

The Case for Free Trade

*Environmentalists are wrong to fear
the effects of free trade. Both causes
can be advanced by imaginative solutions*

by Jagdish Bhagwati

Economists are reconciled to the conflict of absolutes: that is why they invented the concept of trade-offs. It should not surprise them, therefore, that the objective of environmental protection should at times run afoul of the goal of seeking maximum gains from trade. In fact, economists would be suspicious of any claims, such as those made by soothsaying politicians, that both causes would be only mutually beneficial. They are rightly disconcerted, however, by the passion and the ferocity, and hence often the lack of logic or facts, with which environmental groups have recently assailed both free trade and the General Agreement on Tariffs and Trade (GATT), the institution that oversees the world trading system.

The environmentalists' antipathy to trade is perhaps inevitable. Trade has been central to economic thinking since Adam Smith discovered the virtues of specialization and of the markets that naturally sustain it. Because markets do not normally exist for the pursuit of environmental protection, they must be specially created. Trade therefore suggests abstention from governmental intervention, whereas environmentalism

suggests its necessity. Then again, trade is exploited and its virtues extolled by corporate and multinational interests, whereas environmental objectives are embraced typically by nonprofit organizations, which are generally wary of these interests. Trade is an ancient occupation, and its nurture is the objective of institutions crafted over many years of experience and reflection. Protection of the environment, on the other hand, is a recent preoccupation of national and international institutions that are nascent and still evolving.

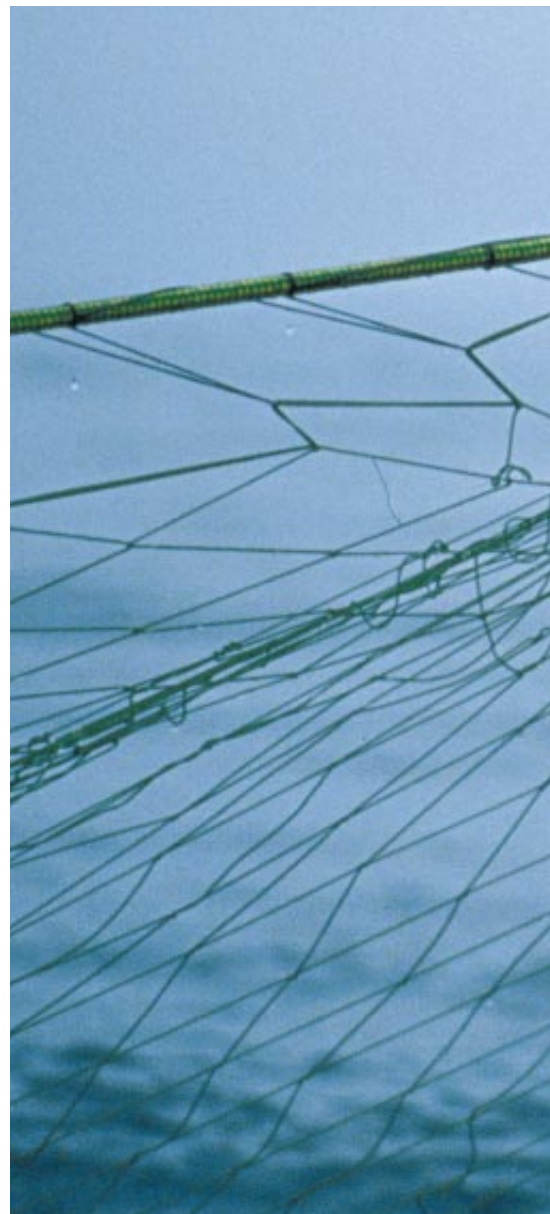
Last year the environmentalists' hostility to trade exploded in outrage when an impartial GATT Dispute Settlement Panel ruled in favor of Mexico and free trade and against the U.S. and the welfare of the dolphin. The U.S. had placed an embargo on the import of Mexican tuna on the grounds that the fish had been caught in purse-seine nets, which kill dolphins cruelly and in greater numbers than U.S. law permits. The GATT panel ruled, in effect, that the U.S. could not suspend Mexico's trading rights by proscribing unilaterally the methods by which that country harvested tuna.

This decision spurred the conservationists' subsequent campaigns against free trade and GATT. GATT has no shortage of detractors, of course. In fact, some of its recent critics have feared its impotence and declared it "dead," referring to it as the General Agreement to Talk and Talk. But the environmentalist attacks, which presume instead GATT's omnipotence, are something else again.

An advertisement by a coalition of environmental groups in the *New York Times* on April 20, 1992, set a new standard for alarmist, even scurrilous, writing, calculated to appeal to one's instincts rather than one's intellect. It talks of "faceless GATT bureaucrats" mounting a "sneak attack on democracy." This veiled reference to Pearl Harbor pro-

vides an example of a common tactic in trade controversy: Japan-bashing. The innuendos have continued unabated and are manifest in the endless battles in Congress over the supplemental environmental accords for the North American Free Trade Agreement (NAFTA). The hostility is also intruding on the conclusion of the Uruguay Round of GATT talks, now in their seventh year, with the environmentalists opposing the establishment of the new Multilateral Trade Organization, which is meant to provide effective discipline and a necessary institutional structure for GATT.

It is surely tragic that the proponents of two of the great causes of the 1990s, trade and the environment, should be



DOLPHIN VERSUS FREE TRADE: the U.S. outlaws fishing methods that result in the death of dolphins such as this one,

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locked in combat. The conflict is largely gratuitous. There are at times philosophical differences between the two that cannot be reconciled, as when some environmentalists assert nature's autonomy, whereas most economists see nature as a handmaiden to humankind. For the most part, however, the differences derive from misconceptions. It is necessary to dissect and dismiss the more egregious of these fallacies before addressing the genuine problems.

The fear is widespread among environmentalists that free trade increases economic growth and that growth harms the environment. That fear is misplaced. Growth enables governments to tax and to raise resources for a variety of objec-

tives, including the abatement of pollution and the general protection of the environment. Without such revenues, little can be achieved, no matter how pure one's motives may be.

How do societies actually spend these additional revenues? It depends on how getting rich affects the desire for a better environment. Rich countries today have more groups worrying about environmental causes than do poor countries. Efficient policies, such as freer trade, should generally help environmentalism, not harm it.

If one wants to predict what growth will do to the environment, however, one must also consider how it will affect the production of pollution. Growth af-

fects not only the demand for a good environment but also the supply of the pollution associated with growth. The net effect on the environment will therefore depend on the kind of economic growth. Gene M. Grossman and Alan B. Krueger of Princeton University found that in cities around the world sulfur dioxide pollution fell as per capita income rose. The only exception was in countries whose per capita incomes fell below \$5,000. In short, environmentalists are in error when they fear that trade, through growth, will necessarily increase pollution.

Economic effects besides those attributable to rising incomes also help to protect the environment. For example, freer trade enables pollution-fighting technologies available elsewhere to be imported. Thus, trade in low-sulfur-content coal will enable the users of local high-sulfur-content coal to shift from the latter to the former.

Free trade can also lead to better environmental outcomes from a shift in the composition of production. An excellent example is provided by Robert C. Feenstra of the University of California at Davis. He has shown how the imposition of restraints on Japanese automobile exports to the U.S. during the 1980s shifted the composition of those exports from small to large cars, as the Japanese attempted to increase their revenues without increasing the number of units they sold. Yet the large cars were fuel inefficient. Thus, protective efforts by the U.S. effectively increased the average amount of pollution produced by imported cars, making it more likely that pollution from cars would increase rather than diminish in the U.S.

Although these erroneous objections to free trade are readily dismissed (but not so easily eliminated from public discourse), there are genuine conflicts between trade and the environment. To understand and solve them, economists draw a distinction between two kinds of environmental problems: those that are intrinsically domestic and those that are intrinsically transnational.

Should Brazil pollute a lake lying wholly within its borders, the problem would be intrinsically domestic. Should it pollute a river that flows into Argentina, the matter would take on an intrinsically transnational character. Perhaps the most important examples of transnational pollution are acid rain, created when sulfur dioxide emissions in one country precipitate into rain in another, and greenhouse gases, such as carbon dioxide, which contribute to global warming wherever they are emitted.



ensnared off the U.S. Atlantic coast. But when the U.S. attempted to apply its standard to Mexico by imposing an embargo on tuna imported from that country, an international tribunal rejected the policy last year as an illegal restriction of trade.

Why do intrinsically domestic environmental questions create international concern? The main reason is the belief that diversity in environmental standards may affect competitiveness. Businesses and labor unions worry that their rivals in other countries may gain an edge if their governments impose lower standards of environmental protection. They decry such differences as unfair. To level the playing field, these lobbies insist that foreign countries raise their standards up to domestic ones. In turn, environmental groups worry that if such "harmonization up" is not undertaken prior to freeing trade, pressures from uncompetitive businesses at home will force down domestic standards, reversing their hard-won victories. Finally, there is the fear, dramatized by H. Ross Perot in his criticisms of NAFTA, that factories will relocate to the countries whose environmental standards are lowest.

But if the competitiveness issue makes the environmentalists, the businesses and the unions into allies, the environmentalists are on their own in other ways. Two problem areas can be distinguished. First, some environmentalists are keen to impose their own ethical preferences on others, using trade sanctions to induce or coerce acceptance

of such preferences. For instance, tuna fishing with purse-seine nets that kill dolphins is opposed by U.S. environmental groups, which consequently favor restraints on the importation of such tuna from Mexico and elsewhere. Second, other environmentalists fear that the rules of free trade, as embodied in GATT and strengthened in the Uruguay Round, will constrain their freedom to pursue even purely domestic environmental objectives, with GATT tribunals outlawing disputed regulation.

Environmentalists have cause for concern. Not all concerns are legitimate, however, and not all the solutions to legitimate concerns are sensible. Worry over competitiveness has thus led to the illegitimate demand that environmental standards abroad be treated as "social dumping." Offending countries are regarded as unfairly subsidizing their exporters through lax environmental requirements. Such implicit subsidies, the reasoning continues, ought to be offset by import duties.

Yet international differences in environmental standards are perfectly natural. Even if two countries share the same environmental objectives, the *specific* pollutions they would attack, and hence the industries they would hin-

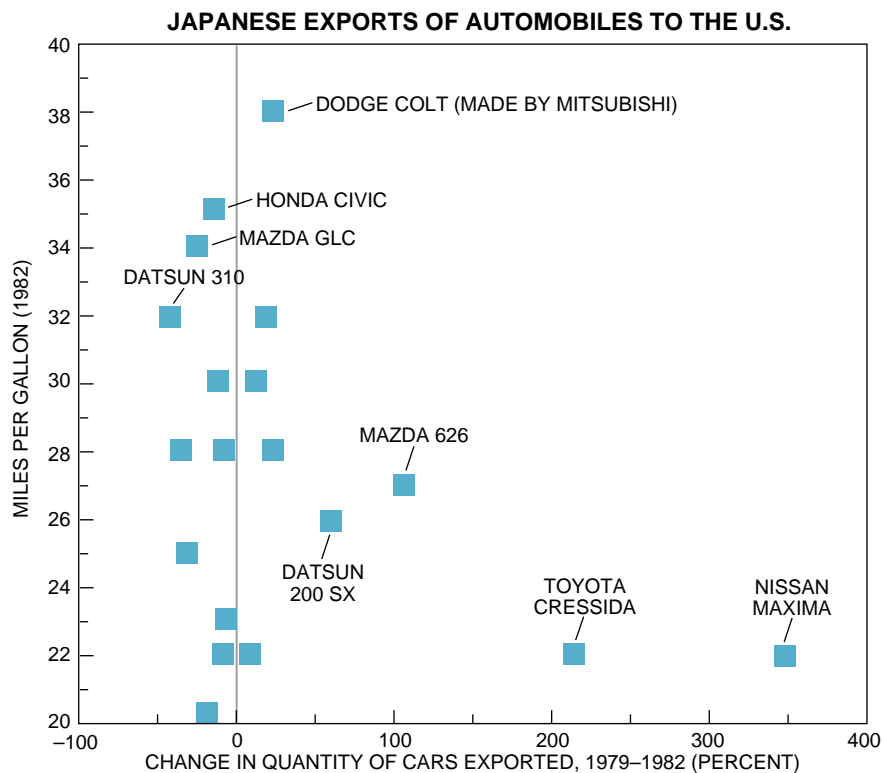
der, will generally not be identical. Mexico has a greater social incentive than does the U.S. to spend an extra dollar preventing dysentery rather than reducing lead in gasoline.

Equally, a certain environmental good might be valued more highly by a poor country than by a rich one. Contrast, for instance, the value assigned to a lake with the cost of cleaning up effluents discharged into it by a pharmaceutical company. In India such a lake's water might be drunk by a malnourished population whose mortality would increase sharply with the rise in pollution. In the U.S. the water might be consumed by few people, all of whom have the means to protect themselves with privately purchased water filters. In this example, India would be the more likely to prefer clean water to the pharmaceutical company's profits.

The consequences of differing standards are clear: each country will have less of the industry whose pollution it fears relatively more than other countries do. Indeed, even if there were no international trade, we would be shrinking industries whose pollution we deter. This result follows from the policy of forcing polluters of all stripes to pay for the harm they cause. To object, then, to the effects our negative valuation of pollution have on a given industry is to be in contradiction: we would be refusing to face the consequences of our environmental preferences.

Nevertheless, there is sentiment for enacting legislation against social dumping. Senator Davil L. Boren of Oklahoma, the proponent of the International Pollution Deterrence Act of 1991, demanded import duties on the grounds that "some U.S. manufacturers, such as the U.S. carbon and steel alloy industry, spend as much as 250 percent more on environmental controls as a percentage of gross domestic product than do other countries.... I see the unfair advantage enjoyed by other nations exploiting the environment and public health for economic gain when I look at many industries important to my own state." Similarly, Vice President Al Gore wrote in *Earth in the Balance: Ecology and the Human Spirit* that "just as government subsidies of a particular industry are sometimes considered unfair under the trade laws, weak and ineffectual enforcement of pollution control measures should also be included in the definition of unfair trading practices."

These demands betray lack of economic logic, and they ignore political reality as well. Remember that the so-called subsidy to foreign producers through lower standards is not given but only implied. According to Senator



SOURCE: Robert C. Feenstra, University of California, Davis

PERVERSE CONSEQUENCES for the environment may result from trade restrictions. This graph shows Japanese car exports to the U.S. before and after Japan's acquiescence in voluntary export restraints. Sales of small, fuel-efficient models declined, whereas those of the larger "gas guzzlers" soared.



EMPLOYMENT IN MEXICAN TUNA FISHERY may offset the saving of dolphins that would result were the industry to forgo purse-seine nets. Countries should not be faulted for placing human welfare ahead of our culture-specific concerns.

Boren, the subsidy would be calculated as “the cost that would have to be incurred by the manufacturer or producer of the foreign articles of merchandise to comply with environmental standards imposed on U.S. producers of the same class of merchandise.” Anyone familiar with the way dumping calculations are made knows that the Environmental Protection Agency could come up with virtually any estimates it cared to produce. Cynical politics would inevitably dictate the calculations.

Still, there may be political good sense in assuaging environmentalists’ concerns about the relocation of factories to countries with lower standards. The governments of higher-standards countries could do so without encumbering free trade by insisting that their businesses accede to the higher standards when they go abroad. Such a policy lies entirely within the jurisdictional powers of a higher-standards country. Moreover, the governments of lower-standards countries would be most unlikely to object to

such an act of good citizenship by the foreign investors.

Environmentalists oppose free trade for yet another reason: they wish to use trade policy to impose their values on other communities and countries. Many environmentalists want to suspend the trading rights of countries that sanction the use of purse-seine nets in tuna fishing and of leg-hold traps in trapping. Such punishments seem an inappropriate use of state power, however. The values in question are not widely accepted, such as human rights, but idiosyncratic. One wonders when the opponents of purse-seine nets put the interests of the dolphin ahead of those of Mexico’s people, who could prosper through more productive fishing. To borrow the campaign manifesto of President Bill Clinton: Should we not put people first?

Moreover, once such values intrude on free trade, the way is opened for an endless succession of demands. Environmentalists favor dolphins; Indians have their sacred cows. Animal-rights activists, who do not prefer one

species over another, will object to our slaughterhouses.

The moral militancy of environmentalists in the industrialized world has begun to disillusion their closest counterparts in the undeveloped countries. These local environmentalists accuse the rich countries of “eco-imperialism,” and they deny that the Western nations have a monopoly on virtue. The most radical of today’s proenvironment magazines in India, *Down to Earth*, editorialized recently: “In the current world reality trade is used as an instrument entirely by Northern countries to discipline environmentally errant nations. Surely, if India or Kenya were to threaten to stop trade with the U.S., it would hardly affect the latter. But the fact of the matter is that it is the Northern countries that have the greatest [adverse] impact on the world’s environment.”

If many countries were to play this game, then repeated suspensions of trading rights would begin to undermine the openness of the trading system and the predictability and stability of international markets. Some environmentalists

assert that each country should be free to insist on the production methods of its trading partners. Yet these environmentalists ignore the certain consequence of their policy: a Pandora's box of protectionism would open up. Rarely are production methods in an industry identical in different countries.

There are certainly better ways to indulge the environmentalists' propensity to export their ethical preferences. The U.S. environmental organizations can lobby in Mexico to persuade its government to adopt their views. Private boycotts can also be undertaken. In fact, boycotts can carry much clout in rich countries with big markets, on which the targeted poor countries often depend. The frequent and enormously expensive advertisements by environmental groups against GATT show also that their resources far exceed those of the cash-strapped countries whose policies they oppose.

Cost-benefit analysis leads one to conclude that unilateral governmental suspension of others' trading rights is not

an appropriate way to promote one's lesser ethical preferences. Such sanctions can, on the other hand, appropriately be invoked multilaterally to defend universal moral values. In such cases—as in the censure of apartheid, as practiced until recently in South Africa—it is possible to secure widespread agreement for sanctions. With a large majority converted to the cause, GATT's waiver procedure can be used to suspend the offending country's trading rights.

Environmentalists are also worried about the obstacles that the current and prospective GATT rules pose for environmental regulations aimed entirely at domestic production and consumption. In principle, GATT lets a country enforce any regulation that does not discriminate against or among foreign suppliers. One can, for example, require airbags in cars, provided that the rule applies to all automobile makers. GATT even permits rules that discriminate against trade for the purpose of safety and health.

GATT, however, recognizes three ways in which regulations may be set in gratuitous restraint of trade; in following procedures aimed at avoiding such outcomes, GATT upsets the environmentalists. First, the true intention—and effect—of a regulation may be to protect not the environment but local business. Second, a country may impose more restrictions than necessary to achieve its stated environmental objective. Third, it may set standards that have no scientific basis.

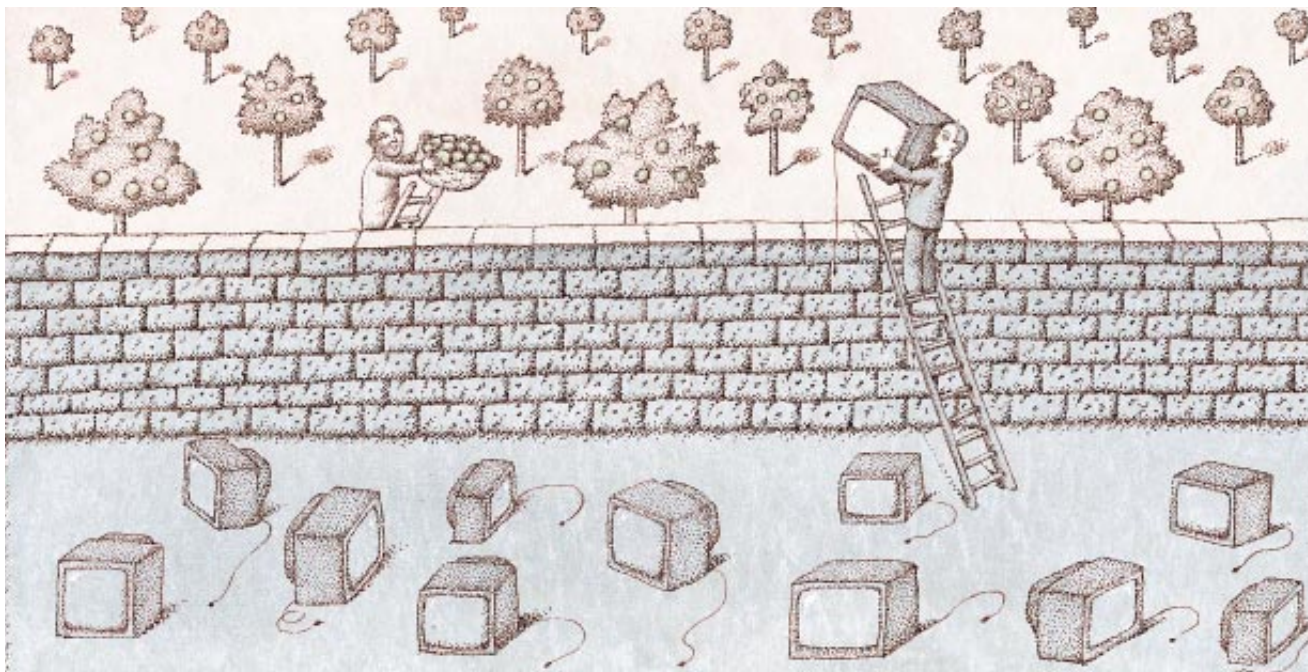
The issue of intentions is illustrated by the recently settled "beer war" between Ontario and the U.S. Five years ago the Canadian province imposed a 10-cents-a-can tax on beer, ostensibly to discourage littering. The U.S. argued that the law in fact intended to discriminate against its beer suppliers, who used aluminum cans, whereas local beer companies used bottles. Ontario had omitted to tax the use of cans for juices and soups, a step that would have affected Ontario producers.

The second problem is generally



PURE DRINKING WATER is essential for Mexican villagers, who wait in line to collect it rather than risk contracting cholera from local sources. The relative value of environmental

benefits varies in different countries: Mexico can better improve public health by concentrating its resources on the purification of water than by reducing the lead in gasoline.



BENEFITS OF TRADE flow from the economies achieved when countries specialize in enterprises in which they enjoy comparative advantage. Such specialization will proceed better when all sides trust in the stability of the trading regime.

tougher because it is impossible to find alternative restrictions that accomplish exactly the same environmental results as the original policy at lower cost. An adjudicating panel is then forced to evaluate, implicitly or explicitly, the trade-offs between the cost in trade disruption and the cost in lesser fulfillment of the environmental objective. It is therefore likely that environmentalists and trade experts will differ on which weights the panel should assign to these divergent interests.

Environmentalists tend to be fearful about the use of scientific tests to determine whether trade in a product can be proscribed. The need to prove one's case is always an unwelcome burden to those who have the political power to take unilateral action. Yet the trade experts have the better of the argument. Imagine that U.S. growers sprayed apples with the pesticide Alar, whereas European growers did not, and that European consumers began to agitate against Alar as harmful. Should the European Community be allowed to end the importation of the U.S. apples without meeting *some* scientific test of its health concerns? Admittedly, even hard science is often not hard enough—different studies may reach different conclusions. But without the restraining hand of science, the itch to indulge one's fears—and to play on the fears of others—would be irresistible.

In all cases, the moderate environmentalists would like to see GATT adopt more transparent procedures for adjudicating

disputes. They also desire greater legal standing to file briefs when environmental regulations are at issue. These goals seem both reasonable and feasible.

Not all environmental problems are local; some are truly global, such as the greenhouse effect and the depletion of the stratospheric ozone. They raise more issues that require cooperative, multilateral solutions. Such solutions must be both efficient and equitable. Still, it is easy to see that rich countries might use their economic power to reach protocols that maximize efficiency at the expense of poorer countries.

For instance, imagine that the drafters of a protocol were to ask Brazil to refrain from cutting down its rain forests while allowing industrialized countries to continue emitting carbon dioxide. They might justify this request on the grounds that it costs Brazil less to keep a tree alive, absorbing a unit of carbon dioxide every year, than it would cost the U.S. or Germany to save a unit by burning less oil. Such a trade-off would indeed be economically efficient. Yet if Brazil, a poorer country, were then left with the bill, the solution would assuredly be inequitable.

Before any group of countries imposes trade sanctions on a country that has not joined a multilateral protocol, it would be important to judge whether the protocol is indeed fair. Nonmembers targeted for trade sanctions should have the right to get an impartial hearing of

their objections, requiring the strong to defend their actions even when they appear to be entirely virtuous.

The simultaneous pursuit of the two causes of free trade and a protected environment often raises problems, to be sure. But none of these conflicts is beyond resolution with goodwill and by imaginative institutional innovation. The aversion to free trade and GATT that many environmentalists display is unfounded, and it is time for them to shed it. Their admirable moral passion and certain intellectual vigor are better devoted to building bridges between the causes of trade and the environment.

FURTHER READING

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