bringing average tariffs in those countries down to 3.8 percent. The remaining tariffs are highly uneven across sectors – relatively low on sophisticated manufactured goods but substantially higher on labor-intensive manufactured goods. Developing countries reduced their tariffs by 20 percent on average, bringing their average rates down to 12.3 percent.

More important, the Uruguay Round incorporated trade in previously exempt goods. Reform of agricultural trade had eluded negotiators ever since the GATT's formation, because of the political sensitivity of domestic support for farmers. The Uruguay Round agreement limits export subsidies and internal price supports by capping and then reducing these outlays. It also requires countries to convert all non-tariff barriers (like import quotas and voluntary export restraints) into a single import tariff. After this tariffication, the levies are to be reduced by an average one-third for developed countries and by one-quarter for developing countries over 10 years.

The resulting tariffs, however, are incredibly high. Many countries used the process of conversion as an opportunity to cheat, raising tariffs above the existing combination of non-tariff restrictions. This practice, known as dirty tariffication, meant that the actual liberalization in agriculture was slight. Still, the agreement on agriculture constituted a critical first step.

The Uruguay Round also abolished the Multifiber Arrangement, the web of export restraints and import quotas that clogs trade in textiles and apparel. The arrangement is to be phased out over 10 years. Yet because much of this liberalization occurs at the end of the transition period, many observers are skeptical that developed countries will have the political will to meet their commitments. Even if the Multifiber Arrangement is abolished, the United States and other developed countries will continue to protect their textile and apparel producers with high tariffs and antidumping measures.

The Uruguay Round made little progress in regulating the use of antidumping laws, but countries did pledge not to "see, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side." If adhered to, this provision will constitute a major improvement in discipline.

The negotiations also produced a General Agreement on Trade in Services (GATS) and established rules regarding trade-related investment measures (TRIMs) and trade-related intellectual property (TRIPs). Although these agreements are weak by the standards of the GATT, they constitute the first attempt to extend the principle of non-discrimination to new areas of international commerce.

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The core obligations in the GATS are set around three principles: most-favored-nation treatment (assuring that all nations will face equivalent tariffs), market access, and national treatment. The main sectors include telecommunications, financial services, air and maritime transport, and construction. Although the agreement contains specific commitments to liberalization, coverage is incomplete because the important provisions of the GATS apply only to the sectors specified by the member countries.

In making national treatment the standard for regulating foreign investment, the TRIMs agreement was even more modest. The agreement aims to eliminate quantitative restrictions on foreign investment, including limits on the share of foreign ownership in certain industries. Because of opposition from developing countries, there was no attempt to consider issues such as the right of firms to establish enterprises in other countries, or the elimination of trade-related performance requirements on foreign investment.

The TRIPs agreement consolidates previous international accords protecting copyrights, trademarks, patents and industrial designs, and provides for enforcement of these agreements by the WTO. But protection of intellectual property is not, strictly speaking, a trade issue that naturally belongs under the purview of the WTO, especially given the existence of the World Intellectual Property Organization. And many developing countries complain that, unlike mutually beneficial tariff reduction, the TRIPs agreement merely transfers income from developing to developed countries by strengthening the ability of multinational corporations to charge higher prices in poorer countries. In addition, using trade policy to protect intellectual property makes it harder to reject demands to use them to enforce other non-trade objectives, like environmental or labor standards, and thus puts the WTO in the business of enforcing behavior in areas only tangentially related to trade.

Under the Uruguay Round agreements, special and differential treatment for developing countries is limited. Although the resulting obligations are extensive, they are apparently less than the costs of remaining outside the agreement and losing the benefits of most-favored-nation treatment by other countries. Hence membership in the WTO has become increasingly attractive. At the start of the Uruguay Round in 1986, the GATT consisted of 91 contracting parties.

The WTO was established in 1995 with nearly 130 members, and by early 2001 its membership had risen to 140 nations, accounting for over 90 percent of world trade. Another 30 countries want to join.

The Uruguay Round was the first in which developing countries played an active role, and their participation helped to shape the outcome. Developed countries agreed to abolish the Multifiber Arrangement's clothing quotas and to reform agricultural trade, increasing trade in sectors where developing countries have what economists call a comparative advantage. In return, developing countries accepted rules in the new areas of trade where developed countries have a comparative advantage.

This exchange came to be known as the grand bargain. However, developing countries increasingly view the grand bargain as a bad deal; they took on many new obligations in services, investment and intellectual property, while developed countries have yet to grant significant access to markets in agriculture and clothing.

The developing countries are now more skeptical about the benefits of multilateral negotiations, particularly if developed countries force them to consider labor standards in future negotiations. As developing countries become more assertive in the WTO, the developed countries will have to be more sensitive to their concerns or the differences between the two could become a serious obstacle to completing the recently commenced Doha Round of trade negotiations.

THE WORLD TRADE ORGANIZATION

The WTO was established in 1995 by the Uruguay Round agreement. It has been a much more visible and controversial organization than the GATT, so it is important to get a sense of what the organization, and particularly its dispute settlement mechanism, is all about.

The scope of the WTO is broader than that of the GATT because it oversees multilateral agreements relating not just to goods, but also to services, investment and intellectual property. But like the GATT, it has virtually no independent power; authority to make trade policy and to write the rules governing it resides with the member governments.

What most distinguishes the WTO from the GATT is the dispute-settlement process. The original GATT made little provision for settling disputes. When conflicts arose, an informal process was developed to resolve them through negotiation. As it evolved, the GATT would often convene a panel of experts to arbitrate a dispute and to interpret GATT rules. But panels would leave a solution to the parties themselves. Over time, these flexible procedures became more complicated and the growing body of case law was viewed as establishing legal precedent.

The Uruguay Round agreement largely formalized existing practices. But it also strengthened the dispute resolution process. The GATT had operated by consensus. As a result, a country accused of violations could block the establishment of a panel or, if a panel were set up, could veto the adoption of the panel's report. Under the WTO, the creation of a panel and the adoption of its report now go forward automatically unless there is a consensus in opposition.

Under the new settlement mechanism, countries file violation complaints, alleging that specific rules (such as nondiscrimination) have been violated, or nonviolation complaints, alleging that a government action "nullifies or impairs" a previous concession, even if no specific rule has been broken. If initial efforts to resolve the dispute are not successful, a three-member panel is appointed to determine whether WTO rules have been violated. The panel's decision can be appealed to a formal group known as the Appellate Body.

As under the GATT, if the policy in question was found to violate the rules, the offending country could bring its policy into conformity with the rules, or keep the policy in place and offer compensation (lower tariffs) on other goods exported from the complaining country. In the latter case, the complaining country then has the option of accepting or rejecting the compensation offer. If neither alternative has been implemented, the complaining country can retaliate by withdrawing previous tariff concessions to the country that has chosen not to comply with the finding. Such retaliations occur infrequently because most disputes are settled through negotiations.

The dispute-settlement process was strengthened in the Uruguay Round largely because the United States Congress insisted on it. In the first five years of the WTO (1995-99), the United States filed 49 complaints and was the object of 35 complaints. Of the 49, fully 25 had been resolved by the end of 1999 – 13 through favorable rulings by WTO panels and 10 through negotiations. Of the 35 complaints brought against the United States, only 7 had been completed by the end of 1999, and in 6 of them some aspect of United States policy was found inconsistent with WTO rules.

The dispute-settlement process has worked well for the United States. Examining 42 cases, the U.S. General Accounting Office found that most led to beneficial changes in foreign regulations and practices and that "none of the changes the United States has made in response to WTO disputes have had major policy or commercial impact to date."

In Washington, there is a tendency to judge the success of dispute-settlement mechanism only by whether the United States "wins" the cases. But sometimes the United States deserves to lose. For example, in 1995 Costa Rica won a complaint against the United States concerning restrictions on imports of underwear. The fact that small countries can receive fair treatment under the rule of law is a strength of the world trading system. The alternative is that more powerful countries simply dictate outcomes to others.

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But even when the United States loses, the WTO cannot force change in United States laws, regulations or policies. WTO panels merely determine whether disputed policies conflict with WTO rules and, if they do, recommend that members bring those policies into conformity. The disputing countries must still resolve the matter themselves, often through a negotiated settlement.

Many nongovernmental organizations, particularly environmental groups, have complained that the WTO is secretive and antidemocratic in its procedures. Although they are now allowed to file "friend of the court" briefs, nongovernmental organizations are generally barred from the dispute-settlement process. This is because the WTO agreements are government-to-government agreements that deal with government policy, not with the behavior of private firms.

ENVIRONMENTAL REGULATIONS AND WTO RULES

Several dispute-settlement rulings have raised questions about whether WTO rules take precedence over domestic environmental, health and safety regulations. Unfortunately, passionate opposition to certain rulings has given rise to much exaggeration and distortion. For example, Public Citizen's Global Trade Watch charges that "in the WTO forum, global commerce takes precedence over everything – democracy, public health, equity, the environment, food safety and more."

That assessment is clearly wrong. As of 1999, fewer than 10 disputes brought before the WTO dealt with environmental or health issues. And these few environmental cases mainly focused on whether the regulation in question had been implemented in a nondiscriminatory way – not whether the regulation was justified. However, some cases do illustrate the difficult issues and potential conflicts that can arise when trade and environmental policy intersect.

Article 20 of the GATT allows countries to enact and enforce measures that restrict trade in order to achieve various objectives, provided the measures are nondiscriminatory, do not constitute a disguised restriction on international trade, and are necessary to achieve the stated objectives. Subsections of Article 20 specify objectives that would justify measures to constrain trade. The most important permit regulation to protect human and animal health, and to conserve natural resources.

A handful of the WTO's environmental cases have become notorious. Here I consider two of them in detail because popular discussion of them has been both emotional and superficial. If the United States insists upon receiving fair treatment abroad, it cannot be surprised that other countries demand nondiscriminatory treatment from the United States. This appears to be an uncontroversial proposition. Yet Public Citizen's most widely trumpeted example of the WTO's weakening of United States environmental regulations involves precisely this issue.

The Reformulated-Gasoline Case

The Global Trade Watch book, *Whose Trade Organization?*, accuses the WTO of forcing the United States Environmental Protection Agency to weaken its standards on imported gasoline. This case, the authors argue, is "an example of how the WTO could be used to skirt a country's democratic policy-making and judicial systems ... [and] was the first concrete evidence of the WTO's threat to environmental policy and to national sovereignty in setting and effectively enforcing important policies."

Yet the case did not involve the stringency of the EPA's regulation, but simply its nondiscriminatory implementation. In December 1993, the EPA issued a regulation to reduce contaminants in gasoline, with the goal of limiting engine emissions. Each domestic refiner was required to meet a new, more stringent standard based on its own 1990 quality level. This individual standard was chosen because a single industry-wide baseline would have made compliance very costly for some domestic oil refiners.

However, foreign refiners were not offered a similar option. As an EPA administrator later testified before Congress, the agency thought "that it was appropriate, if we had a choice, to lean in the direction of doing something that would favor their competitive position [i.e., that of domestic refiners] vis-a-vis the [foreign producers]."

In other words, the EPA built in discrimination to help domestic refiners compete against foreign refiners. In 1995, Venezuela and Brazil complained to the WTO. A WTO panel ruled against the United States, which then appealed. The WTO's Appellate Body recommended that the regulation be brought into conformity with WTO obligations, but left how it would comply up to the United States.

The United States could have ignored the Appellate finding, let the regulation stand, and offered compensation to Venezuela and Brazil in the form of lower tariffs on other products, or brought the regulation into conformity with the WTO rules. If the United States had chosen to ignore the ruling, Venezuela and Brazil could have withdrawn previous tariff concessions extended to United States goods, equivalent in value to their lost gasoline exports.

The second possible United States response would have been to keep the existing regulation in place, but to compensate Venezuela and Brazil by lowering tariffs against other goods. But this response would have required lowering tariffs on another industry – an unlikely outcome. As one trade lawyer explains, "imagine the United States Trade Representative explaining to an industry why the United States had agreed to lower tariffs on its products in order to keep in place a discriminatory rule that favored the oil industry." Hence the United States chose to bring the regulation into conformity with the WTO non-discrimination requirement. This could have been accomplished by requiring domestic refiners to meet the same uniform baseline that applied to imports, but the domestic industry did not want this option. Instead, in August 1997 the EPA allowed foreign refiners to use individual baselines.

Note again that the EPA could have resolved the case by raising the domestic standard, rather than lowering the import standard. Thus, the case is far from one in which the WTO undermined domestic environmental regulation, as Global Trade Watch claims. The United States may have lost this case. But

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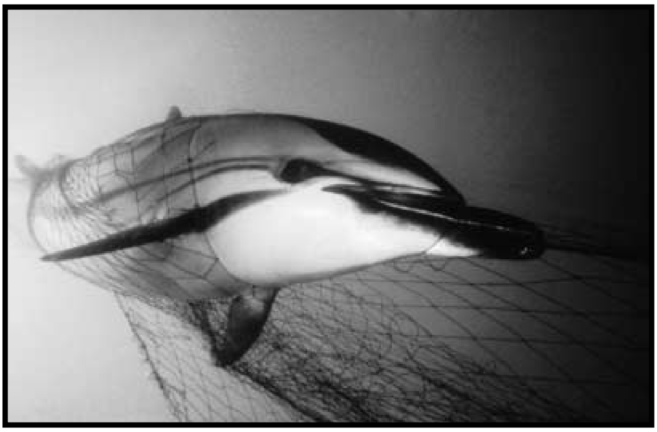
the system worked as Washington wanted, leaving the United States free to invoke the same rule against discriminatory regulations in other countries.

Finally, it is important to put the stakes in this case in perspective: the United States imported just 3.7 percent of the total United States supply of refined gasoline in 1998.

The Tuna-Dolphin Case

In 1991, a GATT panel ruled that a United States ban on imported tuna caught without using dolphin-safe methods was inconsistent with GATT rules. In a sense, this case is now completely moot: it was decided under the old GATT (rather than WTO) rules, it did not force any change in United States policy, and it was later resolved through negotiations. But the case is important because the panel's legal interpretation continues to cast a shadow over the debate about conflicts between environmental and trade rules.

Dolphins had long been accidentally killed by tuna fisherman who use purse-seine fishing nets. Under the Marine Mammal Protection Act, the United States established dolphin-protection standards for the American fishing fleet and for countries fishing for yellowfin tuna in parts of the Pacific Ocean. The Act required that the United States ban the importation of tuna from countries that failed to meet United States standards.



Mexico objected, and in 1991 requested that a panel review the case. Mexico argued that the ban violated prohibitions against quantitative restrictions or embargoes on goods from other member countries. It noted that dolphins were not an endangered species, and that no international agreement forbade the use of purse-seine nets. All 11 countries making representations to the panel supported Mexico.

The United States was outnumbered mainly because other countries objected to the unilateral nature of the ban. They believed that by imposing such standards, the United States was trying to force other countries to adhere to America's view of how non-American resources should be protected.

The United States argued that the import restrictions were justified under GATT rules allowing the enforcement of domestic regulations at the border and allowing trade measures to protect health and safety and to promote conservation. The GATT panel rejected both defenses. The panel ruled that the trade restrictions justified by the GATT rules applied only to products as such, and not to the process by which they were produced. This distinction became known as the "product-process" doctrine. Because tuna caught by dolphin-safe methods were the same as tuna caught by dolphin-endangering methods, the panel saw no legal basis for differentiating between them.

The panel also ruled that GATT rules did not allow a country to take trade actions for the purpose of enforcing its own standards in another country. Finally, the Article 20 defense failed because the measure was not shown to be necessary since other GATT-consistent options (such a multilateral negotiations) had not been explored. (The ruling in a parallel case brought by the European Community in 1994, known as Tuna-Dolphin II, backed much of the Tuna-Dolphin I ruling.)

Under the old GATT dispute system, a panel report was not official until adopted by the GATT Council. Mexico did not pursue the panel decision further, and the United States blocked adoption of the Tuna-Dolphin II panel report. The United States import ban remained in place. The tuna dispute was resolved in 1992 when the United States, Mexico and eight other tuna-fishing nations signed an international agreement to regulate tuna fishing. Since then, incidental dolphin deaths due to tuna fishing have dropped dramatically.

LESSONS FROM THE ENVIRONMENTAL CASES

Although there may be tensions between trade policy and environmental objectives, world trade rules are not inherently anti-environmental. Several less-publicized decisions reaffirm that the rules allow countries to maintain consistent and nondiscriminatory environmental regulations. For example, in 1994 a GATT panel affirmed that the corporate average fuel-economy standards regulating the fuel efficiency of automobiles sold in the United States were a perfectly acceptable form of regulation to protect public health and environment – as long as those standards did not explicitly discriminate on the basis of country of origin. Similarly, a WTO panel in 2000 upheld France's ban on asbestos imports on the grounds that they involved hazardous materials, after Canada had challenged the embargo.

The product-process doctrine that prevents consideration of how tuna are fished is a source of great concern. The doctrine, never explicitly propounded or endorsed by WTO members, gradually took on a life of its own. The distinction is unsustainable because process-based regulation has already been introduced in the agreement on trade-related intellectual property. For example, original and copied software are similar products, but the process by which they were produced is quite different. Besides, many people in developed countries care about how products are made: tuna may be tuna, but tuna caught with dolphin-safe methods is not viewed as identical to tuna caught with dolphin-unsafe methods.

At the same time, there are sound reasons for not allowing any and all process regulations. Developing countries fear that if the method of production of a particular good becomes grounds for blocking trade, then labor and environmental conditions will be introduced as excuses for keeping out their products.

Another lesson is that unilateral trade sanctions are a poor instrument for achieving environmental objectives. Sanctions would not prevent a country from diverting tuna caught with harmful methods away from the United States market toward other markets that would accept them. In the end, international agreements on standards are clearly preferable to trade embargoes, and a global approach must be taken in negotiations because the lack of cooperation by a few key countries can undermine the goal.

When other nations are reluctant to negotiate, the carrot of subsidies rather than the stick of sanctions can promote the adoption of safer production methods. For example, a straightforward solution to the dolphin problem would have been to subsidize dolphin-safe nets for use around the world. Rather than spending millions of dollars on legal fees to solve the problem through compulsion, a combination of foreign aid, World Bank assistance, and nongovernmental organizations' financial resources should have been pooled to give these dolphin-saving technologies to fishermen in developing countries. There should be enough common ground between the trade policy and the environmental community to work out these differences.

What has become clear is that it will not be acceptable to ignore environmental concerns when there appears to be a global consensus on those concerns. Effective environmental and safety regulations should not be blocked simply because they reduce international trade. The notion that all trade must be kept free at all costs is simply wrong.

PUBLIC HEALTH AND THE BEEF-HORMONES CASE

World trade rules do not stand in the way of government action to protect public health. When the United States banned imports of livestock and meats from Europe in 2001 because of fears of mad-cow disease and foot-and-mouth disease, the action was legal according to WTO rules. Yet public health is sometimes used to justify regulations intended only to protect special interests.

The use of public health as an excuse for protectionist regulations is not a new problem. In the late 1980s, for example, many European countries banned American pork after rumors spread that it was infected with trichinosis. Today, the United States and other countries still maintain trade barriers that are ostensibly designed to protect public health, but are actually for the benefit of producers. The Department of Agriculture estimates that questionable foreign regulations cost the United States about $5 billion in agricultural, forestry and fishery exports in 1996.

The United States-European Union dispute over hormone-treated beef is a classic example of the difficulty in drawing the line. The conflict began in 1985, when Europe restricted the use of natural hormones for therapeutic purposes and banned the use of synthetic hormones for growth purposes in cattle and meat sold in the European Union. At the same time, the European Union prohibited imports of animals or meat from animals that had been treated with such hormones. Thus the regulation seemed non-discriminatory because the same standard was applied to domestic and imported meat.

Implemented in 1989, the measure wiped out about $100 million in American beef exports to Europe. The United States strenuously objected, arguing that the European Union ban was unjustifiable because the hormones had been found safe when used in accordance with good practices of animal husbandry. Efforts to resolve the dispute under the Tokyo Round's Agreement on Technical Barriers failed because it dealt only with end-product characteristics, and naturally occurring hormones cannot be distinguished from cattle and beef treated with supplemental hormones. As a result, the United States retaliated in 1989 by imposing 100 percent tariffs on $100 million of agricultural imports from Europe.

The United States sought to clarify international rules on health and safety regulations during the Uruguay Round, and the result was the Agreement on the Application of Sanitary and Phytosanitary Measures. The agreement provides that trade-related sanitary measures should be based on scientific principles and should not restrict trade more than required to achieve the appropriate level of health protection. In addition, it states that governments "shall avoid arbitrary or unjustifiable distinctions …"

The United States, supported by Australia, Canada and New Zealand, used the agreement to challenge the European Union's ban on beef imports, arguing that the ban failed to meet any of these requirements. The WTO five-scientist panel concluded there was no public health risk.

The record also showed that high levels of several of the hormones occurred naturally in animal products, and yet these products were not regulated. For example, of the six hormones at issue, the one identified as most dangerous by the European Union is found in concentrations from 10 to hundreds of times greater in eggs, cabbage, broccoli and soybean oil than in hormone-treated beef. Why was the sale of eggs not banned, since there is 34 times more naturally occurring hormones in a single egg than in a pound of beef?

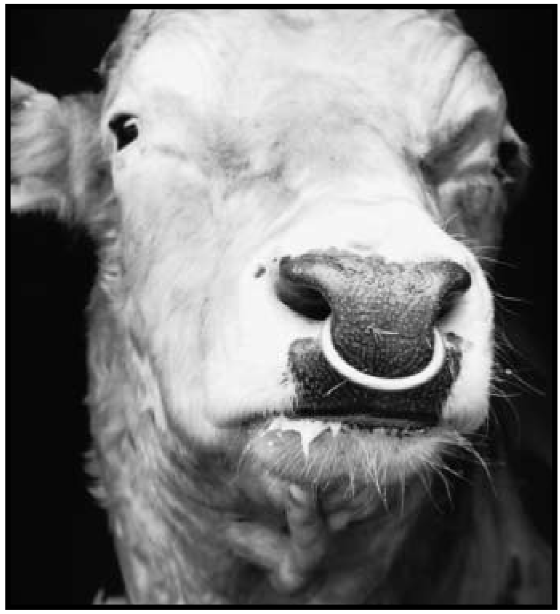
According to the United States, the real motivation for the ban was to protect domestic beef producers from foreign competition and to reduce surplus beef supplies in the European Union. If consumer health were the true motivation, then the European Union should not have continued to allow the use of growth additives by its competitive pork producers instead of disallowing it only in its less-competitive beef industry.

The European Union claimed that the United States was simply attacking the level of protection provided. It argued that the ban was based on the precautionary principle – the view that if scientific evidence did not establish beyond a doubt that the hormone residues were safe, then a ban was appropriate.

In 1997, the WTO panel ruled that the hormone ban was not based on scientific evidence or on a risk assessment, and therefore was inconsistent with the European Union's obligations under the agreement. The Appellate Body reaffirmed that decision in 1998. In 1999, after the European Union failed to implement any changes in policy, the United States imposed 100 percent tariffs on European imports valued at nearly $120 million, the estimated annual amount of lost United States beef exports.

As already noted, the rules allow trade restrictions with the proviso that they be imposed in a nondiscriminatory fashion, but also that they are not "a disguised restriction on international trade." Discrimination was never an issue in this case, because the use of hormones was forbidden in domestic as well as in imported meat. The question is whether the measure was a disguised restriction on trade. The problem is that this standard is virtually impossible to use because it gets to the unobserved motives behind a trade action.

Negotiated rules are a useful way to define common ground, but countries are bound to have different assessments of the risk trade-offs involved in any given regulation. For example, the United States and European Union have different assessments of the risks of genetically modified foods. In Europe, a food is under suspicion until proven safe, whereas in the United States a food is acceptable until proven harmful. These different approaches cannot be easily reconciled. The question is how far WTO members want to go in limiting the ability of governments to adopt trade restrictions when supporting scientific evidence does not exist or is ambiguous.



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THE ECONOMICS OF LABOR STANDARDS

The world trading system has also come under attack for omitting labor standards from trade agreements and thus allegedly failing to protect workers. Demands for labor standards are not new, but have recently come to the forefront of the debate over trade policy.

Student activists, human rights groups and other nongovernmental organizations have decried the poor working conditions in developing countries, and are sharply critical of multinational corporations for failing to pay what they consider living wages. Labor unions in the developed countries have long maintained that countries with lower labor standards have an unfair competitive advantage in trade, and that they attract investment at the expense of countries with higher standards. Most developing countries, by contrast, fear that if countries are allowed to restrict imports from others deemed not to have adequate labor standards, developed countries will have yet another excuse for denying low-wage countries access to their markets.

It is worth examining the claim that low wages give a country an unfair advantage in trade. Low wages generally reflect low labor productivity. Econometric evidence has regularly shown that labor productivity alone explains about 70 to 80 percent of the cross-country variation in average wages in manufacturing. After also accounting for differences in per capita GDP and in price levels across countries, over 90 percent of the variation in wages between countries can be explained.

Since average wages reflect average productivity, the cost advantage of low wages is generally offset by the cost disadvantage of low productivity. This implies that labor costs per unit of output are roughly comparable across countries. In India and the Philippines, for example, average wages are less than 10 percent of those in the United States, but the average productivity of workers is also less than 10 percent of that in the United States. Thus multinationals generally find it profitable to turn to developing countries only for unskilled, labor-intensive activities – particularly those in which the productivity of workers is comparable to that in developed countries, but the average wage they have to pay is much less.

As developing countries improve the productivity of their workers through the acquisition of better technology or other mechanisms, competitive pressures bid up wages. As a result, the growth in domestic wages tracks the growth in domestic productivity. Indeed, a country's average wage rate is determined almost exclusively by domestic productivity performance.

The fundamental problem facing workers in developing countries is not the existence of foreign sweatshops, but the lack of good alternative employment opportunities at home.

Low wages and poor working conditions in developing countries have sparked protests from concerned citizens in developed countries. The Worker Rights Consortium, established by students, unions and human rights groups, has accused Nike and other multinationals of subjecting workers to sweatshop conditions and not paying a living wage.

Working conditions in many developing countries are indeed horrible by the standards of developed countries, and everyone wants to see them improve. Still, the most direct way to raise wages and improve working conditions is to enhance productivity through economic development. Trade and investment are important components of that development, and therefore efforts to limit international trade or to shut down sweatshops are counterproductive. Most foreign-owned firms pay higher wages than comparable domestic firms. The "sweatshops" in poorer countries also pay better than the local labor market, which may explain the low turnover rate of workers at such firms.

The fundamental problem facing workers in developing countries is not the existence of foreign sweatshops, but the lack of good alternative employment opportunities at home. Efforts to stop exports from low-wage countries, to prevent investment there by multinationals, or to impose minimum wages or benefits that exceed the productivity of the domestic work force will simply diminish the demand for labor and take away workers' opportunities.

SHOULD TRADE AGREEMENTS HAVE LABOR STANDARDS?

Almost alone, the United States has pressed for considering labor standards in trade negotiations. Two categories are typically discussed. Core standards, such as a prohibition on forced labor, are related to fundamental human rights and can be universal in their application. Economic labor standards, by contrast, are tied more closely to a country's level of economic development and include minimum wages and working conditions.

Core labor standards have been defined by the International Labor Organization, an international body created in 1919 and composed of member governments, employers and workers. In 1996, the ILO issued a Declaration on Fundamental Principles and Rights at Work, stating that all countries are obliged to promote freedom of association and the effective recognition of the right to collective bargaining, the elimination of all forms of forced labor, the abolition of child labor, and the elimination of discrimination in employment and occupation.

However, with the exception of slavery, there is remarkably little agreement about the meaning of these standards or how they should be implemented. The ILO oversees more than 180 conventions on aspects of labor rights and practices, but few have been ratified by all ILO members.

As of early 2001, for example, the United States had ratified just 14 and had agreed to only two of the core conventions (on the abolition of forced labor and the prohibition of the worst forms of child labor). This is partly because domestic labor law is largely the prerogative of state governments, and partly because the language of the conventions may conflict with national policy. For example, convention 111, which seeks to abolish employment discrimination on the basis of sex and race, has not been ratified by the United States because it might conflict with affirmative action.

Child labor has been a particularly controversial issue, and illustrates the limits of using ILO conventions and trade policy to reduce this practice. The United States prohibits imports made with forced child labor, but does not have a generic ban on imported goods made with child labor. Indeed, dealing with non-exploitative child labor is a more difficult issue. The ILO charter establishing minimum ages of work has not been ratified by the United States, Canada or other developed countries because of differing national views on the details. For example, Canada chooses not to prohibit work at night for children under the age of 13.

Of course, child labor is a major issue in developing countries, and some activists have suggested that developed countries should refuse to import any goods made by children. A ban on imports made with child labor might stop their employment making goods for the United States market, but it would not put an end to child labor. Only about 5 percent of working children are employed in the export sector in developing countries. An import ban might simply shift them to other sectors of the domestic economy (about 80 percent are employed in the primary agricultural sector).

About 80 percent of the international variation in child labor is explained by per capita GDP. Child labor virtually disappears once a country's per capita income reaches $5,000. Developed countries could help developing countries raise incomes by allowing them to sell their products more easily in richer economies. Instead, developed countries have maintained high trade barriers on agricultural goods and clothing – precisely the goods in which developing countries have a comparative advantage.

THE POLITICS OF LABOR STANDARDS

Political pressures in developed countries push governments to go beyond core standards and into the realm of economic standards. Labor unions and other nongovernmental organizations have pressed for minimum wages, employment hours, occupational health and safety regulations, minimum age of employment, and so on. Without these standards, it is argued, developing countries will attract investment and gain jobs at the expense of developed countries – which will then face pressures to reduce labor standards.

Such economic standards, however, have no place in a trade agreement because they are a function of economic development.

At the 1996 WTO meeting in Singapore, the United States pressed for the creation of a working group on labor standards. Responding to sharp opposition by developing countries, the WTO agreed that the ILO was the more appropriate venue for considering labor standards. Despite this agreement, the United States again called for an examination of labor standards by the WTO at the 1999 Seattle ministerial meeting. Developing countries were again hostile, and even Canada failed to support the United States. When President Clinton let slip the idea that labor standards should be included in trade agreements and enforced with trade sanctions, developing countries accused the United States of bad faith in ignoring the Singapore declaration and were galvanized to oppose any new trade round on this basis. The President's statement thus almost single-handedly ensured the failure of the Seattle meeting.

There are inherent flaws in giving the WTO missions not related to trade, like enforcing environmental agreements or minimum labor standards. The risk is that these poorly targeted and indirect instruments will fail to achieve their objective, while at the same time they will expand the allowable rationales for trade barriers – and thus undermine the liberal trading system without generating compensating benefits.