

the dispute settlement mechanism is better than its reputation among environmentalists. Even when dealing with international environmental problems import restrictions should only be allowed after the failure of genuine efforts to reach cooperation, including offers of technical and financial assistance, and under tight disciplines. Admittedly, it is difficult to conclude and to enforce international environmental agreements, but loosening free trade rules is not a wise choice. In view of the numerous environmental concerns that may motivate claims for trade

measures and the difficulties of domestic politicians in resisting protectionist pressure, the alternative to the WTO's stern position may well be a proliferation of protectionism and a breakdown of the rule-based world trading system that has generated substantial benefits for its members and is still the superior alternative compared to other real world institutions. At least in the long run, such a process will neither remedy local and international environmental problems nor is it compatible with the concept of sustainable development.

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## The WTO and the Trade-Environment Conflict

### The (New) Political Economy of the World Trading System

*The shrimp-turtle case and the angry reactions it produced both inside and outside the WTO are only one striking example of the explosive force with which environmental policy disputes can shake the world trade system. Given a world whose economies are more closely linked and where environmental problems extend over national borders, it is to be expected that interest groups increasingly concentrate on influencing the institution which is dedicated to promoting international trade, the WTO.*

Press statements from representatives of important industrial countries suggest that a new negotiating round to liberalize world trade will get under way at the end of 1999. Hopes as well as fears will accompany the 'Millennium Round' as it is auspiciously being called, and interest groups are already lining up to put their own particular demands on the negotiating agenda.

As the Uruguay Round was drawing to a close it was already clear that the environment would play a major part in a future trade liberalization round. This has changed little in the interim. It is therefore important, before the next round takes place, to consider the extent to which integrating the environment into the negotiations will influence the round's trade policy outcomes. To find an answer, the relevant interest groups' stances and actions must be predicted, as this will influence the political negotiating process. This article attempts to do so by discussing the interaction of trade policy and environmental policy from the viewpoint of economic theory. The main emphasis is put on the strategic interests of

environmental groups, business federations and trade politicians that are of special significance within the political competition that takes place in representative democracies. First of all, however, the relevance of the subject will be demonstrated by a topical environmental policy dispute in the WTO.

#### The Shrimp-Turtle Case

The 1998 shrimp-turtle case caused a considerable stir both within the WTO and among the environmentally aware public. It is seen as pointing the way for the future development of the GATT laws affecting environmental policy in situations in which they apply to cross-border externalities. The case arose out of an import ban by the USA on shrimps from countries whose fishing fleets do not use 'turtle-excluder devices' (TEDs). TEDs are designed to reduce the number of sea turtles killed in a shrimp catch. Sea turtles have been designated an endangered species in various multilateral agreements.<sup>1</sup> The use of TEDs was made compulsory in the USA in

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<sup>1</sup> The sea turtles are mentioned in CITES, the Convention on Migratory Species, and the IUCN.

1990 by the Endangered Species Act (Public Law 109-162). Section 609 of the Act requires the US government to certify all shrimp imports and only to permit imports from countries which can prove that their shrimp fleets use TEDs.

The US government began implementing the legislation in 1991 by requiring Latin-American and Caribbean countries to bring their fishing methods in line with the US regulations within three years. In the end the countries involved signed a multilateral agreement for the compulsory use of TEDs, while the USA undertook to give technical support to install them. In 1995 the US Court of International Trade upheld an objection filed by the Earth Island Institute, an environmental non-governmental organization (NGO), that the geographical limitation of the implementation process was contrary to Section 609. The US government was then required to implement the regulations of Section 609 world-wide, which it reluctantly did by imposing its import embargo. As a result, in January 1997 India, Malaysia, Pakistan and Thailand filed a complaint at the WTO to contest the implementation of Section 609.<sup>2</sup>

The WTO Panel report was published on 6th April 1998.<sup>3</sup> As had been widely expected, the Dispute Settlement Body forced the USA to revise its law, which, it found, could not be justified under the exceptional rules of Article XX of the GATT and represented a clear threat to the multilateral trade system. The Shrimp-Turtle-Panel broadened the

restrictive legal interpretation of earlier panels by not even considering whether the criteria for exceptional treatment under Article XX (b) and (g) had been fulfilled, once it had established that Section 609 discriminated arbitrarily and unjustifiably and that it, moreover, implied a unilateral imposition of US environmental legislation on other countries.<sup>4</sup>

Although some environmental groups shared this criticism, the nature of the legal grounds given for the ruling and the tone of the report caused an outcry amongst environmental non-governmental organizations (NGOs).<sup>5</sup> 'Whether or not correct, the panel lacked tact. In reviewing an arguably legitimate environmental measure as potential "threat" to the WTO's primary "object" of "liberalization", the panel revealed the WTO's trade bias. In this, it supplied ammunition to some of the WTO's fiercest critics. Given the clout of these critics in the U.S. and EC, the panel's report may have posed more of a threat to the trading system than the U.S. measure which was its object.'<sup>6</sup>

The USA, under pressure from environmental groups, did not accept the judgement and went to appeal. The Appellate Body report published on 12th October 1998 upholds the original ruling but differs significantly from the Panel report both in the legal grounds given for the judgement and in its tone. The import ban pursuant to Section 609 is now expressly recognized as a legitimate measure under Article XX (g). However, the Appellate Body, like the Panel, criticizes the implementation of the import ban as unjustified and arbitrary and failing in this respect to meet the requirements of Article XX.<sup>7</sup> What is new from an environmental policy viewpoint is that the Appellate Body report sets out certain procedural requirements for the implementation of unilateral trade measures. In doing so it moves away from a very restrictive, trade-centred interpretation of GATT law and towards a position in which trade and environmental objectives are more carefully weighed against one another. Thus the WTO did succeed, on the one hand, in calming the angry reactions which the original judgement had provoked. However, in a way this was like locking the stable door after the horse had bolted, because the environmentally aware public had already adopted the (over-simplified) view that the WTO obstructs national environmental policies.

### **The WTO's Current Politico-economic Setting**

The shrimp-turtle case and the angry reactions it produced both inside and outside the WTO are only one striking example of the explosive force with which environmental policy disputes can shake the world

<sup>2</sup> The shrimp-turtle case is strongly reminiscent of the tuna-dolphin cases in 1991 and 1994. One reason why the recent case takes on a new quality is that the two older ones never entered into the formal GATT case law; another is that the Appellate Body changed the way the rules had initially been interpreted in the shrimp-turtle case. The legal point at issue in these cases was whether or not the USA was in a position to justify quantitative import restrictions – normally prohibited under the terms of Article XI – by invoking the exceptional rules provided in Articles XX (b) or (g), in this instance on environmental grounds.

<sup>3</sup> The Report can be read on the WTO's website, at: <http://www.wto.org>.

<sup>4</sup> For an extensive jurisprudential assessment of the case, see: Robert Howse: *The Turtles Panel. Another Environmental Disaster* in Geneva, in: *Journal of World Trade*, Vol. 32 (1998), No. 5, pp. 73-100.

<sup>5</sup> Cf., e.g., Matthew Stilwell, Charles Arden-Clarke: *The WTO Shrimp-Turtle Ruling: International Trade versus the Global Environment*, in: WWF International et al. (eds.): *Dispute Settlement in the WTO: A Crisis for Sustainable Development*, Discussion Paper, Geneva 1998.

<sup>6</sup> Gregory Shaffer: *The U.S. Shrimp-Turtle Appellate Body Report: Setting Guidelines toward Moderating the Trade-Environment Conflict*, in: *BRIDGES Between Trade and Sustainable Development*, Vol. 2 (1998), No. 7, pp. 9-12.

<sup>7</sup> In its report, the Appellate Body lists six examples of unjustified discrimination and one example of arbitrary discrimination in the implementation of the US legislation. Cf. Gregory Shaffer, *op. cit.*

trade system.<sup>8</sup> The subject of the environment has, without doubt, grown in significance in most industrial countries. Given a world whose economies are internationally more closely linked and where environmental problems extend over national borders, it is only natural that interest groups concentrate on influencing the institution which is dedicated to promoting international trade: the WTO.

Non-governmental organizations now play an increasingly important part in the process of political competition in the industrial nations. Both environmental and development NGOs have clearly become more effectively organized, at least since the UNCED-conference in Rio de Janeiro.<sup>9</sup> In many countries they now have institutionalized channels for lobbying at their disposal, they are connected world-wide via the Internet, actively use the latest information technology, and are effective in influencing public opinion.

It would be a mistake to classify NGOs as diehard protectionists across the board. On the contrary, many groups endeavour to reconcile the advantages of a multilateral liberal trade system with environmental and developmental needs.<sup>10</sup> However, three observations concerning the actions of NGOs are notable: firstly, in order to effectively articulate the subject of the environment in public, NGOs seize on topics which can be made into good campaigns. A striking example is the great public appeal of issues which either concern popular animal species (dolphins, turtles) or are connected with possible risks to human health (BSE, genetically manipulated food). Secondly, here is a point directly affecting trade policy: they recognize that protectionist intervention to save the environment can often be 'sold' better than other environmental policy measures. The main reason for this can be seen in the fact that the ecological 'usefulness' of an import ban (e.g. a boycott of tropical timber) is easily recognized, whereas the economic costs of such an instrument are not. Thirdly, environmentalists frequently form coalitions with interest groups from import-competing industries. This is especially obvious in the USA where environmental groups, in coalition with trade unions, succeeded in influencing the trade regulations of NAFTA to be far more ecological than those of GATT.<sup>11</sup> Recently the American Congress refused to grant the President 'fast-track authority'.<sup>12</sup> Now President Clinton is again trying to get this mandate, but its terms have been extended to include a commitment to pay due consideration to ecological and social standards in negotiations.<sup>13</sup>

Parallel to the NGOs, the significance of transnational corporations (TNCs) is growing too. As global

players they have to rely on keeping the transaction costs of their integrated production as low as possible. As a rule they will thus be more free-traded-minded than locally operating businesses, especially as the volume of their turnover makes them dependent on large (open) markets. The transnational corporations in the chemical and pharmaceutical industries, for example, showed enormous interest in the Uruguay Round agreements, as did the entertainment giants from the USA in particular.

This trend is likely to be intensified by progressive globalization. At the same time, two different tendencies are observable in corporate environmental policy. On the one hand businesses understandably have no interest in environmental laws which raise their costs, in particular when countries implement them differently. For example, the businesses which joined forces in the 'Global Climate Coalition' invested enormous sums of money to influence public opinion against the US government signing the Kyoto Protocol.<sup>14</sup> On the other hand they now face growing public pressure to demonstrate that they go about their business in an environmentally acceptable manner (in a wider sense). Hence there is increasing dialogue between environmental groups and representatives of industry about particular environmental standards: the business guarantees by contract to adhere to these standards, and in return is awarded an environmental label.

<sup>8</sup> While the Panel's judgement was criticized by environmentalist groups, the report of the Appellate Body came under fire from a number of the developing countries in the WTO. Their criticism was that, by interpreting the law broadly, the body had ranged beyond the powers accorded to it and had been too extensive in the concessions made to environmental interest groups in the industrial countries.

<sup>9</sup> Cf. Daniel C. Esty: *Greening the GATT. Trade, Environment, and the Future*. Institute for International Economics, Washington, D.C. 1994, pp. 26f.; Peter Wahl: *NGO-Multis, McGreenpeace und Netzwerk-Guerilla. Zu einigen Trends in der internationalen Zivilgesellschaft*, in: *Peripherie*, 1998, No. 71, pp. 55-68.

<sup>10</sup> An exemplary organization in this respect is the International Center for Trade and Sustainable Development (ICTSD) established in 1996, which devotes itself to activities such as disseminating information and encouraging contacts between trade and environmental policymakers (Internet address: <http://www.ictsd.org>).

<sup>11</sup> Cf. Andreas Knorr: *Umweltschutz, nachhaltige Entwicklung und Freihandel: WTO und NAFTA im Vergleich*, Stuttgart 1997.

<sup>12</sup> 'Fast-track authority' allows the President of the United States to negotiate trade liberalization agreements within a fixed period of time which can subsequently only be accepted or rejected as a complete package by Congress. This is designed to reduce the influence of interest groups. The Shrimp-Turtle Panel Report is likely to be one of the reasons why fast-track authority was refused in mid-1998.

<sup>13</sup> BRIDGES Weekly Trade News Digest, Vol. 2 No. 39 (October 12, 1998). The NGOs also played a substantial part in the failure of the OECD negotiations on a multilateral agreement on investment (MAI).

<sup>14</sup> Cf. Axel Michaelowa: *Climate Policy and Interest Groups – A Public Choice Analysis*, in: *INTERECONOMICS*, Vol. 33 (1998), No. 6, pp. 251-259.

Trade politicians – considered, for the sake of simplicity, to consist of the bureaucrats and politicians in the WTO and in (most) trade ministries – like to claim that they are independent of the interests of industry and environmentalists. However, while they at least share the goal of free trade with parts of the business world, they tend to meet the demands of the NGOs with great scepticism. Indeed, Esty speaks of a ‘cultural conflict’ when referring to the ability of environmentalists and trade politicians to discuss matters together.<sup>15</sup> Nevertheless there are now signs of a rapprochement between the environmental NGOs and the WTO. The WTO secretariat has taken various initiatives to promote better understanding (such as arranging discussion forums, setting up an NGO page on its website, and speeding up the publication of certain documents).<sup>16</sup>

In the run-up to the next liberalization round, then, both NGOs and multinational businesses are growing in significance, as they pursue their partly conflicting interests. Liberally-minded trade politicians continue to follow the activities of environmental NGOs with great scepticism because they fear that the NGOs’ activities will endanger the multilateral trade system. The predictions made by economic theory for the relevant groups’ actions, and the consequences which could result from this in the next negotiating round, will be explained below.

### **Normative and Positive Theory of Trade Liberalization<sup>17</sup>**

The familiar conclusion of traditional international trade theory is that free trade maximizes both world economic welfare and that of the participating countries. State intervention in foreign trade is thus rejected as it reduces the advantages flowing from the international division of labour. A great majority of economists concur with this policy recommendation. In most cases it is upheld even if one departs from the rigid premises of traditional trade theory to include market imperfections in the analysis. The general tenor then is: always treat problems at their roots! Foreign trade itself almost never creates the problem, hence as a rule there are economically more efficient instruments than protectionist ones to tackle the problem.<sup>18</sup>

The WTO can be interpreted as the – albeit imperfect – institutional embodiment of such thinking. The aim of the world trading system is to improve market access by dismantling trade barriers and promoting productive international competition. In this way resources are allocated efficiently, the prices

of products fall and the opportunities for growth increase. At the same time redistribution processes are triggered off in the trading countries. As a rule all consumers will benefit, together with the producers in export-intensive industries. Losers will be found in the short term in import-substituting branches of industry. In theory it is possible for the losers to be compensated by the winners, hence trade liberalization is potentially Pareto-improving.

Nevertheless we observe protectionist measures being taken time and again in every society. Even in the WTO there are numerous exceptions to the principle of free trade, so the ‘pure doctrine’ cannot, by a long chalk, be said to have been asserted in the real world. The positive theory of international trade relations aims to explain precisely why protectionism persists, by incorporating into its investigations the domestic political decision-making processes as they affect trade-policy measures.<sup>19</sup> The New Political Economy of trade policy assumes that the relevant players such as politicians, lobbying groups and bureaucrats will act rationally and in their own interests, and attributes the measures ultimately taken by governments to the interaction of these various players.

The trade policy of a government is obviously subject to political debate. In order to be able to take trade liberalizing measures the advocates of liberalization need to compete for a political majority. The means they can apply include theoretical economic arguments (‘free trade benefits everyone in the long term’), promising compensation payments, or mobilizing the beneficiaries. The New Political Economy of protectionism points out that the benefits of trade are very widely dispersed (among consumers) or uncertain (which exporting industry stands to win on the world market?), whereas its adverse effects are quite likely to be borne by clearly delimited and well organized groups. In principle then, the protectionist lobbying groups are the ones that have the

<sup>15</sup> Cf. Daniel C. Esty, *op. cit.*, pp. 36 f.

<sup>16</sup> Cf. WTO Focus, No. 32, July 1998.

<sup>17</sup> Normative welfare economics works out policy recommendations which well-meaning policymakers are advised to follow. Positive economics (the New Political Economy) sets out to explain *why* particular policy instruments are applied.

<sup>18</sup> Cf., e.g., Peter J. Lloyd: The Problem of Optimal Environmental Policy Choice, in: Kym Anderson, Richard Blackhurst: The Greening of World Trade Issues, New York etc. 1992, pp. 49-72.

<sup>19</sup> Cf. Hannelore Weck-Hannemann: Politische Ökonomie des Protektionismus. Eine institutionelle und empirische Analyse, Frankfurt am Main 1992, p. 34.

advantage.<sup>20</sup> Consequently governments regularly endeavour to represent the interests of their country in multilateral liberalization negotiations in such a way that their exporting industries are guaranteed better access to markets abroad, while at the same time ensuring that their import-substituting industries are protected.

For progress to be made in spite of these antagonistic governmental interests, the principle of reciprocity becomes the most important negotiating principle.<sup>21</sup> Liberalizing agreements firmly establish rights and responsibilities which have first been haggled over in the political market. A country grants liberal market access if it also gets improved access to other markets in return. The WTO monitors these mutually agreed commitments, which only apply to member countries. In doing so it attempts to minimize free-rider activities by non-member countries, for only those who have themselves made concessions ought to be allowed to enjoy the advantages.

In this sense the WTO applies a code of conduct to participating governments. It stabilizes member states' expectations of each other's trade policy by defining stable rules of behaviour. In this respect it restricts trade-policy options with the aim of achieving a better collective outcome. At the same time, applying the principle of reciprocity, national governments endeavour to put together compromise liberalization packages that will obtain a political majority in their home countries.<sup>22</sup> The growing political influence of environmental groups could undermine this fragile system by which majority support is obtained.

### Normative and Positive Environmental Economics

Environmental problems arise through the inefficient use of the environment as a form of public good. The environment is sometimes used profligately as a production factor because it is too cheap (the extreme case being when it is available as a free good, e.g. the atmosphere). In part it is overused because access to it is not restricted – e.g. fish stocks. Neoclassical environmental economics hence views environmental problems as an allocation problem, especially one of externalities. These arise when property rights are not fully defined and – subsequently – price signals in the market process fail to reflect social opportunity costs.<sup>23</sup>

Following on from this diagnosis, the prescribed treatment is to correct the price signals in such a way that the externalities are internalized, i.e. are integrated into the price system. There are various ideas on how to achieve this, ranging from Coase's solution

of negotiated agreements, via Pigouvian taxes, to tradable emission certificates. All the instruments lead to an optimal level of environmental quality as long as certain conditions are fulfilled. At the same time redistribution processes take place between economic actors, away from the intensive users of the environment (now more expensive), to those who are less heavy users.<sup>24</sup>

Particular problems naturally occur when cross-border externalities are generated. Even if the polluter-pays principle is held to apply, there still needs to be a higher authority of international law than the nation state to push through the claims of the litigant country. In extreme cases where externalities have a global impact (classic example: the hole in the ozone layer) the environmental-quality good finally takes on the characteristics of a public good, bringing with it the free-rider problem: every country could optimize its own economic welfare if all other countries except itself stopped generating the externality (=> CFCs). Countries thus find themselves in the prisoners' dilemma, and the consequent outcome is sub-optimal for the world as a whole (=> the hole in the ozone layer becomes inefficiently large). The sensible solution put forward in environmental economics is a multilateral agreement to overcome the dilemma, whereby countries must commit themselves to cooperative action and punish free-riders.<sup>25</sup>

Normatively oriented theory already takes into account the enormous information and transaction costs which implementing these instruments would involve. Hence it concludes realistically that the desired environmental goals need to be defined in the political sphere. Although 'optimal environmental quality' can then only be attained coincidentally, it nevertheless makes sense to use the most efficient instruments available, notably taxes and tradable certificates.

Although progress is indeed being made on environmental policy in the real world, it is rarely

<sup>20</sup> For more extensive investigations, cf. Hannelore Weck-Hannemann, *op. cit.* or Dani Rodrik: *Political Economy of Trade Policy*, in: Gene M. Grossman, Kenneth Rogoff (eds.): *Handbook of International Economics*, Vol. III, pp. 1457-1494, Amsterdam etc. 1995.

<sup>21</sup> Cf. Bernard Hoekman, Michel Kosteci: *The Political Economy of the World Trading System. From GATT to WTO*, Oxford 1995, pp. 27-30.

<sup>22</sup> Cf. *ibid.*

<sup>23</sup> Cf., e.g., Horst Siebert: *Economics of the Environment. Theory and Policy*, 3rd ed., Berlin etc. 1992.

<sup>24</sup> This holds true as long as the polluter-pays principle is in operation.

<sup>25</sup> Cf. Horst Siebert, *op. cit.*, p. 189.

based on market-oriented instruments.<sup>26</sup> This can be explained using the positive branch of environmental economics. The fundamental principles of the New Political Economy attribute the extent to which environmental policy is applied and the choice of instruments to the self-interest of the participating players. The majority of investigations so far made predict that policymakers will not supply enough of the public good of environmental quality. The main reason is to be found in the interest groups' differing abilities to organize and assert themselves. Environmental groups have been found to be at a structural disadvantage relative to the affected parties in branches of the economy that use environment-intensive production methods.<sup>27</sup> With regard to the instruments chosen the theory predicts that the political decision-makers in a representative democracy will prefer state 'command-and-control' measures.<sup>28</sup> These include, for example, prohibitions, and product and process standards. Such legalistic measures hold advantages for all participants: politicians can demonstrate determination to implement environmental policy, bureaucrats find a multitude of tasks in monitoring the instruments, quasi-rents frequently arise for producers, and environmental groups can present clearly visible successes. The ecological effectiveness and the economic efficiency of these instruments, however, is often dubious.

### The Interplay between Trade and Environmental Policies

As was already beginning to become apparent in the previous two sections, there are some quite remarkable parallels between trade policy and environmental policy when they are analysed from an economic viewpoint. Normatively oriented neoclassical theory reaches unambiguous conclusions in both cases: from an allocative viewpoint, free trade and environmental policy which uses incentive-driven instruments are both optimal. Redistribution effects

also arise in both cases, in which the losers could be compensated by the winners. If applied consistently, this approach does not result in any conflict between free trade and conservation. On the contrary, the social Pareto optimum is reached if liberal environmental and trade policies are applied hand-in-hand.<sup>29</sup>

The Political Economy approach has also demonstrated, however, that the chances of this succeeding are not great in either policy area. This is because the advocates of free trade and a consistent environmental policy have to organize political support for initiatives that are effectively public goods. Hence they both face the typical problems of collective action.<sup>30</sup> Groups opposed to either of them in the political arena can overcome these problems more easily because losses which are relatively certain and clearly calculable make free-riding less attractive. The interests of protectionists and of opponents of environmental policy can both therefore be expected to succeed more easily in the political process.<sup>31</sup>

In practice two tendencies can be observed which appear to contradict the theoretical considerations thus far. First of all, greater progress is being made in liberalizing world trade than in incentive-driven environmental policy. Its principal manifestation is the founding of the WTO and the advancement of that body's liberalizing agreements. By contrast national environmental legislation lags some way behind and a comparable multilateral organization for the environment has yet to be founded.<sup>32</sup> The obvious reason for this lack of symmetry is that the environment has only received greater attention in recent years, hence the political pressure needed to push through more stringent conservation measures has not yet been strong enough. On the other hand, the beneficiaries of further trade liberalization have evidently been more successful in winning the necessary political support for their cause.

<sup>26</sup> This assertion is not quite so applicable to the USA, where some considerable experience has been gained over time with tradable certificates.

<sup>27</sup> Cf. Sigrid Meyer: *Ökonomische Theorie der Umweltpolitik. Der Erklärungswert der Neuen Politischen Ökonomie für umweltpolitische Entscheidungsprozesse*, Bergisch Gladbach & Cologne 1996, pp. 133 ff. Specifically on the issue of climate policy, see also Axel Michaelowa, *op. cit.*

<sup>28</sup> Cf. Bernhard Hoekman, Michael Leidy: *Environmental Policy Formation in a Trading Economy: A Public Choice Perspective*, in: Kym Anderson, Richard Blackhurst, *op. cit.*; see also Sigrid Meyer, *op. cit.* In addition, there is an evident preference in Germany for consensus-based environmental measures: one example is the voluntary agreement by retailers and the beverages industry to maintain a 72% share of returnable bottles for all drinks sold.

<sup>29</sup> Cf., e.g., Kym Anderson: *The Standard Welfare Economics of Policies Affecting Trade and the Environment*, in: Kym Anderson, Richard Blackhurst, *op. cit.*, who writes in this tradition of theory. The OECD also recently published a study taking much the same line: *OECD: Open Markets Matter. The Benefits of Trade and Investment Liberalisation*, Paris 1998.

<sup>30</sup> Cf. Mancur Olson: *The Logic of Collective Action. Public Goods and the Theory of Groups*, Cambridge etc. 1965, for the classic text in this field.

<sup>31</sup> On this topic, cf. Carsten Helm: *Sind Freihandel und Umweltschutz vereinbar? Ökologischer Reformbedarf des GATT/WTO-Regimes*, Berlin 1995.

<sup>32</sup> UNEP has not managed to fulfil this role so far. International environmental policy, which has to rely on a cooperative spirit, is currently based on approximately 50 multilateral and more than 100 bilateral environmental agreements. Cf. Margareta Kulesa: *Umweltpolitik in einer offenen Volkswirtschaft. Zum Spannungsfeld von Freihandel und Umweltschutz*, Baden-Baden 1995.

Secondly, coalitions of 'conservationists' with 'protectionists' dominate the public debate.<sup>33</sup> This contradicts the conclusion of normative neoclassical theory that 'free traders' and 'conservationists' ought to be 'natural allies'. Neoclassical theorists (and trade politicians) often regret or criticize the phenomenon, but can rarely explain it.

The points discussed above suggest the following explanation: for conservationists an alliance with protectionist groups can make sense for strategic and for substantive reasons. Seen from a political-economy perspective, an alliance of two relatively weak interest groups does not necessarily increase their chances of political success. Both environmental groups and trade politicians benefit more from entering an alliance with a relatively influential interest group from another policy area, allowing them to achieve their separate goals in a common package solution. The alliances of environmental groups with industries threatened by export competition have been documented in economic literature.<sup>34</sup> Less attention has been paid to the coalitions which also exist between trade politicians and parts of industry which tend to be free-trade-minded but are simultaneously fighting environmental measures because of their export interests. For free traders these representatives of export industries present an obvious coalition partner, since both groups (in part at least) pursue a common interest and exporting industry, which is becoming ever more important in a globalized world, has effective means of influencing politicians and public opinion at its disposal. The political price which a free-trade-minded government has to pay for this support is having to accommodate the export industry's concept of environmental policy.<sup>35</sup> Thus each of the two parties standing opposite one another has its own coalition partners, and each one stands up for its ally's objectives for strategic reasons (or at least, it does not actively question them).

In such a situation conservationists always prefer a protectionist trade policy irrespective of the environmental policy being pursued. Conversely, free traders are more likely to support 'bad' environmental policy for strategic reasons, whatever trade-policy option is taken. A stable equilibrium, typical of the prisoners' dilemma, is thus produced for society as a whole in the sub-optimal combination of protectionism plus bad environmental policy.

Many environmental groups have substantive as well as strategic reasons for fighting further liberalizing measures in the WTO. Assuming, for example, a situation in which an environmental policy in Germany

is based essentially on state prohibitions and standards, liberalizing measures can make what is actually bad environmental policy even worse. Process standards and product standards in particular are coming under increasing pressure in the WTO because of the distorting effects they have on trade.<sup>36</sup> On top of this there is the problem of cross-border and global externalities which have not yet been adequately internalized. Even free-trade-minded economists acknowledge that further liberalizing world trade without internalizing global externalities can lead to increased environmental problems and national welfare losses.<sup>37</sup> It is not very helpful to then reproach conservationists by saying that good environmental policy needs instruments other than those of trade policy. Conservationists retort by calling this the 'nirvana approach', saying it is based on unrealistic premises and is (for them) politically unachievable. They maintain that the conditions for optimal world-wide internalization of externalities (the first-best solution) do not exist, nor are there sufficient multilateral agreements which could at least safeguard minimum environmental standards (a possible second-best solution).<sup>38</sup> When environmental groups demand ecological reform of the rules in the world trading system and oppose further liberalizing measures they choose the rational next-best strategy from their own viewpoint.

Hence the crux of the argument set out here is that, based on strategic and substantive calculations, it can be a rational strategy for environmentalists to reject further liberalization of world trade. This stance is influenced by the behaviour of trade politicians and the existing structure of (national and international) environmental policy. If the desire is to avoid the sub-

<sup>33</sup> These groups are described here in ideal-typical terms, in order to bring out their prime objectives. It goes without saying that the groups operating in the real world cannot be 'pigeon-holed' as easily as this.

<sup>34</sup> Cf., e.g. Andreas Knorr, *op. cit.* Arye Hillman, Heinrich W. Ursprung: The Influence of Environmental Concerns on the Political Determination of Trade Policy, in: Kym Anderson, Richard Blackhurst, *op. cit.*, demonstrates using a straightforward politico-economic model that environmentalists have an incentive in almost all conceivable cases to work in concert with protectionist industrial interests.

<sup>35</sup> This strategic orientation is quite apparent in Germany: the Federal Ministry of Economic Affairs, which is responsible for trade policy, certainly has not proved to be any great public advocate of environmental policy measures, no matter what sort of measures they might be!

<sup>36</sup> The case of hormones in meat is the best current example of this kind of dispute. After the USA had filed a complaint, the WTO's court of arbitration ruled that the EU's import ban on hormone-treated beef did not comply with the GATT.

<sup>37</sup> Cf., e.g., Andreas Knorr, *op. cit.*, p. 33.

<sup>38</sup> Cf. Margareta Kulessa, *op. cit.*, pp. 69-74.

optimal outcome of 'protectionism plus bad environmental policy', it is not enough simply to appeal to conservationists to be reasonable. The more promising way forward would be to eliminate the reasons for the environmentalists' behaviour.

### Outlook

First of all, the great public appeal of the shrimp-turtle case and the fact that it was started by pressure from environmental groups in domestic politics in the USA confirms the impression that environmental NGOs must be seen as important players in the next liberalizing round. They alter the balance of power in the political competition process in many industrialized nations and as a result may be able to prevent agreement of further trade liberalization.

But what is the sense of such action for environmental groups? The material reason essentially rests on the premise that in a world where there are inadequate measures for the conservation of the environment the use of second-best instruments which may have the incidental effect of obstructing trade is justified. Environmental groups consequently criticize international trade rules when the GATT prevents the use of such second-best instruments. This is the impression one might indeed get from reading the Panel report in the shrimp-turtle case. It was only the Appellate Body which made it clear that in this dispute there were legitimate conflicting goals which had to be considered. Making realistic procedural requirements for environmentally motivated and unilaterally imposed import embargoes ultimately means that the use of second-best instruments will not be prevented by the GATT.<sup>39</sup>

The actions of environmental groups can only fully be understood, however, when politico-economic interrelations are considered. It is not just free traders, but conservationists too who face the problems of collective action, because they have to organize political support for a public good. In substantive terms, protectionist branches of industry – often heavy polluters – are not necessarily obvious coalition partners for conservationists, yet they may offer the next-best alternative for at least some of the environmentalists' demands to be realized politically. Trade politicians encourage such action when – again for understandable strategic reasons of their own – they oppose more rigorous conservation measures.

This set of circumstances could produce a sub-optimal outcome for society: i.e. little progress in liberalizing trade *and* in environmental policy. It was not the purpose of this article to discuss solutions.

However, two thoughts are worth briefly highlighting: the implementation of a better international environmental policy would relieve the WTO of a lot of work dealing with pseudo-trade-conflicts and would take into account the substantive concerns of many environmental groups in an economically more efficient way than within the trading system. Progress in this complementary political sphere is thus *also* in the interests of trade politicians (although less so for exporting industries, hence conflicts will arise). Governments wishing to achieve progress at the 'Millennium Round' would hence be advised at the same time to consider vigorously pursuing negotiations to establish enforceable multilateral environmental agreements.

Even if this policy should succeed however, there will continue to be tension between environmental policy measures and the rules governing the system of world trade. In order to tone down these conflicts and to reduce political pressure on the WTO, some of the areas in which it deals with the environment will have to be reformed at the coming liberalizing negotiations.<sup>40</sup> Action particularly needs to be taken on the way the dispute-settlement mechanism functions, because its decisions publicly symbolize national governments' loss of sovereignty. 'Improving the Dispute Settlement Understanding will be important not only to elicit the right outcomes from trade adjudication but also to assure continuing public support for the world trading system.'<sup>41</sup>

The current process of *rapprochement* between trade and environmental groups could be a step towards cooperative solutions which, though they might not eliminate the tensions between trade and environmental concerns, might possibly tone them down. However, one must wait for political processes to show whether the necessary political support for the two causes can be organized in such a way that both groups can expect to benefit from a 'win-win' coalition.

<sup>39</sup> Of course, this assertion only holds on the premise that future panels will also follow the relatively broad interpretation applied by the Appellate Body. This cannot be taken for granted, as panels have often popped up with surprise rulings in the past, and have differed in their interpretation of specific GATT passages. On this, cf. Steve Charnovitz: Environment and Health Under WTO Dispute Settlement, in: the International Lawyer, Vol. 32 (1998), No. 3, pp. 901-921, esp. p. 912. So the real 'litmus test' for environmental policy is yet to come.

<sup>40</sup> For a number of proposals, see e.g. Daniel C. Esty: Greening World Trade, in: Jeffrey Schott (ed.): The World Trading System. Challenges Ahead, Institute for International Economics, Washington, D.C. 1996, pp. 69-85; see also Margareta Kullessa, op. cit.

<sup>41</sup> Steve Charnovitz, op. cit. This article, well worth reading, also sets out a number of proposals for procedural reform applying to the dispute settlement mechanism.