

## Chapter 3

# Escape Clauses and Social Conditions as Threats to the World Trade Organization

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### **The Broader Issue**

Escape clauses (in the following named safeguard measures) and social conditions stand for an increasing trade-off in the World Trade Organization (WTO) between allocative efficiency (trade liberalization, most favoured nation (MFN), national treatment) and equity considerations to be achieved by unequal treatment (positive discrimination) of sectors, countries and factors of production.

This trade-off has existed from the very beginning of the GATT when Contracting Parties established special rights for countries in the stage of development out of infant industry considerations as well as a special trade regime for agriculture and later also textiles. After the establishment of the General Agreement on Trade in Services (GATS), for services, unequal treatment between factors of production became implicitly anchored through differentiation between mode 3 supply of services (commercial presence or service trade via capital flows, respectively) and mode 4 supply of services (temporary movement of natural persons or service trade via labour flows, respectively). As a matter of fact, mode 4 supply of services has been discriminated against compared to mode 3 supply, as cross-border labour movement is generally less favourably treated than cross-border capital movement.

### **In Detail**

Safeguard measures in compliance with the Agreement on Safeguards, countervailing duties and—more importantly—anti-dumping measures are the three most important measures which discriminate between sectors and products. While safeguard measures are in principle not allowed to be country-specific (Article 19 of the GATT), in the past measures both discriminated against sectors and countries if so-called import “surges” originated from individual countries such as China. Accession treaties with new WTO member countries allow for transitional country-specific safeguard measures (see China until 2008).

Indirect safeguard measures in favour of specific products are initiated when these products are labelled “sensitive” and thus excluded from normal commitments of market opening. In the Doha negotiations on non-agricultural market access

(NAMA), lists of sensitive industrial products which major emerging countries want to exclude from Swiss-tariff cutting formulas (so-called flexibility 8a, 8b provisions) range high on the agenda as a stumbling block to an agreement. Anti-dumping measures are the most important safeguard. They are both country and product specific as individual products from individual countries are targeted.

Social conditions have not yet found *direct* entry as an exception to MFN treatment. The existence and competence of the International Labour Organization (ILO) with its social standards provisions has so far protected the WTO against the direct intrusion of social standards. A further protective shield arises from the WTO principle that measures against imports are only allowed in the case of negative consumer externalities (if consumers' health, for instance, is impaired by consuming imported goods), but not in the case of producer externalities (measures of production and processing). Yet, indirect measures to protect social conditions do exist. In the agreement on agriculture, for instance, protecting social conditions are translated into so-called "non-agricultural concerns" which place conditions on trade liberalization to protect social stability in rural regions. This includes products of vital importance to rural regions ("multifunctionality" of the rural supply). Social conditions are also targeted when infant industry protection (Article 18 of the GATT) is legitimized for developing countries. In the service sector, opening the market is subject to the so-called "needs tests" that measure whether more foreign supply is really needed in the domestic markets. Again, protecting well-established social conditions is at the heart of needs tests. At the macro level, any developing countries preference is rooted in giving trade policies the task of improving social conditions of poor countries.

Protecting social conditions, however, generally means protecting the relatively least abundant factor: unskilled labour in industrialized countries and physical capital and skilled labour in developing countries. The result is a factor price distortion which raises unskilled labour income in industrialized countries and skilled labour income in developing countries and allocates resources to the protected activities beyond the economically efficient level. This flies into the face of employment generation in developing countries and structural change in industrialized countries.

The trade-off between efficiency and equity threatens to turn the WTO into a victim of mercantilist conduct (as in the past and even today in the Doha round). It could also expose the organization to offensive rent-seeking strategies in non-preferred sectors and factors of production, and to defensive strategies in preferred sectors and factors, in order to be exempted from preference erosion. In the literature, this is referred to as directly unproductive activities.

In general, public choice theory and institutional economics explain why specific sectors are successful in acquiring rents by protection while others fail. In recent years, there is more tail wind for sector and factor discrimination coming from the increasing income inequality within countries. Inequality within countries receives more political attention than inequality between countries. Safeguard measures and social conditions are more successful in attaining governmental support for protection under WTO rules at the micro level of sectors and factors

of production than at the macro level. Social conditions are subject to erosion due to MFN treatment. In developing countries, production employ a large variety of factors. Safeguard measures, consumer protection, animal protection, environmental protection, stability, environmental protection, arguments in disguise, and only in the case of market failure, such as the

If lenience towards equity is not applied, it will water down the efficiency principle. The efficiency principle will make meaningful bilateralism and regionalism and specific and group-specific interests in multilateral negotiations which are not in line with agreements, on the other hand, will lead to unequal market power.

Those vested interests are not protected. Social conditions may be contained by the protection of unskilled labour, and by the in the service sectors within the globalization. Safeguard measures and protection of domestic production sites must be maintained. But with capital becoming increasingly mobile, vested interests must take into account the impact on domestic capital invested abroad. Domestic product (GDP) must be protected. Income (GNI). Rapid technological progress, safeguard measures. Safeguard measures raise the marginal income above the marginal cost of labour-saving technical progress. technical progress, there will be a Pyrrhic victory for labour in the

The advancement of equity is not in line with making in the multilateral system. The origin of equity considerations is not before the foundation of the WTO. for developing countries, specifically on import protection as a means. In general, a mercantilist view of protection (concession) and exports as a goal. organizations (NGOs) having a role in the WTO, governments today are not and only pay lip service to free international trade policy.

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of production than at the macro level of countries. While country preferences are subject to erosion due to MFN tariff cuts, specific interests of sectors and factors of production employ a large variety of arguments to defend their interests, including consumer protection, animal protection, protection of geographic origin, social stability, environmental protection, etc. Many of these arguments are protectionist arguments in disguise, and only very few really address aspects of externalities and market failure, such as the management of cross-border mobile resources.

If lenience towards equity targets continues to intrude into the WTO and to water down the efficiency principle of non-discrimination, the single undertaking principle will make meaningful agreements very difficult to conclude. Yet bilateralism and regionalism are worse alternatives. In those agreements, product-specific and group-specific interests can make stronger claims for protection than in multilateral negotiations where a level playing field is more possible. Bilateral agreements, on the other hand, are usually concluded between partners with unequal market power.

Those vested interests arguing for safeguard measures and equal social conditions may be contained by the increasing mobility of labour, including unskilled labour, and by the ineffectiveness of trade measures to protect specific sectors within the globalization of capital markets and rapid technology diffusion. Safeguard measures and protecting social conditions are rooted in the idea that domestic production sites must be protected against "unfair foreign competition." But with capital becoming increasingly mobile, a rational policy to protect national interests must take into account that any protection against products produced by domestic capital invested abroad means income foregone. The concept of gross domestic product (GDP) must be substituted by the concept of gross national income (GNI). Rapid technology diffusion is another stumbling block to effective safeguard measures. Safeguard measures intended to protect unskilled labour raise the marginal income above marginal productivity and will induce unskilled labour-saving technical progress. Thus, in addition to exogenous labour-saving technical progress, there will be endogenous progress of the same direction, a Pyrrhic victory for labour in the end.

The advancement of equity considerations in the WTO threatens decision-making in the multilateral system. Yet, it is less the WTO that is to blame. The origin of equity considerations was established in the GATT history a long time before the foundation of the WTO. This history included infant industry protection for developing countries, special rules for agriculture, a dated Keynesian view on import protection as a means to remedy balance-of-payment problems and, in general, a mercantilist view of imports as a burden (and thus market opening as a concession) and exports as a gain. With protests by anti-WTO non-governmental organizations (NGOs) having reached the inner circles of ministerial meetings of the WTO, governments today increasingly act to appease and mitigate protests, and only pay lip service to freer trade. The call for equity has taken its toll in international trade policy.