

Wealth for the World

Policies on International Trade and Investment

Policy Paper 65



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Summary

Under the right conditions, trade and investment liberalisation can reduce poverty, extend choice and opportunity, improve environmental standards and reduce the likelihood of conflict between nations. However, liberalisation has been pursued to a much greater extent than any other global public good, resulting in an unbalanced world economy, with insufficient attention paid to the impacts on development, environment and the interests of local communities.

Liberal Democrats call for trade and investment liberalisation to proceed as long as it contributes to national and global sustainable development; this requires:

- The balancing of economic imperatives with environmental and social requirements.
- Reform of the key international institutions to fully integrate these priorities, and to improve their transparency and democratic accountability.
- A sustained effort to ensure that developing countries can benefit from trade and investment liberalisation to a much greater extent that they currently do.

Liberal Democrats propose to regulate the international finance system to reduce instability and support development, including:

- Establishing a new International Financial Authority to assist developing countries in reducing their exchange - and interest-rate volatility; investigate means of implementing, when politically practical, international taxes on foreign exchange transactions; lead negotiations to reform the financial policies of the richest countries to introduce greater stability to capital outflows; and help developing countries manage their debt.
- Reforming the IMF to render it more responsive, effective and accountable by: improving transparency and ensuring that decisions in all committees are taken by majority voting, and increasing its resources and ensuring that funding is independent of individual members' economic and political influence.

Liberal Democrats will encourage flows of foreign direct investment (FDI), in particular to support the poorer developing countries and improvements in environmental standards, through:

- Calling for a new international set of negotiations within the UN on the creation of a multilateral regulatory framework to encourage FDI, balancing additional rights for investors against additional responsibilities, and replacing current bilateral investment treaties by the new multilateral agreement.
- Privatising the Export Credit Guarantee Department and transferring support for export credit guarantees for investments in the poorest developing countries to DFID.

Liberal Democrats will support continuing attempts to salvage the WTO Doha Round as long as the outcome is positive for developing countries; in particular, we call for:

- A substantial reduction in agricultural subsidies, including the elimination of CAP production subsidies and trade barriers.
- Major revisions to the General Agreement on Trade in Services (GATS), allowing countries to reverse their original decisions on liberalisation and/or add new derogations.

- The establishment of a royalty-based system for fair reward of harvested genetic or biological materials, and the creation of a system by which countries in genuine medical need are allowed to manufacture or procure royalty-free drugs.

Liberal Democrats would work to increase WTO transparency and accountability and reform its internal procedures in order to redress the imbalance between developed and developing countries by:

- Providing support to the poorest member countries to enable them to participate fully in WTO negotiations and conduct WTO disputes, and extending the structure of ‘special and differential treatment’ through which the poorest countries can open their markets over a much longer timescale.
- Appointing an independent Advocate General to represent the public in trade disputes, and establishing an annual assembly of Parliamentarians to scrutinise the work of the WTO.

Liberal Democrats will work to reform EU trade policy and processes by arguing for the right of the European Parliament to veto all international trade and investment agreements, and reforming Economic Partnership Agreements established under the Cotonou Agreement to ensure that developing countries can take longer to open their markets to EU exports.

Liberal Democrats will enable and regulate enterprise at the international level by:

- Promoting greater market competition and anti-monopoly policies.
- Ensuring that enterprises benefiting from open markets are required to behave responsibly, by strengthening the OECD Guidelines for Multinational Enterprises and incorporating them in trade and investment liberalisation agreements; legislating to make it clear that parent companies can be sued in UK courts for the behaviour of their overseas affiliates; extending the liability of company directors to make them responsible for the social and environmental impacts of their companies and subsidiaries; and requiring corporations to report on their environmental and social impacts and reforming stock exchange listing rules to require full reporting.
- Encouraging corporate responsibility initiatives and socially responsible investment.

Liberal Democrats will ensure that trade and investment rules support environmental regulation by calling for a new sustainability clause to be added to the GATT, including:

- Incorporation of the Precautionary Principle and the Polluter Pays Principles into the GATT.
- Making it clear that discrimination on the basis of production processes is permitted where the environmental damage caused is transboundary.
- Recognising and permitting trade measures within multilateral environmental agreements.
- Allowing subsidies designed to make environmentally friendly technologies more affordable and accessible.

Liberal Democrats will work to improve international labour standards by setting a minimum floor of basic global labour standards through the extension of Article XX of GATT to allow discrimination against products produced with forced labour; and supporting the framework established by the International Labour Organisation and giving it a major role in negotiations in the WTO and on the proposed international investment agreement.

1 Introduction

1.0.1 This paper deals with the topic of international economic activity: international trade in goods and services, cross-border investment activities and international flows of capital. The rapid expansion of international trade and investment has been one of the defining characteristics of the world economy since 1945, and a key factor in the complex of processes known as 'globalisation'.

1.0.2 For example, international merchandise trade (primary commodities and manufactured products) has grown twenty-fold since 1950, to a total value of over \$6 trillion. Twenty-five years ago one-eighth of world product was traded; now the proportion is one-fifth. Flows of foreign direct investment (FDI) increased fivefold between 1990 and 2000, to \$1.15 trillion. Much of this growth took place in international trade within firms; indeed, one-third of the total trade of both the US and Japan takes place within transnational corporations (TNCs) and their affiliates. The stock of cross-border portfolio investment - bonds and shares - was some \$12 trillion at the end of 2001, while the worldwide stock of cross-border bank loans and deposits reached \$9 trillion.

1.0.3 One of the principal reasons for this expansion of cross-border economic activity has been the steady removal of government-imposed barriers to international trade and investment: tariffs, non-tariff barriers such as quotas or administrative requirements, foreign exchange controls and limitations on foreign ownership of domestic enterprises. This process has proceeded furthest and fastest in the area of trade in goods, where the world-wide removal of trade barriers has been coordinated and promoted under the framework of the international agreement known as the General Agreement on Tariffs and Trade (GATT), overseen since 1995 by the World Trade Organisation (WTO).

1.0.4 First adopted in 1947, GATT has been augmented through successive rounds of international negotiation, of which the Doha Round, currently under way, is the ninth. WTO agreements now cover areas such as agriculture, textiles, services, intellectual property, and health standards - a significant extension in scope compared with their predecessors. This means

that international trade regulation increasingly impinges on other areas of public policy, such as health, environment and labour.

1.0.5 Similar processes are under way in the area of international investment, where the deregulation of financial markets from the 1970s on has led to a vast increase in the volumes of financial capital traded internationally. Despite the rapid increase in volumes of foreign direct investment, however, successive attempts at negotiating a global investment agreement have so far failed, an indication of the greater degree of controversy raised by questions of cross-border investment and foreign ownership of enterprises. Even more than trade policy, investment policy interacts with other areas of public policy. And, of course, investment and trade policy inevitably interact with each other.

1.0.6 The framework set by international trade and investment rules increasingly constrains the actions of national governments - but is it the right framework? The expansion of trade and investment has led to new stresses, from growing economic inequality to concern over transnational corporate behaviour to fears of cultural homogenisation and a loss of independence and identity. One does not have to sign up to the anti-globalisation agenda to be rightly concerned over the impacts of global economic deregulation on the natural environment, labour standards, or developing countries lacking strong regulatory capacity, and the lack of democracy and transparency exhibited by the WTO and the International Monetary Fund (IMF).

1.0.7 At the same time, however, international institutions and processes find themselves under threat from a new quarter, of a return to bilateralism at the expense of multilateral agreements. The current US administration is threatening to sideline multilateral institutions - notably the UN, but also the WTO - and is using bilateral trade agreements as a weapon of diplomacy. The EU's own long-standing network of bilateral agreements, while they do not possess such political overtones, are similarly inimical to multilateralism; bilateral agreements may be easier to agree, but they are often one-sided and discriminatory.

1.0.8 This paper sets out Liberal Democrat proposals for a new international framework to govern international trade and investment. Chapter Two sets out the principles that underlie our proposals, while Chapters Three, Four and Five examine in turn issues of international finance, investment and trade. Chapter Six looks at the critical topic of regulating and enabling private enterprise at the international level, and Chapters Seven and Eight examine the crosscutting issues of environment and labour.

2 The Liberal Democrat Approach

2.0.1 The arguments around trade and investment liberalisation have generally been conducted in terms of their economic, environmental and social costs and benefits. There are indeed major benefits, including the removal of the distortions in the market created by trade barriers, and resulting lower prices, and access to a wider range of markets, extending choice for firms and consumers alike. All economies develop by exporting the goods and services they produce best in exchange for other goods and services they need. The various forms of trade protectionism - subsidies, tariffs, dumping, and so on - generally benefit elites and vested interests, restrict choice and opportunity and raise prices in particular for the poorest people and the poorest communities.

2.0.2 Alongside the economic benefits of trade liberalisation, however, Liberals - the historic defenders of free trade throughout the nineteenth and twentieth centuries - always saw a more powerful case. The dismantling of protectionism was part of the assault on privilege and on the control of the state by vested interests, a liberation of individuals' talents and the creation of what would, in modern parlance, be called a 'level playing field'. In addition, the extension of trade promoted interdependence and a sense of international community, building links between peoples, communities and nations and rendering armed conflict less likely. Liberal Democrats have consistently upheld these arguments, still relevant in the early years of the twenty-first century.

2.0.3 The world of the Doha Round, however, is very different from that of the repeal of the Corn Laws. Any functioning economy needs to balance the benefits of free trade with wider public needs - a clean environment, civil liberties, the protection of local culture, safe workplaces, effective public health regulation, social infrastructure for those suffering from ill-health or disability and a strategy to reduce poverty, all subject to democratic accountability and redress. At the national level this can be achieved with varying degrees of success.

2.0.4 At the *global* level, however, the international institution that governs trade - the WTO and its range of trade agreements - is far

more effective and powerful than those that handle environmental protection, health, human rights or social development. International trade has been pursued and developed to a much greater extent than any other global public good. This has resulted in an *unbalanced* world economy, where the interests of exporters and big companies usually seem to be given a higher priority than environmental protection, for example, or the interests of local communities.

2.0.5 Similar arguments can be applied to cross-border investment. Opening borders to foreign investment can, if regulated appropriately, extend choice and opportunities to nations and communities. Furthermore, it will only be through investment in new technologies and services that environmentally sustainable development will be achieved. However, the opening of opportunities to foreign investors has also sometimes led to the exploitation of local environments and communities in the interests of owners and shareholders situated thousands of miles away. The competition for foreign investment can also lead to a 'race to the bottom', as countries seek to attract investors by offering ever-lower standards of regulation. And although developing countries need external investment to develop out of poverty, the poorest amongst them attract almost no investment capital. Again, we believe that an international framework which promotes a more *balanced* approach to global public policy objectives needs to be created.

2.0.6 International capital movements can similarly widen choices for individuals and nations. Trade in capital makes it possible for countries to invest more than they save by borrowing the difference from abroad, or invest less than they save by lending out the surplus. But the experience of recent financial crises has demonstrated that capital markets can be highly volatile, leading to recurrent financial calamities and stock-market crashes. Very few economies have the strength to withstand major adverse capital flows, and international financial markets are far less regulated than are those in goods and services. The World Bank and the multilateral development banks provide only a limited counter-balance, and IMF prescriptions often further reduce nations' control over currency

flows. There is a lack of effective regulation and, again, of *balance*.

2.0.7 It would be simplistic to blame the relevant international institutions - the WTO, IMF and so on - for this imbalance; it is their member states - national governments - which are to blame for affording a much greater priority to trade and investment liberalisation than to any other objective. And the institutions do offer clear benefits: the WTO provides a rules-based and non-discriminatory structure for the resolution of trade disputes in which every country, at least in principle, is treated equally. There have been many disagreements between WTO members over the conduct of trade policy over the years, but there has been no return to the downwards spiral of protectionism that characterised the 1930s, which would harm the poorest people and poorest nations the most.

2.1 The aim of trade and investment liberalisation: sustainable development

2.1.1 Liberal Democrats believe, therefore, that under the right conditions, and if governed by effective international institutions, trade and investment liberalisation can reduce poverty, extend choice and opportunity, improve environmental standards and reduce the likelihood of conflict between nations. However, we recognise that trade and investment liberalisation are not ends in themselves, and do not, by themselves, always lead to positive outcomes. They are valuable in so far as they contribute to national and global *sustainable development* - as the 1987 Brundtland Report put it, development which 'meets the needs of the present generation without compromising the ability of future generations to meet their own needs'.

2.1.2 Sustainable development, which applies equally to industrialised as well as to developing countries (all economies develop) has three dimensions, economic, social and environmental, which must all be addressed equally if development is to be successful. In the current set-up, however, we believe that the key institutions - the WTO, IMF and others - pay too much attention to the economic dimension of sustainable development, at the expense of social development, environmental protection, human rights, and all the other components of quality of life. They therefore need *rebalancing*. The rest of

this paper outlines ways in which we believe this rebalancing should take place.

2.1.3 As well as trying to ensure that the process of globalisation works with, rather than against, the principles of sustainable development, such a reordering of global economic priorities would also strengthen the political acceptability of these organisations. As described in Chapter One, international institutions find themselves under threat both from the anti-globalisation movement and from a return to bilateralism in international economic relations. Liberal Democrats believe firmly in the principle of multilateralism in trade and investment regimes, protecting weaker countries from the untrammelled exercise of power by stronger partners. Such a principle will be easier to defend if the objective of global sustainable development can be located firmly as the guiding aim of the key international institutions.

2.1.4 The principle of multilateralism will also be easier to defend if institutional shortcomings can be addressed. The WTO, IMF and World Bank are still excessively secretive, undemocratic, prone to poor decision-making and unaccountable for their actions or their outcomes. Their limitations are caused primarily by the pressure put upon them by wealthy members, but are augmented by undemocratic management processes and weak monitoring by member nations. Proposals for reform of the IMF and WTO are outlined below in Chapters Three and Five; the World Bank is dealt with in Policy Paper 64.

2.1.5 Institutions at home need reform just as badly as those in the international arena, and reforms of EU processes are described in Chapter Five. In the UK, trade and investment policy is currently handled by the Department of Trade & Industry, but, as explained in Policy Paper 59, *Setting Business Free*, Liberal Democrats aim to abolish this department, thus simplifying and clarifying the role of government in relation to business. Its valuable functions would be transferred elsewhere, and as part of this reform we believe that trade and investment policy should transfer to the Foreign & Commonwealth Office - helping to ensure that it is pursued with wider public policy goals firmly in mind.

2.2 Trade and investment and developing countries

2.2.1 Liberal Democrats have consistently argued that the current system is stacked against the poorest countries. No country has ever been lifted out of poverty through development aid alone; developing countries need the access to international markets and foreign investment that allows their economies to develop and diversify. Yet the process of trade liberalisation has been deeply uneven, benefiting rich economies more than the poorest, and the gains from trade have not been distributed evenly throughout the global economy.

2.2.2 Industrialised countries still maintain higher trade barriers against many developing-country exports than they do against each others'. Flows of foreign direct investment are highly unevenly distributed, and many of the poorest nations lack the investment capital and political capacity to diversify and adjust to new opportunities, remaining dependent on a small number of primary commodity exports liable to wide price fluctuations. Further, while the international movement of goods and financial capital has been liberalised, movement of labour - a major export of poor countries - has not.

2.2.3 As above, *rebalancing* is needed, in the interests of the world's poor. This includes a sustained effort to dismantle the remaining trade barriers against developing-country exports and an attempt to construct international agreements on investment which will make developing countries more attractive to foreign investors, and foreign investment of much more lasting value to developing countries.

2.2.4 Even if all these proposals are adopted, though, development assistance still has a crucial role to play. Many poor countries lack the capacity fully to benefit from trade and investment liberalisation, which needs effective governance structures such as a lack of corruption, trade-friendly customs agencies, an independent judiciary, a tax system that does not need to rely on import and export duties, and so on. Furthermore the deregulation and privatisation that often accompanies trade and investment liberalisation opens developing country economies to new stresses and new requirements for government regulation and enforcement for which they would benefit from capacity-building assistance. Development assistance should be designed, therefore, to enable developing countries to benefit from open markets and new investment opportunities, themes which are explored in more detail in Policy Paper 64, *A World Free from Poverty*.

3 *International Finance*

3.0.1 We now live in a world dominated by financial markets operating seamlessly around the clock. Over the past three decades, the liberalisation of international capital markets has been reinforced by the deregulation of domestic financial markets, the arrival of powerful computers and telecommunications, and rapid financial innovation. The argument for deregulated international capital markets, promoted by the IMF and others, has been that, by analogy with free trade in goods, free capital markets would lead to a better use of resources and greater stability. The experience of the last few decades, however, has comprehensively undermined this point of view: the exchange rates of the major currencies have continued to move about with little regard for underlying economic developments, and capital flows have been a major source of instability, especially for developing countries. Risks associated with liberalised trade in capital include sovereign debt default, capital flight, currency crises, bank failures and stock-market crashes, all with the capacity to project their effects across domestic, regional and even global economies - the process known as contagion.

3.0.2 Very few controls now restrict capital flows. Whereas long-term capital flows have many benefits and should be encouraged (see further in Chapter Four), short-term capital movements have a high propensity to be harmful, undermining the financial and economic sovereignty of national governments. Liberal Democrats, therefore, argue for the need to control currencies and capital flows to ensure that capital supports the real economy, not vice versa.

3.0.3 Although the G7 group of nations was initially established, among other things, to manage the global economy, its successor, the G8, has persistently failed to respond to major exchange rate misalignments. This is an increasingly important failing, with the advent of the euro creating the possibility of a new global reserve currency as an alternative to the US dollar. We therefore believe that discussions should take place between the major currency blocs - at a minimum the US and eurozone (a 'Finance G2'), and possibly the UK and Japan as well - to establish the principle of intervention to keep their currencies within target zones.

3.0.4 We also recommend a thorough evaluation of the governance of international finance, a 'new Bretton Woods' examination of the roles of international financial institutions in a world vastly different from that in which they were created sixty years ago. The IMF, in particular, was set up to administer a fixed exchange rate system that has not existed for decades. While it has found a new role as a short-term financier of developing countries it is not the appropriate institution for many of the international regulatory functions that are now needed.

3.0.5 We therefore call for the establishment of a new International Financial Authority (IFA) to coordinate aspects of the regulation of the international financial system. Opening talks on this proposal should be a key priority for the UK during its presidency of the G8 in 2005. The new authority would deal with regulation of:

- Capital flows to and from developing countries.
- Capital flows from source countries.
- The after-effects of inappropriate capital flows.

We deal with these functions in turn.

3.1 Capital flows and developing countries

3.1.1 As indicated above, short-term bank lending - 'hot money' - can be highly volatile, contributing to economic instability, particularly in developing countries. Many such financial crises, however, are exacerbated rather than reduced by the countries' own borrowing structures, magnifying the effects of exchange- and interest-rate and commodity price volatility. Borrowings are often short term and usually in foreign currencies. The IFA should provide advice to developing countries on their exchange - and interest-rate volatility exposure, and assistance in using and, where necessary setting up, international derivatives markets to minimise this exposure.

3.1.2 In addition, however, there may be a need for additional measures to reduce speculative movements of short-term financial flows, especially in emergencies. Examples include:

- The so-called ‘Chilean tax’ on capital inflows and outflows. In 1991 Chile imposed an implicit tax on inflows of short-term capital by requiring 30 per cent of all inflows to be deposited with Chile’s central bank for a year. While total investment was not changed much, the pattern of inflows shifted away from short-term debts.
- The use of temporary capital controls in the event of currency crisis: the so-called ‘Malaysian option’, used by Malaysia to control capital outflows during the Asian financial crisis in 1997-99. The danger to countries employing this measure is of locking themselves out from the international financial system.

3.1.3 We believe that the IFA should provide advice to developing countries on the suitable application - and withdrawal - of measures such as these, or other options. The Authority should also assist developing countries to withstand any requirements in bilateral agreements that would reduce their freedom to control capital flows.

3.1.4 In addition, the IFA should investigate means of implementing, when politically practical, international taxes on foreign exchange transactions. This idea behind this - the ‘Tobin Tax’ - is to discourage destabilising speculation and thus make foreign exchange markets less volatile; rates would need to be set relatively low to avoid penalising capital flows for normal trading or investment purposes. Since every major foreign exchange trading centre would have to agree to implement such a tax for it to be effective, it is not a realistic option in the short term, but we believe that it would be a valuable instrument in limiting speculation. (It would also generate substantial sums of revenue, which could be used, for example, to finance international environment and development goals, but this is such a distant prospect that it would be dangerous to rely on this as a realistic funding mechanism.)

3.1.5 All these measures would help prevent temporary liquidity difficulties becoming full-blown financial crises. In addition, in the absence of an international ‘lender of last resort’, the

IMF’s resources should be enlarged (see para. 3.4.6) to allow it to organise and fund significantly the necessary refinancing for temporary liquidity crises.

3.2 Capital flows from source countries

3.2.1 While developing countries themselves, and the international financial institutions, can implement various measures to reduce the adverse impact of capital flow volatility, evidence shows that the financial crises of the 1980s and 1990s were caused as much by mistakes made by rich-country institutions under the supervision of rich-country regulators as by inadequate regulation and macroeconomic policies in poor countries.

3.2.2 We therefore support reform of the financial policies of the richest countries, most particularly in the prudential regulation of private bank lending. This would not only help avoid financial crises, but also reduce the possibilities of financial losses to the banks and subsequent tax revenue losses to the governments. The new IFA should lead negotiations to:

- Harmonise national bank and accounting regulations and supervision.
- Harmonise and promote consistency and transparency in national accounting.
- Extend capital liquidity regulations beyond the banking sector to other financial institutions, such as US money market mutual funds (unit trusts), an increasing source of international short-term money flows. This would reduce the need for distress selling by these funds to meet redemptions at the onset of a liquidity crisis.
- Introduce more sophisticated measures of bank risk, e.g. by formally noting individual country risk in terms of macroeconomic policy, volatility exposure etc.

These measures may lead to a short-term reduction of capital flows, but should, in the longer term, mean that they would be a more stable, and therefore more productive, element in developing country funding.

3.3 Managing after-effects

3.3.1 At present the costs of adjustment after a financial crisis are largely borne by the citizens of the country involved as its economy is reshaped to pay off the debts incurred by their government. These adjustment programmes protect external debt and do not distinguish, for instance, between lending to:

- Oppressive regimes that are using their position purely for personal gain ('odious debt'), where the lenders are complicit in the misappropriation of national resources.
- Incompetent regimes with economic policies that are only going to pay back if the debt is 'worked out' after adjustment programmes are imposed.
- Governments that are unlucky, say with major and unpredictable changes in the terms of trade, wars, natural disasters, and so on.
- Stable economies that suffer a liquidity crisis that is then turned into a self-fulfilling financial crisis by outflows of short-term capital.

3.3.2 We believe that the new IFA should pursue the quasi-judicial function of:

- Determining the causation of debt in times of crisis.
- Assessing whether debt has been incurred criminally, irresponsibly or just mistakenly, and identifying debts that can be paid back.
- Making clear that 'odious debt' will not be supported.
- Supervising an 'administration/bankruptcy' procedure for sovereign nations that cannot repay all their debt.

(Policy Paper 64, *A World Free from Poverty*, contains more detail on our proposals for dealing with developing countries' existing debts.)

3.3.3 The last proposal would ensure that the developed country creditors shared the adjustment costs with the defaulting country - as would happen if a company goes bankrupt and is put under administration - with the degree of cost

sharing being partly dependent on the competency of the economic policy of the country concerned.

3.3.4 An immediate improvement can be made without international action by insisting on 'collective action' clauses in sovereign bond issues. These clauses, which are standard in UK bond issues but not in the US, allow for formal procedures for bondholders to negotiate settlements with borrowers, analogous to creditors' committees in private administration proceedings. Given the overlapping claims of different bonds, however, a formal sovereign bankruptcy procedure administered by the IFA would still be preferable.

3.4 Reforming the IMF

3.4.1 The International Monetary Fund was set up to provide short-term emergency assistance for countries in severe balance-of-payments difficulties. In recent years, the conditions it has placed on its loans, in the form of structural adjustment programmes, intended to establish conditions for long-term development, have led it to become more and more directly involved in the micromanagement of national economies - and in practice, its form of assistance has too often retarded recovery and damaged the recipient country. Structural adjustment has been imposed regardless of the impact on countries' growth rates, job creation or wealth distribution, and frequently at the expense of public services. Developing countries which have rejected IMF conditions, such as China, Chile, India and Vietnam, have often performed better than those which have accepted them.

3.4.2 The IMF has remained unresponsive to these outcomes, a situation which may relate both to its funding and to its personnel. It is funded by member nations according to their GNP and trading volume, and decisions are taken by the IMF Board of Directors. The USA's contribution to IMF funds is such that it can *de facto* exercise a veto on any decision. National representatives tend to be financial experts accountable only to their ministers of finance and central banks; they are appointed in secrecy and are not required to have any particular knowledge of the countries whose applications they consider, resulting in a tendency to impose 'one size fits all' programmes.

3.4.3 The task of helping nations to recover from financial crisis remains important, but we believe that there is an urgent need to review the remit of the IMF and to render it more responsive, and its activities more effective, transparent and accountable. The establishment of the IFA would enable the IMF to focus more on its original role of short-term assistance in emergencies. Longer-term interventions in national economies should continue only in exceptional circumstances, where economic strategies have been scrutinised and approved by receiving governments' national parliaments, and social and environmental impact assessments have been carried out on all loan conditions. Even in crises, it should be required to work closely with the governments of applying countries to ensure that programmes for recovery are appropriately timetabled and adjusted in the light of experience.

3.4.4 In common with other institutions, it should improve its transparency, with greater disclosure of decisions and background papers. Decisions in all committees should be by majority voting, and the names of all representatives and their backgrounds should be published, along with their attendance and voting records.

3.4.5 The basis of IMF funding also needs to be modified. Funds need to be assured at a sustainable level and made independent of individual members' economic and political influence. In the short term, the UK should encourage greater collaboration amongst EU member states in order to increase European influence on the IMF. Total EU funds already well exceed those of the US and a combined approach just by UK, Germany and France would be sufficient to modify the impact of conditionalities.

3.4.6 The IMF's lending resources have failed to grow in line with international trade flows, with the result that the pace of change for countries receiving assistance is now much faster than it used to be, with accompanying much greater stresses, as governments are required to reduce imports and cut government spending over relatively short periods. IMF resources therefore need to be greatly increased, for example through increasing special drawing rights, in order to provide more effective assistance to economies in crisis in the current climate of instability.

3.5 Tax evasion and tax competition

3.5.1 The global freedom of movement of capital has increasingly placed pressure on governments' capacity to tax income and capital:

- Money can be illegally hidden abroad due to low-transparency financial systems and secrecy laws (tax evasion).
- Overseas countries can be used for constructing schemes artificially to reduce tax liabilities (tax avoidance). While these 'tax havens' may be small states, they may also be specifically ring-fenced areas (geographic or legal) in larger states.
- Nation states may feel constrained to reduce their tax rates on capital to prevent it moving abroad (tax competition).

3.5.2 The worst fears of erosion of the tax base have not, however, been realised, as the share of developed-country tax revenue taken up by taxes on capital has not significantly changed in recent decades. However, it could be argued that the proportion of revenue raised by taxes on capital should in fact have risen with the increasing share of profits in recent years. Furthermore, as the UK exports capital-intensive goods and imports labour-intensive goods, international trade itself will tend to increase the return on capital relative to labour. There is also a strong argument that a reduction in taxes on labour, relative to taxes on capital, is justified to reduce unemployment, including that caused by adjustments resulting from international trade (see further in Chapter Eight).

3.5.3 We therefore:

- Support the OECD's 'Project on Harmful Tax Practices' in endeavouring to deal with the lack of transparency and lack of information exchange for tax purposes, that undercut the ability of OECD countries to enforce their own tax laws.
- Would go further than the OECD, in supporting UN moves to reduce harmful tax competition itself.

- Concentrate particularly on the tax havens in British overseas territories, such as the Cayman Islands.

It should also be remembered that Liberal Democrat policy on gradually shifting the tax basis to taxes on resource use (land, pollution, etc.) would reduce the scope for such tax avoidance, as these factors tend to be immobile.

4 *International Investment*

4.0.1 In contrast to the short-term capital flows considered in the previous chapter, on a global scale longer-term capital flows are smaller in magnitude but considerably more important in achieving the goal of sustainable development. Flows of foreign direct investment (FDI) in particular are critical to this objective, especially for poor countries aiming to develop new forms of economic activity. Recent OECD research suggests that a rise of one percentage point in the ratio of the stock of FDI to GDP will raise GDP by 0.4 per cent. FDI also tends to be longer lasting than other forms of cross-border investment (bank loans and portfolio investment) and investors are less likely to withdraw when times are bad. Considering the environmental dimension of sustainable development, it is clear that the development and spread of new, less-polluting and resource-intensive technologies and processes - through FDI - is vital to the future of the planet.

4.0.2 FDI has grown substantially in recent decades, and for the developing world as a whole is worth more than ten times as much as overseas aid. Yet this is very heavily skewed towards the richer developing countries; in recent years China has been overwhelmingly the most important destination, and throughout the 1990s the top ten developing-country recipients together received more than 70 per cent of total flows to the developing world. For the bottom 70 countries on the UN's Human Development Index, FDI was greater than overseas aid for only nine of them - yet no countries have ever been lifted out of poverty through aid alone. Poor countries enjoy least access to FDI primarily because of structural problems in their economies: a shortage of skills needed to convert the capital, political risk, and restrictions on capital inflows.

4.0.3 Developing countries themselves can therefore do much to attract FDI, but often tend to find themselves at a disadvantage when negotiating with the TNCs which are the major sources of FDI. Not all cross-border investment is beneficial to the host country in the long - or even sometimes the short-term. Particularly in the extractive sector (mining, oil and gas) there are many examples of investments which have caused significant environmental damage and disruption

to local communities and their way of life, have failed to transfer skills and have been associated with corruption and bribery. A recent development has been the spread of 'host country agreements', through which major projects such as oil pipelines are explicitly excluded from national government regulation.

4.1 **An international investment agreement**

4.1.1 There is therefore a strong case for a multilateral regulatory framework to secure transparent, stable and predictable conditions that will encourage FDI, protect investors' investments and enable host countries to regulate their conditions. Previous attempts to negotiate such an agreement have not, however, been encouraging. The OECD's proposed Multilateral Agreement on Investment (MAI), which was abandoned in 1998, was widely seen as failing to balance investors' rights with responsibilities, for example for environmental and social standards. This danger has become real in North America through the investor-state provisions in the North American Free Trade Agreement (NAFTA), which has seen courts interpreting the term 'expropriation' (of investments) as including any government regulation (for example on waste disposal or pollution) which affects a company's profits or even its share price.

4.1.2 The inclusion of a possible international investment agreement in the WTO's Doha Round proved deeply unpopular with developing countries, and was one of the reasons behind the failure of the Cancun WTO ministerial in September 2003. We believe that the WTO model of liberalised trade in goods is not in general transferable to cross-border investment, which involves longer-term and closer relationships between economic actors, and therefore welcome the EU's indication that it is prepared to withdraw the topic of investment from the Doha talks. The WTO principle of non-discriminatory treatment, however, should clearly be retained in the new agreement.

4.1.3 Liberal Democrats therefore call for a new international set of negotiations on the creation of a multilateral framework that

liberalises FDI where it contributes to the wider public policy goals inherent in the achievement of sustainable development (see above, Chapter Two). This should be defined more precisely in the agreement itself, but definitions are available through, for example, the UN Millennium Development Goals and the many multilateral environmental agreements. Additional rights for investors guaranteed by the agreement (access to contracts, protection from expropriation, etc.) must be balanced by additional responsibilities, for example to high environmental, social and labour standards. This could most easily be achieved through incorporating a binding commitment to the OECD Guidelines for Multinational Enterprises into the agreement (see further in Chapter Five).

4.1.4 The negotiations should be held under the auspices of the UN Commission on Sustainable Development; several UN agencies, together with non-UN bodies like the World Bank, will have useful input. Laying the groundwork for these negotiations should be a key objective for the UK during its presidency of the G8 in 2005.

4.1.5 Once such an international investment agreement is in place, it should in due course supersede all the 2000 or so bilateral investment treaties (BITs) which have grown up since the 1970s. Despite their number, research suggests that the treaties have been of little, or no, benefit to sustainable development or even to the narrower goal of facilitating cross-border investment more generally. Instead, BITs between rich and poor countries have sometimes been used to impose unfair conditions on the weaker partner.

4.2 Export credit agencies

4.2.1 Export credit agencies (ECAs) are public or semi-public agencies that provide government-backed loans, guarantees and insurance to companies seeking to do business in countries where the investment climate is judged to be too risky for conventional corporate financing. Most countries of the OECD possess at least one ECA. Worldwide in 2002, ECAs supported an estimated \$432 billion in trade and investment - nearly 10 per cent of world exports. Yet, despite some recent improvements, most ECAs are not subject to any binding environmental, human rights or development guidelines and their activities do little to promote the wider agenda of sustainable development we support; indeed, their primary

purpose is to provide support to home businesses, and much of their assistance, particularly in the case of the UK, has been allocated to arms exports.

4.2.2 We therefore reiterate Liberal Democrat policy (in Policy Paper 59, *Setting Business Free*) of privatising the British Export Credit Guarantee Department (ECGD). Since it claims it breaks even (though it is highly untransparent in the way in which it operates) it should be able to conduct its activities in the private sector without any need for public support.

4.2.3 There is still a case, however, for providing export credit guarantees which do genuinely support sustainable development, and which help to increase flows of FDI to the poorest countries. We believe that this function should be transferred to the Department for International Development (DFID), which has much wider public policy goals than the ECGD, or any ECA. The UK should also take the opportunity of its presidency of the G8 to argue for similar developments in other countries' ECAs.

5 **International Trade**

5.1 **The Doha Round**

5.1.1 The Doha Round is the latest in the series of wide-ranging trade negotiations that began with the creation of the GATT in 1947. Often referred to as the ‘Doha Development Round’, it was initially hoped that the talks would focus on the needs and perspectives of developing countries, and, in particular, the least developed among them. Yet in reality, the richer countries dominated the agenda-setting process in Doha and have similarly set the pace - or failed to - in the talks to date. The unattractiveness to poorer countries of the deal on offer at the ministerial conference in Cancun in September 2003, together with the increasing assertiveness of the developing world, were the main reasons why that conference ended without agreement.

5.1.2 While regretting the delays in reaching final agreement, Liberal Democrats view the rejection of the Cancun deal as, on balance, a positive outcome. A major cause for division are the so-called ‘Singapore issues’ (agreed for discussion at the WTO ministerial in Singapore in 1996): investment, competition, government procurement and trade facilitation. Always favoured far more by the richer countries, most developing countries saw these as inappropriate extensions of the WTO mandate when more basic questions, for example of protectionism against their exports, remained unresolved. We believe it right for these issues (with the exception of the relatively uncontroversial issue of trade facilitation) to be withdrawn from the talks. We deal with our proposals for investment in Chapter Four and for competition in Chapter Six.

5.1.3 The Doha agenda also includes, for the first time in a WTO negotiation, an important component on trade and environment (see further below in Chapter Seven). We regret the fact that it seems likely that this component will be abandoned, and call for its reinstatement (in an improved form) in future negotiations. It is important, however, for eventual agreement to be reached in the Round, as a total failure would open the door to a return to bilateral agreements, which generally see negotiating pressure applied by the richer countries to the detriment of the poorer. We are therefore in favour of continuing

attempts to salvage the Doha Round, as long as the outcome is positive for developing countries. Some of the key elements of the Round are touched on below.

5.2 **Agriculture**

5.2.1 Three-quarters of the world’s poor live in rural areas. Agriculture accounts for about 27 per cent of GDP and export earnings in developing countries, and 50 per cent of employment. Yet at the same time, agricultural markets around the world are the most heavily protected; in OECD countries, the average tariff rate for agricultural products is 60 per cent, twelve times the rate for industrial products. Developed countries also protect their agricultural sectors through a \$1 billion a day worth of subsidies, more than the entire GDP of sub-Saharan Africa. Every dairy farmer in the EU receives \$2 a day per cow, higher than the income of nearly half of humanity.

5.2.2 This structure of tariffs plus subsidies has resulted in a hugely distorted world market for agricultural products. Developing countries are systematically prevented from benefiting from their comparative advantages of cheap labour and land; many potential food exporters in fact rely on cheap imports because their domestic production has been destroyed by subsidised exports from OECD countries. Consumers in almost every country pay more for food than they should do, and many agricultural subsidies result in hugely environmentally damaging farming practices.

5.2.3 Liberal Democrats have consistently opposed the current structure of support for agricultural production in the developed world, in particular through the EU’s Common Agricultural Policy (CAP) and its US and Japanese counterparts. We call for the elimination of CAP production subsidies and trade barriers, both direct and indirect, and the conversion of the CAP to a countryside support policy with the emphasis on maintaining biodiversity (as described in detail in Policy Paper 52, *Rural Futures*). This should be a major component of the Doha negotiations, but even if they do end without agreement, CAP reform should proceed regardless. We also welcome recent indications that the WTO may rule against US cotton subsidies in the dispute

case brought by Brazil: if confirmed, this would be of major benefit for some of the poorest countries, as well as consumers and the environment.

5.3 GATS

5.3.1 The General Agreement on Trade in Services (GATS) is a WTO agreement covering nearly all internationally traded services. It encourages countries to make individual commitments to liberalise trade in services through a 'bottom-up' approach, allowing each member to determine the sectors it will open up to foreign service providers. Under a framework of rules based on the core WTO principles of non-discrimination and transparency, members are required to give immediate and unconditional equal treatment to other member countries in any sector they have chosen to list. Exemptions are possible, but usually only for new members, and they should in principle last not longer than ten years.

5.3.2 Expansion of the GATS is a major feature of the Doha Round. WTO members are being encouraged to widen the list of activities for which they are prepared to offer market access and non-discriminatory treatment to foreign providers. National governments retain the right to choose whether or not to open up particular sectors to competition, however - though once a decision is taken it is effectively irreversible - and derogations from market access and non-discriminatory treatment are permitted, based on the number of suppliers, operations or employees in the sector, the value of transactions, the legal form of the supplier, or foreign capital. Despite an active NGO campaign against the GATS, nothing in the agreement compels government to privatise public services (such as water supplies), and examples of detrimental privatisations in developing countries cited by critics of GATS generally have nothing to do with the agreement.

5.3.3 Despite the theoretical ability to apply safeguards, however, there is considerable unease about the likelihood in practice of developing country governments being able to impose conditions - for example, for high environmental standards or local employment requirements - on foreign service providers, and in practice developing countries have come under considerable pressure, not least from the EU, not to implement such derogations. The irreversibility

of sector liberalisation, and the difficulty in projecting exactly what is likely to happen, has led to calls for a review of the GATS before its further expansion, which we share. We also recognise that the privatisation of important service sectors, such as water or energy, requires a level of monitoring and regulation by government that may well be beyond the current capacity of many poorer countries (see above in 2.2.4). Even developed countries have had difficulties establishing adequate regulation of privatised utilities.

5.3.4 We therefore believe that the GATS should be subject to major revisions before it is extended:

- Countries should be able to review their judgements on the sectors to be offered for liberalisation after a number of years (perhaps ten), at which time they should be able to reverse their original decision and/or add new derogations.
- The least developed countries should be afforded the greatest flexibility in applying derogations and in reversing original decisions should the impacts prove negative (see further below in para 5.5.5).
- In order to ensure that service deregulation leads to positive outcomes, companies offered new opportunities by GATS-led deregulation should be subject to a binding commitment to the OECD Guidelines for Multinational Enterprises (see further in Chapter Six).

At the same time, developing countries should be assisted in building the capacity required to monitor privatised services sectors. The EU (and other countries) should immediately cease applying pressure to developing country governments not to implement derogations.

5.4 TRIPS

5.4.1 Intellectual property (IP) rights provide the legal basis for recognition of the value of individuals' innovations, ideas and creativity. They take various forms - copyrights, patents, industrial designs, and trademarks - depending on what is being protected. The first three provide the owner a time-related exclusive right to control their IP's use; trademarks guarantee origin and

protect reputation. The objective of the IP system is a balance between the public good and the interests of the creator. Disclosure of technology via patents allows more rapid developments than the alternative of industrial secrecy. Intellectual property law has developed over centuries and is territorial rather than global.

5.4.2 The enforcement of uniform intellectual property standards, through the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement) was introduced into the GATT Uruguay Round by the developed countries as a quid pro quo for reductions in their trade barriers of interest to the developing countries such as agriculture and textiles. Setting up patent systems, in a few years, of a type and standard that took the US or Europe centuries has resulted in major problems for developing nations. Capacity building is of prime importance in this area (see further below) and we also believe that the TRIPS Agreement should be reformed to allow further time for implementation by developing nations.

5.4.3 In environmental policy, there is a growing concern over instances of ‘biopiracy’, where traditional medical or agricultural knowledge, or genetic resources, in developing countries are ‘discovered’, patented, and marketed by developed-country industries without any compensation for the real inventors of these technologies. Such knowledge or resources should receive a fair share of the benefits of their commercialisation, and we therefore propose that a royalty-based system should be established for the fair reward of harvested genetic or biological materials, in place of the patenting of naturally occurring genes, which Liberal Democrats have always opposed. This would also help bring the TRIPS Agreement into line with the provisions in the UN Convention on Biological Diversity on fair and equitable sharing of the benefits of genetic resources.

5.4.4 In the high-profile area of health, patents allow pharmaceutical companies to make drugs very expensive, which they claim is justified by the costs of research and development. Even in developed countries this has a major impact upon health-care costs, and in developing countries it has prevented access to essential medicines. In Doha, it was agreed in principle that countries unable to pay for patents to manufacture essential drugs for their populations should be allowed to

procure ‘generic’ drugs from other countries. However, the US has blocked this agreement, arguing that developing countries cannot determine unilaterally which medicines are essential to their public health needs. We support the EU’s proposal that the World Health Organisation (WHO) should adjudicate in such cases, establishing a system by which a country can demonstrate genuine medical need and be entitled to make or procure royalty-free drugs.

5.5 Reforming the WTO

5.5.1 The procedures of the WTO itself - described as ‘medieval’ by EU Trade Commissioner Lamy - are in urgent need of reform. Despite some improvements, the WTO is widely criticised as undemocratic and secretive in its processes, favouring developed over developing countries in its decisions, failing to enforce compliance of wealthy members to agreed terms and ignoring non-trade issues vital to global well-being. As we identified in Chapter Two, WTO member states have effectively created an organisation which pursues trade liberalisation in isolation from other public policy goals. Our proposals throughout this paper should help to rebalance the system, but the internal procedures of the WTO itself need reform.

5.5.2 The most important set of proposals we make relate to developing countries’ participation in the WTO. We welcome the emergence, at Cancun, of stronger negotiating groups amongst the developing world, though the most effective, the G20, primarily represents middle-income agricultural exporters and includes none of the least developed countries. Most of the negotiations, however, take place in between ministerial conferences at WTO headquarters in Geneva, where representatives of wealthy countries are supported by teams of experts, which many poor countries cannot sustain. Indeed, thirty-seven WTO members cannot afford a permanent office in Geneva.

5.5.3 To redress this imbalance, we support:

- Financial assistance to the poorest member countries to enable them to maintain adequate, permanent delegations in Geneva (perhaps on a regional group basis).
- The establishment of a pool of legal and technical experts available to assist members

in negotiating, to train delegations in negotiating skills and to provide legal assistance in conducting WTO disputes.

- Making mandatory the WTO's own guidelines proposing preliminary assessment of the impact of GATS agreements before final negotiations; currently, these are generally ignored.

5.5.4 The most important thing industrialised countries can do to assist the developing world, of course, is to reduce their trade barriers against developing-country exports. As noted above in Section 2.2, however, many poor countries lack the capacity fully to benefit from trade liberalisation and require assistance with building the necessary institutions and enterprises. This is a partly a job for WTO technical assistance, which we believe should be increased, and partly for development assistance policy. As pointed out above (in para. 5.3.3), trade and investment liberalisation, and the deregulation and privatisation that usually accompanies it, opens developing country economies to new stresses and new requirements for government regulation and enforcement for which they would benefit from capacity-building assistance.

5.5.5 In addition, we believe that the current structure of 'special and differential treatment', through which developing country markets may be protected more than their counterparts in developed countries, should be extended and made more sensitive, with a graduated scale of treatment depending on the GNP of the country concerned; this is of particular relevance to GATS and TRIPS commitments.

5.5.6 More broadly, WTO decision-making processes suffer from a lack of transparency and accountability. The WTO General Council meets in private. Outside the Council, a great deal of negotiation is undertaken through informal meetings from which developing nations are often excluded. Decisions also tend to be excessively influenced by TNCs and industry groups. In the UK, for example, GATS documents which are not generally available have been released to the Liberalisation of Trade in Services (LOTIS) group. WTO staff have acknowledged that the US financial sector has been the prime mover in promoting GATS.

5.5.7 The WTO does now make most of its internal documents available to the public, but very few organisations are accorded observer status at its meetings and its debates remain closed to civil society. This combination of isolation and secrecy, plus the absence of any monitoring authority, mean that its decisions and actions are accountable only to some of its members. To increase WTO transparency and accountability, Liberal Democrats propose:

- Extending observer status to all international institutions concerned with the impact of trade, such as WHO and UNEP. There is an argument, also, for extending observer status to significant international commercial organisations and NGOs.
- Opening all general meetings to the public, except where this would endanger negotiations.
- Appointing an independent Advocate General, to represent the public in trade disputes, with powers to interrogate officials and delegates.
- Allowing and encouraging 'amicus' interventions in dispute cases from civil society organisations.
- Establishing an annual assembly of Parliamentarians, to scrutinise the work of the WTO.
- Requiring the WTO, IMF and World Bank to confer regularly to ensure that their policies are compatible and supportive of their (reformed) remits.
- Encouraging national parliaments, including that of the UK, to find time regularly to review the work of the international institutions and their impact on world trade and well-being.

5.6 EU trade policy

5.6.1 The EU, operating through its Common Commercial Policy, is the only trading bloc with the potential to counterbalance US influence on the international institutions regulating trade and investment. In recent years its record has been mixed: it has proved readier than other WTO

members to consider issues such as environmental protection and standards of employment, but it has failed to dismantle its own environmentally and economically damaging subsidies, particularly for agriculture. It has also pushed for conditions which would further its short-term economic interests but damage the long-term development of sustainable markets, for example in seeking to remove India's requirement that foreign countries should work through a local counterpart, a requirement which strengthens the country's ability to hold TNCS to account and to retain their assets if necessary. It has also applied pressure to developing countries for service sector access under GATS (see above in Section 5.3).

5.6.2 Trade is a matter of exclusive EU competence: the European Commission negotiates on behalf of member states, in regular consultation with the Article 133 Committee (named after the relevant article of the Treaty), a working group of the Council of Ministers. This makes it essential that the European Parliament is enabled to give EU trade policy full democratic oversight. In 1990, the European Parliament secured the right to veto any multilateral trade agreement negotiated by the Commission, which somewhat redressed the balance of power in favour of the elected representatives and increased the accountability and transparency of EU trade policy-making. EU trade policy, however, is not regularly scrutinised by all national parliaments.

5.6.3 Liberal Democrats would press for the following reforms in EU trade negotiating processes:

- The right of the European Parliament to veto all international trade agreements (multilateral and bilateral) should be confirmed by the EU constitution.
- The full text of all EU requests in WTO negotiations should be made available to all MEPs, except where negotiations are at a stage where transparency could damage the outcome.
- Outcomes should be published on the internet.

- A preliminary environmental and social sustainability impact assessment of any new proposed agreement should be made obligatory, and all developing countries' conditions for trading should be accepted and reviewed only in the light of impact assessment findings.
- The UK Parliament should set aside time regularly to scrutinise EU trade policy, agreements and proposals.

5.6.4 The EU's trade relations with developing countries are also in need of reform. Cooperation between the EU and the 'African Caribbean Pacific' (ACP) group of developing countries (mostly former colonies of EU member states) is governed by the Cotonou Agreement (the successor to the Lomé Agreements) signed in 2000; this creates Economic Partnership Agreements (EPAs) which are currently being negotiated and should be concluded by the end of 2007. The ACP group contains many of the poorest and most vulnerable developing nations, and their trade and development relations with the EU are of considerable importance to their future development.

5.6.5 The proposed EPAs, however, have a number of flaws. Under WTO pressure, the unilateral trade preferences granted to the ACP countries under the Lomé Agreements are to be replaced by WTO-style free trade areas, implying the elimination of duties and other regulations on essentially all trade in both directions between the EU and the ACP group. While we do wish to see trade barriers against ACP *exports* removed, the opening of ACP economies to all *imports* from EU countries (including heavily subsidised agricultural and other products) over a very short period is likely to have a devastating effect, particularly on the least developed countries. In addition the EPAs are to contain elements of the WTO 'Singapore issues' of investment, competition and so on (see 5.1.2) which have been strongly opposed by developing countries in the Doha Round.

5.6.6 Liberal Democrats therefore call for:

- The introduction of far greater flexibility into trade preferences in the EPAs, retaining the removal of EU trade barriers to ACP

- countries' exports but allowing them to retain controls on EU imports, if they so wish.
- Accompanying the negotiations on trade preferences with generous capacity-building assistance (see Section 2.2).
- The withdrawal of the wider elements of the EPAs, including negotiations on investment and competition.

6 *Enabling and Regulating Enterprise*

6.0.1 This paper deals with the regulation, by international institutions and national governments, of international trade and investment. It should not be forgotten, of course, that the entities that actually trade and invest under these rules are not governments, but private companies. The processes of trade and investment liberalisation, coupled with advances in technology, mean that many enterprises, even small ones, can now operate on an international scale. We believe that enterprise works best, however, when it operates within communities, and that it often works most effectively when it arises out of local roots.

6.0.2 Enterprise is an integral part of any liberal society. Liberal Democrats regard open markets as a means to participation and involvement, and as a way to reward fairly work, effort and innovation. A logical corollary of this position is that we must make sure that market enterprise really meets these goals. Genuinely free enterprise requires effective regulation; unregulated capital flows, a lack of social and environmental rules, or concentrations of power, all work against open markets. Increasingly globalised economies, however, mean that regulation of corporate behaviour poses difficult questions; there are as yet few effective international regulatory bodies, and close cooperation between nation states is still required. Individual countries, such as the UK, can often take a lead in establishing best practice in enabling and regulating enterprise.

6.0.3 Our proposals therefore centre on three core elements:

- Improving competition on a global scale, and acting against monopolies and cartels, which concentrate power.
- Ensuring that enterprises benefiting from open markets are required to behave responsibly, even where government regulation in the host country is weak; this includes developing the OECD Guidelines on Multinational Enterprises, introducing rules for ‘foreign direct liability’, requiring transparent reporting requirements and reforming accounting practices.

- Encouraging companies to go beyond government regulation and behave in an ethically responsible manner, contributing to social and environmental improvements wherever they operate.

6.1 **Global competition policy**

6.1.1 The transnational nature of many companies means that they can escape national regulation on competition by shifting their operations between national jurisdictions. Global markets can encourage private monopolies, especially if these are supported by internationally enforceable intellectual property rights. What is needed ultimately is a global competition policy enforced by effective and democratically accountable global institutions. Yet there are steps that can be taken even without this. National competition and anti-trust agencies can improve their links with each other, sharing information and experience in the enforcement of existing law, leading in due course to the development of common global competition standards.

6.1.2 The EU is large enough to be able to impose competition conditions not just on companies based in EU member states but also on companies trading into it. Yet its standing is harmed by its failure to impose fair competition in some internal sectors, such as agriculture, where government subsidies are prevalent, or defence equipment, which is usually not open to competition. The UK should take a lead in promoting better market competition and anti-monopoly policies both within the EU and the UK, and in encouraging greater international cooperation between competition authorities.

6.2 **Corporate accountability**

6.2.1 At an international level, the most effective instrument for regulating corporate behaviour is the OECD Guidelines for Multinational Enterprises, recommendations addressed by governments to TNCs operating in or from adhering countries (the OECD’s thirty member countries plus a few others). The Guidelines provide relatively detailed guidance on good business conduct in a wide range of

areas, including human rights, accountability, disclosure, employment, industrial relations, environmental protection, bribery, consumer interests, competition, taxation and science and technology. They are reviewed every six years; the next review is due in 2006.

6.2.2 At present the Guidelines are a voluntary code, and have not been applied particularly consistently or rigorously within the adhering countries. We believe that if codes are based on a strong regulatory framework, they can be enormously beneficial - not just in reducing the negative impacts of corporate behaviour but also in encouraging innovation and establishing a level playing field for all competitors. The Guidelines therefore urgently need more teeth and better enforcement.

6.2.3 In the short term, we will argue for:

- Incorporating adherence to the Guidelines as a requirement of companies benefiting from markets opened up through, for example, GATS (see para 5.3.4) or our proposed new international investment agreement (see para 4.1.3).
- Linking export credit guarantees, where they still exist (see Section 4.3) to meeting the requirements of the Guidelines.
- Ensuring that government procurement contracts are limited to companies that are working within the Guidelines.
- Strengthening the national contact points (NCPs) responsible for overseeing implementation of the Guidelines in each country (the UK NCP currently consists of just one member of staff).

6.2.4 We will use the 2006 review of the Guidelines to argue to expand their reach, for example by incorporating other international codes, such as International Labour Organisation (ILO) core labour standards. In the long term we wish to see the Guidelines become legally binding in all circumstances, giving companies duties to report, consult with stakeholders and carry out impact assessments. This will probably need a phased approach, applying the most stringent requirements to the largest companies first.

6.2.5 Corporations should also be legally liable for violations of national law carried out by their subsidiaries abroad; this is especially important where justice is not easily accessible in the country where the violation took place. This is the concept of 'foreign direct liability' (the counterpart of foreign direct investment); a number of cases have already been brought before courts in the US, under the Alien Torts Claims Act, and in the UK, US, Canada and Australia under general principles of civil liability (e.g. negligence) and the principle has now been established in the UN Convention on Corruption. Nevertheless, the idea is controversial and its application still disputed. We will:

- Legislate to make it clear that parent companies can be sued in UK courts for the behaviour of their overseas subsidiaries (i.e. entities directly or indirectly controlled by or in common control with them).
- Institute preliminary hearings to exclude frivolous or malicious claims to ensure that these cases do not bring the new practice into disrepute.
- Extend the liability of company directors to make them responsible for the social and environmental impacts of both their companies and their subsidiaries.
- Make it explicit in domestic regulation that corporations based or operating in the UK have a 'duty of care' in their social and environmental impacts wherever they may fall.

6.2.6 We also believe that corporations should be required to report on their environmental and social impacts, both on staff and other stakeholders (such as local communities), just as they do on their financial performance. It is ironic and anachronistic that rafts of regulation and requirement (however imperfect) exist to inform and protect shareholders, while broader responsibilities remain undefined, vague and largely voluntary. In recent years voluntary initiatives and codes have proliferated, but inevitably, behaviour and reporting is patchy and inconsistent, and it is usually impossible to distinguish consistently between genuine efforts at accountability and corporate 'spin.'

6.2.7 Our aim is to give ordinary citizens the right to access information on the environmental and social impact of companies' operations. We will therefore:

- Amend the reporting rules for listed companies to incorporate accountability and reporting standards for social and environmental impacts. Just as there are financial audits, so considerable development work has been done in the area of environmental and social auditing.
- Identify best practice in reporting standards in order to codify them through regulation. We will support and draw on the work of the Global Reporting Initiative, which works to develop sustainability reporting guidelines.
- Reform stock exchange listing rules to require full reporting of environmental and social impacts.
- Work to see these initiatives adopted throughout the EU and beyond.

6.2.8 Transparency is also needed to combat corruption. Some TNCs and developing-country governments hide behind confidentiality agreements to conceal billions of dollars of payments annually that 'disappear'. We believe that declaring details of such payments, together with particulars of institutional lending and technical assistance programmes, will encourage governments to invest more widely in public services and infrastructure. We will work through international institutions to achieve a multilateral agreement on a mandatory protocol for payment disclosure which does not competitively disadvantage UK businesses.

6.2.9 Finally, fraud and corporate failure in global organisations such as Enron, Tyco and WorldCom demonstrate that the regulation of the accountancy profession, which as the standard monitor acts as the guardian of financial probity, requires further reform. Consequently, we will:

- Support the creation of common cross-border accounting practices to bring US and European standards into line.
- Legislate to: restrict accountancy firms from working for audit clients in any other capacity; require firms to de-merge their

accounting business units and management consultancy practices; require the rotation of auditors for UK-registered companies at least every five years; and establish a three-year 'cooling off' period before auditors can be employed by former clients.

- Request European competition authorities to investigate the accounting sector, in order, if necessary, to take action against any evidence of market abuse.
- Support moves to curb intra-company transfer pricing, where it is used by TNCs to limit tax liability, effectively by shifting reported profits to low tax regimes or tax havens. (See also in Section 3.5.)

6.2.10 These reforms must be proportionate, so that small businesses and professional service firms do not suffer unduly from additional bureaucratic and financial burdens. We will therefore establish appropriate thresholds for both accounting firms and their small- and medium-sized enterprise clients, below which these de-merger, rotation and 'cooling-off' requirements will not apply.

6.3 Corporate responsibility

6.3.1 The burgeoning 'corporate social responsibility' or 'corporate responsibility' movement seeks to encourage companies to move beyond government regulation in their environmental and social impacts. By definition these are voluntary initiatives, but government can play a role in encouraging and facilitating them. We will therefore:

- Encourage initiatives such as the Ethical Trading Initiative and the Fair Trade Foundation, which aim to increase the share of products' purchase price which flows back to the producers (generally small companies and individuals in poor countries). (For further details, see Policy Paper 64, *A World Free from Poverty*.)
- Promote voluntary labelling schemes which inform consumers about the conditions in which end products are produced, to enable them to make enlightened choices. (For mandatory ecolabels, see below in para 7.0.8.)

- Encourage socially responsible investment, through which investors choose companies with good records of corporate responsibility.
- Launch an international policy dialogue aimed at implementing the World Summit on Sustainable Development commitments on corporate responsibility.
- Support the UN Global Compact, a voluntary initiative which seeks to advance good corporate citizenship by encouraging companies to work with UN agencies, governments, labour organisations and civil society to advance a number of universal principles in the areas of human rights, labour and the environment.

7 Trade, Investment and Environment

7.0.1 Trade liberalisation impacts the environment both positively and negatively. It can help to ensure that resources are used efficiently, it can spread the use of more efficient and less polluting technology and it can generate the wealth to pay for it. On occasion, trade liberalisation has been used directly to reduce environmentally harmful activities, such as the reduction in agricultural subsidies stemming from the Uruguay Round. Conversely, however, trade can also magnify problems of pollution and resource depletion caused by unsustainable economic activity - and in addition, transporting goods around the world, particularly by air, has direct environmental costs.

7.0.2 With the exception of transport costs, however, at base, environmental problems are caused by environmentally unsustainable patterns of production and consumption, not by trade itself. A fall in levels of trade will not stop these, and may in many cases make them worse. Nevertheless, the current trade rules administered by the WTO are often insensitive to environmental objectives, and attempts to modify them, through the WTO Committee on Trade and Environment, have so far achieved nothing. The trade and environment components of the Doha agenda are highly limited and have failed to generate support outside the EU; it seems quite likely that they will be abandoned before the end of the Round. However, recent dispute settlement cases have led to a number of significant reinterpretations of WTO rules, resolving some trade-environment tensions.

7.0.3 Nevertheless, it is clearly unsatisfactory that the relationship between trade rules and environmental regulations rests on the interpretation of texts written over fifty years ago, before most major environmental problems even began to emerge. To ensure that trade rules really do support genuine environmental regulation, we call for a new 'sustainability clause' to be added to the GATT, setting out agreed principles of environmental policy - such as the Polluter Pays Principle and the Precautionary Principle - against which trade measures can be judged. This is similar to provisions in the EU treaty which enable EU institutions to pursue *both* trade liberalisation and environmental sustainability as

objectives; it should ensure both that trade rules do not undermine environmental protection and that environmental regulation is not used as a disguise for covert protectionism. In particular, we want to see the modification of existing WTO rules in four key areas.

7.0.4 First, in the area of product standards. The WTO encourages the use of international standards - for example, for health and safety, or labelling requirements - in order to reduce unnecessary barriers to trade. It has consequently proved difficult for countries to set higher standards - for example on the presence of hormone residues or GM products in food - without providing compelling scientific justification, which is often difficult or impossible to obtain for new technological developments. Recent WTO dispute cases have suggested, however, that WTO rules are being interpreted in a more precautionary manner, accepting lower levels of scientific proof, which is clearly sensible in relation to emerging and often poorly understood environmental threats.

7.0.5 We believe that explicit incorporation of the Precautionary Principle into the GATT, as we call for above, will strengthen this development. We recognise also, however, that the adoption of higher standards in developed countries may create barriers to developing country exporters unless significant assistance is made available to enable them to improve their product standards and to submit them to the testing and certification procedures necessary. Such assistance should therefore be made available through support for institutions such as the Sustainable Trade & Innovation Centre, a new global partnership designed to help developing country producers to benefit from growing market pressures to integrate environmental and social factors into their export strategies.

7.0.6 Second, where production *processes* are unsustainable, because, for example, they generate transboundary pollution or deplete natural resources such as timber or fish. International trade rules used not to allow trade discrimination on this basis, but more recent WTO dispute settlements, with new interpretations of the text of the GATT, suggest

that in some cases this should be permitted. We believe that the new GATT sustainability clause should make it clear that discrimination in trade against products on the basis of the processes by which they are produced is permitted, under carefully defined circumstances, such as where the environmental damage caused is transboundary in scope (in other words, pollution restricted only to the country of production would not be sufficient for a trade barrier). Inclusion of this provision in the GATT would ensure that the measures taken would be non-discriminatory as between foreign and domestic producers, and would of course be subject to the normal procedure of appeal.

7.0.7 Third, on multilateral environmental agreements (treaties), such as the Convention on International Trade in Endangered Species (CITES), or the Cartagena Protocol on trade in GM products. Several important agreements contain trade measures, such as a requirement for licences before trade can be permitted, or complete bans on trade in controlled products with non-parties or non-complying parties to the agreement. Such trade measures have proved essential to the success of treaties where trade is a major cause of environmental damage or where there are no alternative compliance mechanism, yet at least in theory they could still be challenged at the WTO. We believe that trade measures within multilateral environmental agreements should be recognised and permitted under WTO rules, through the new GATT sustainability clause.

7.0.8 Fourth, the status of ecolabels under WTO rules is not always clear, and it has sometimes been suggested that trade rules do not permit mandatory labelling for environmental purposes. Yet the use of informational tools such as labels is an essential component in allowing consumers an informed choice over whether to purchase more or less unsustainable products. The new GATT sustainability clause should clarify the acceptability of non-discriminatory product - and process-based labels. Efforts should also be made to ensure that labelling rules are developed on an international basis, where possible, and that developing country exporters are provided with assistance in subjecting their products to the testing and certification procedures necessary (see above, 7.0.5).

7.0.9 Many of the policies we outline elsewhere in this paper will of course contribute to environmental improvements, including the reduction of subsidies for unsustainable agricultural practices. Similarly, we believe that subsidies designed to make environmentally friendly technologies more affordable and accessible should be excluded from the operation of the WTO Agreement on Subsidies and Countervailing Measures. A global agreement to remove the tax-exempt status of aviation fuel (as described in Policy Paper 46, *Transport for People*) would help to reduce the environmental impact of trade.

7.0.10 Individual governments can take actions by themselves which can help build sustainable trading patterns. In particular, governments are major purchasers of goods and services, and government procurement policy can be used to grow the markets for less environmentally damaging products, such as sustainably harvested timber, or energy-efficient equipment. The UK should take the lead, within the EU, in developing green procurement strategies and ensuring that EU procurement directives support them.

7.0.11 The liberalisation of cross-border investment also raises environmental issues. Environmentally sustainable development will not be possible without very substantial investment in new, less resource - and pollution-intensive technologies and practices around the world, and anything that increases the ease with which investment capital can flow to such activities is very welcome. A number of key environmental agreements - such as the Montreal Protocol on ozone-depleting substances, or (when it enters into force) the Kyoto Protocol on climate change - create mechanisms to facilitate these cross-border flows, but many important activities are not governed by such agreements, highlighting the need for a more general approach.

7.0.12 There are also dangers, however, in unregulated cross-border investment flows. Since environmental regulation proceeds at different rates round the world, resource- and pollution-intensive firms may migrate to less regulated locations - the so-called 'pollution havens'. Very few bilateral investment treaties contain provisions dealing with environmental standards, and one of the reasons for the collapse of the MAI in 1998 was its failure to deal adequately with

environmental policy. In the NAFTA investment provisions, the increasingly wide interpretation given to the concept of expropriation has led to companies challenging NAFTA governments' legitimate environmental regulations on the grounds that they might affect the companies' profits, or share prices. This kind of investment liberalisation, which gives rights to investors without any accompanying responsibilities, is not acceptable - which is why we call, in Chapter Four, for a new international framework for investment liberalisation which reinforces environmentally sustainable development rather than undermines it, and allows solutions to environmental problems to spread around the world as quickly as possible.

8 Trade, Investment and Labour

8.0.1 The inter-relationship between trade and investment liberalisation and labour standards is a controversial one. On the one hand, trade and investment help economies to grow and develop, generating prosperity and creating new employment opportunities. On the other hand, poor countries, exploiting their competitive advantage of cheap labour, invariably experience lower wages and poorer working conditions than those of the richer countries. The spread of trade and investment makes it much easier for TNCs to move their operations to take advantage of these lower labour costs, sometimes with severe impacts on unemployment and local prosperity in their former host countries, and not always to the benefit of workers in their new host countries. And while the movement of goods and capital is increasingly easy, the movement of labour, particularly of economic migrants, is heavily restricted.

8.0.2 The movement of jobs from developed to developing countries is not in itself undesirable - indeed, it is part of the process by which economies develop. In the richer countries, however, it requires active government, prepared to create the conditions - such as investing in education and promoting a culture of innovation - by which new jobs, and sometimes entire new industries, can be continuously created to replace those lost. It also requires active local and regional development policies, particularly for areas overly dependent on declining industries (such as the coal-mining areas of Britain in the 1980s).

8.0.3 The activities of TNCs in poorer countries can often be positive: they usually pay higher wages than local firms, and can provide useful training and technology transfer, thus assisting development. Further, working conditions in paid employment are usually better than alternatives in the small farming and informal sectors. Nevertheless, some TNC operations do not contribute to sustainable development, and relocation of their activities to countries lacking strong regulatory systems may be pursued simply to enable them to drive down wages, avoid decent health and safety provisions and boost their profits.

8.0.4 The challenge is therefore to find a reasonable balance between the concerns of development and of labour, between the continuing liberalisation of flows of goods and services to encourage the creation of employment opportunities and wealth in developing countries, on the one hand, and protection of the fundamental rights of workers, on the other. We aim to achieve this in three main ways:

- Setting a minimum floor of basic global labour standards.
- Supporting the framework established by the International Labour Organisation.
- Regulating to improve corporate behaviour.

8.0.5 Minimum global labour standards are clearly desirable if they protect workers from exploitation without at the same time impeding the process of development, or providing an excuse for protectionism against developing-country exports. An extremely careful approach needs to be taken, then, to identifying circumstances in which products produced under poor labour conditions can be lawfully discriminated against in trade.

8.0.6 We will therefore widen the scope of Article XX of the GATT ('General Exceptions'), which already contains a clause allowing WTO members to discriminate against products produced with prison labour. Although countries must themselves decide the labour standards they desire, we believe that participation in that decision is a basic human right. The prison labour clause should therefore be extended to allow discrimination against products produced with *forced* labour. This represents an extension of the current clause to include slave and bonded, as well as prison, labour, and would cover, for instance, many of the worst cases of child labour. This new provision would, of course, be subject to the normal procedure of appeal under the WTO disputes resolution procedure; WTO panels should have recourse to international agreements outside the GATT system (such as ILO conventions) in deciding its applicability.

8.0.7 The widening of this GATT clause can only, of course, affect traded products. For the wider promotion of high labour standards, we look to the International Labour Organisation. The ILO was created in 1919; it has subsequently assisted in the establishment of some 174 conventions setting various international standards of employment, and has developed an effective monitoring system, underpinned by its tripartite structure of governments, employers and unions. Labour standards have undoubtedly been raised in many countries as a result. Its core conventions, which include demands for the abolition of forced labour, freedom of association, the right to organise, collective bargaining, anti-discrimination and equal remuneration, are collectively described by the ILO as ‘fundamental to the rights of human beings at work irrespective of levels of development of individual member states’.

8.0.8 We wish to see the ILO strengthened, through the provision of greater resources, so that it is better able to enforce these conventions. It should also have a major role in negotiations in the WTO and on our proposed international investment agreement, in order to represent the interests of workers and thereby to ensure more balanced agreements. The UK should play an active role in the ILO, and follow the example of other EU countries, with parliamentary consideration of ILO proposals and much wider public awareness and debate.

8.0.9 The companies involved in employing workers in developing countries of course have a crucial role to play in improving labour standards. We deal with this topic above in Chapter Six; our proposals include making adherence to the OECD Guidelines for Multinational Enterprises (which include consideration of labour standards) mandatory for companies benefiting from open markets and investment opportunities; legislating to ensure that UK companies are liable for the activities (including conditions of employment) of their subsidiaries overseas; and ensuring that companies report fully on labour standards and conditions of employment. To encourage transparency, we also call for the establishment of an internationally recognised labelling system guaranteeing that goods have been produced under decent working conditions.

8.0.10 Finally, an important part of the globalised economy is the freedom of movement of labour - yet, as mentioned above, this is far more tightly constrained than movement of goods, services and capital. We believe that immigration is generally of substantial benefit, to the recipient countries (in terms of new skills and workers), to the immigrants themselves, moving in search of new opportunities for their talents, and often to the countries of origin of the immigrants, which may benefit from remittances sent back to families left at home (for some countries, remittances far exceed the value of development aid). Nevertheless, there is also clearly a limit on the extent to which recipient countries can absorb immigration, a topic which raises questions beyond the remit of this policy paper. In the WTO context, we will seek to meet the concerns of developing countries in the negotiations over GATS ‘Mode 4’, which deals with the rights of temporary workers supplying services in foreign countries.

8.0.11 Steps can be taken, however, to improve conditions for migrant workers. We believe that the UK should ratify the UN Convention on Migrant Workers, which entered into force in July 2003. Persons who qualify as migrant workers under its provisions are entitled to enjoy their human rights regardless of their legal status and should be given due legal protection and other assistance. The Convention also contains measures to combat illegal trafficking of labour.

This paper has been approved for debate by the Federal Conference by the Federal Policy Committee under the terms of Article 5.4 of the Federal Constitution. Within the policy-making procedure of the Liberal Democrats, the Federal Party determines the policy of the Party in those areas which might reasonably be expected to fall within the remit of the federal institutions in the context of a federal United Kingdom. The Party in England, the Scottish Liberal Democrats and the Welsh Liberal Democrats and the Northern Ireland Local Party determine the policy of the Party on all other issues, except that any or all of them may confer this power upon the Federal Party in any specified area or areas. If approved by Conference, this paper will form the policy of the Federal Party, except in appropriate areas where any national party policy would take precedence.

Many Liberal Democrat policy papers contain proposals which would change the way public money is spent. Many also involve passing new primary legislation. Clearly, in a single parliament, it might not be possible to implement all of our policies. Therefore, at the time of a General Election, the Liberal Democrats produce a manifesto which details specific spending and legislative priorities should the party be elected to government. This means that no proposal in this paper should be taken as a guarantee or as a spending commitment for a first parliamentary term until it has been published in a fully costed manifesto containing our priorities and guarantees.

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Note: Membership of the Working Group should not be taken to indicate that every member necessarily agrees with every statement or every proposal in this Paper.

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