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Coercion or Cooperation: Social Policy and Future Trade Negotiations

*Michael Hart**

If carefully managed, unilateral action can spur multilateral agreements — just as a multilateral commitment can facilitate politically difficult national reforms.

Steve Charnovitz, U.S. environmental and social activist.

In 1988, in the heat of the Canada-U.S. free-trade debate, trade analysts maintained that trade policy and trade agreements had nothing to do with social policy and programs. The standard reply to the charge that the Canada-U.S. Free Trade Agreement (FTA) would erode Canada's social safety net was the assertion that trade agreements did not deal with social programs and any suggestion to the contrary was irresponsible and uninformed. In a narrow sense, that was true. Historically, social policy had never been an issue in negotiating and implementing trade agreements. Trade agreements dealt with the policies and programs that governments use to influence the quality and quantity of goods, services, investment and technology that flow across national frontiers. That is still what trade agreements are largely about. But, slowly and steadily, we are beginning to recognize that in a globalized economy where borders have been largely erased, the policies and programs that now influence decisions about where to invest and to what purpose are influenced by a much broader range of government policies and measures. As a result, governments are beginning to look at this broader range of measures and are likely to negotiate about them in order to reduce conflict arising from differing approaches.

Social policies will not escape this broader scrutiny. The primary goal of trade liberalization agreements is to reduce barriers to international transactions and thus contribute to economic growth and prosperity. Meeting these goals has social impacts which, as the global economy becomes more open and integrated, will become sharper and more important. Traditionally viewed as external to trade negotiations, social policy issues may now have to become more integral to them in order to safeguard the ability of governments to continue to pursue trade liberalization while at the same time promoting the social and economic welfare of their citizens.

One of the reasons it was possible to dismiss a direct social policy/

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trade policy interface in 1988 was that populist critics of the FTA made such extravagant claims based on rather heroic assumptions. As a result, it was possible to ignore the more subtle aspects that now need to be considered.¹ Recent discussion of the future multilateral trade agenda prior to the signing at Marrakesh of the new GATT agreements, however, made it clear that the issue has gained, if not economic currency, at least greater political urgency. The United States, with some support from the EC and other members of the Organization for Economic Cooperation and Development (OECD), is insisting that GATT begin to address the interaction of two social policy issues with trade: environmental protection and labor standards. LDCs have so far quite properly and successfully resisted these calls. They are right to resist the agenda as currently defined and perceived. Properly defined, however, as a result of more serious analytical work which takes into account the changing nature of the organization and structure of international trade and production, the issues are likely to be joined, less for economic than for political reasons. The perceived impact of the two sets of policies on each other can no longer be ignored.

Social policy is thus part of a new class of issues arising from what Sylvia Ostry and others have called system friction. It is in effect an argument of reaching for a second-best solution in order to avoid much worse. Governments will respond to the pressures generated by groups disadvantaged by the forces of globalization and will address the policies perceived to be the most immediate causes of such disadvantage. The governments of economically powerful states will seek to implement solutions that export their political problems, i.e., that will penalize the divergent policies practiced in other jurisdictions. In many cases, this will involve new barriers to trade. To forestall such distortions, it makes sense to consider negotiating international rules — globally or regionally — that constrain the ability of powerful states to act unilaterally. In return, smaller states may need to bring their policies more into line with those of the powerful. In short, in order to avoid the tyranny of coercion by the powerful, it may be in the interest of smaller countries to behave cooperatively and thus constrain the coercive capacity of the powerful. The challenge is to find the balance between coercion and cooperation that will appeal to the political needs of both the small and the big.

The political basis for this new direction in trade policy is much more robust than its economic foundations. The impact of differing regulatory regimes on levels of trade, investment and production can easily be exaggerated. In the case of subsidies, for example, analysts have long concluded that the economic impact of various subsidy practices is

¹ See, e.g., CANADIAN COUNCIL ON SOCIAL DEVELOPMENT, *FREE TRADE AND SOCIAL POLICY* (Glenn Drover, ed., Ottawa 1988) for a good example of this kind of intemperate analysis.

usually quite marginal, but such studies have had little impact on the ability of affected industries to make a convincing political case for countervailing duties.² More recently, industries have begun to argue about the unfair impact of differing environmental regulations, despite the rather feeble empirical base for their assertions.³ Next we may see some clever trade lawyer argue that the absence of a comprehensive social welfare net and the corresponding tax burden constitutes an unfair trade advantage. During the debate about the North American Free Trade Agreement (NAFTA), opponents insisted that countries with different levels of social safety nets could not trade with one another under conditions of free trade. Research will probably show the rather marginal impact of differing social programs on trade and investment flows, but this will have little impact on the calls by embattled special interests for government action to protect them from what is characterized as unfair competition.

There is, in addition, a moral dimension. Environmentalists are convinced that it is the moral duty of the state to take positive steps to protect the environment and to ensure that internationally involved industries cannot escape from such regulation through relocation. Similarly, human rights activists are convinced that trade sanctions can be used as an effective means to improve the observance of human rights throughout the world while labor leaders believe that minimum levels of labor legislation should be universally applied and enforced through trade instruments.

In effect, the old debate about fair trade has now entered a new and more dangerous phase. A whole range of policy differences among states are now being cited as creating unfair competition which must be countered with measures that safeguard one's own policy choices while keeping the "unfair" competition created by other societies' choices out of the market. An old idea is being retooled for today's circumstances. The choice is either to tolerate new forms of protection or set out to negotiate new rules to keep protectionism at bay.

As national frontiers become increasingly porous and even irrelevant and governments respond with new forms of international cooperation to reduce potential conflicts, the scope for independent political action steadily narrows. Signature of each new international agreement may reflect a sovereign choice, but the reality is that for many countries, the choice is more theoretical than real. Thus the issues raised by the interaction of trade and social policies are both appropriate to a conference on sovereignty and compelling to anyone interested in either trade or social policy.

² See Michael Hart, *The Canada-U.S. Working Group on Subsidies: Problem, Solution or Opportunity?* (Occasional Paper, Centre for Trade Policy and Law, Ottawa, 1989).

³ See Michael Hart, *Trade and the Environment: Dialogue of the Deaf or Scope for Cooperation?*, in 18 Can.-U.S. L.J. (1992).

Unfortunately, studies analyzing what is involved and what can usefully be done are only beginning to be undertaken. At this stage, therefore, it is too early to provide much in the way of startlingly new insights or compelling new arguments as to why we need to consider negotiating new international agreements that address the social policy/trade policy interface. Nevertheless, it is clear that we are headed in that direction. Whether social policy issues will be negotiated as integral aspects of the trade agreements of the future or whether international instruments on social policy issues will be negotiated on their own merits is less clear. In either case, however, trade negotiators will need to begin developing appropriate cross-walks between trade and social policy issues and trade analysts need to provide government with the least distorting options.

As such, we cannot go much beyond examining the context which has given rise to the expectation that social policy and trade policy need to be addressed jointly and more coherently in international agreements, the kinds of questions this expectation must give rise to, the differing kinds of political and analytical approaches that can be taken to these questions, and the contours of a practical research and discussion program that will help us think our way through these issues.

I. WHY NOW? — GLOBALIZATION, TRADE AND SOCIAL POLICY

Interaction between trade and social matters, of course, is not new. Trade takes place within a social and political institutional setting — domestic and international — that influences who trades what with whom. In one direction, social issues can raise concerns about the terms of trade, i.e., the issue of fair competition in terms of both exports and imports. In the other direction, there are concerns about the effects of trade on the environment and workers. Trade policy decisions, therefore, affect social policy decisions and vice-versa. Government decisions about social programs, for example, will influence firm investment behavior and thus affect future trade and investment flows. Social policies such as labor market regulations, training programs, environmental protection laws, health care systems or income support programs all influence a society's capacity to respond to structural changes, and the pressure of structural changes will in turn affect the design and delivery of such programs and policies.

There is thus a complex interplay between social issues and trade issues. What is new is the extent and intensity of international transactions and their capacity to influence matters that were traditionally addressed wholly within the confines of the nation state. In the case of product and process standards, for example, "increasing world economic integration through international trade has resulted in increasing conflicts . . . In a given country, relatively high product standards may

restrict imports while comparatively low process standards may increase exports.”⁴ As a result, producers and their governments now have a greater interest in the social policy decisions made by other governments because such decisions are now perceived to have more immediate impacts on their welfare.

Globalization is thus the key to the new urgency in discussions about the interaction between trade and social issues. Narrowly defined, globalization involves a quantum leap in the internationalization of the production, distribution and marketing of goods and services. More loosely understood, however, it invokes a wide variety of political, sociological, environmental and economic trends based on the processes that bring people and places together in more frequent contact, more sustained contact and more varied contact. The globalization experience of the past few decades has led to a much wider interpretation of what it means to live in an open economy.

For many firms, the organizational breakthrough that has made globalization possible is the ability to disperse economic activity geographically and bring it together electronically. Its realization has led to spectacular growth in the internationalization of services, particularly financial services, and the further disaggregation of manufacturing. As a result, the future for the advanced industrial economies no longer lies in standard-technology manufacturing that relies on economies of scale to reduce costs and maintain competitiveness, but in a much more sophisticated strategy combining the best in technology, skills, management and policy. The key to each is information and the key to the intelligent use of information is the computer. Adopting computer-based manufacturing and management systems can increase the productivity of workers, managers and administrative support personnel alike, decrease the cost of labor, materials, waste disposal, service and sales, improve the quality of products and after-market service, increase the control of production through inventory control and waste management and increase customer satisfaction through improvement in the quality and differentiation of products and services. The key to success in manufacturing in the new economy is to integrate the new technologies with suitable management and production practices, i.e., integrating the new machinery with the appropriate skills and management mix.

These developments are leading to fundamental changes in the nature of work and the structure of wages and income distribution involving a slowdown in the rate of growth of incomes in industrialized countries, an increase in the inequality of incomes, and a significant increase in the premium for education. Unskilled labor is now in oversupply on

⁴ George Foy, *Toward Extension of the GATT Standards Code to Production Processes*, 26-6 J. OF WORLD TRADE 121 (Dec. 1992).

a global basis and skilled/knowledge-intensive labor is in short supply.⁶

The literature suggests that there were three basic catalysts to the acceleration of globalization: the steady liberalization of trade and investment among industrialized countries after the second world war through a combination of multilateral and regional arrangements and unilateral measures, the more recent rapid industrialization of the third world,⁶ and the impact of technological changes that have brought down the costs of transportation and communication.⁷ The effect of these three factors has been mutually reinforcing and cumulative.⁸ Of these three factors, the phenomenal reduction in transportation and communication costs has made feasible much of the exponential growth in the activities of financial markets, global firms and strategic alliances. The GATT-based trade regime helped to underwrite this technologically driven integration, while more recent government efforts to negotiate deeper liberalization and fixed-rule regimes are further reinforcing the process of globalization.

The resultant restructuring of global and domestic economies has generated pressures for change that run against the grain of public preferences. Keith Banting notes that "the growing integration of world markets increasingly constrains the autonomy of individual nations, eroding their political and social sovereignty; and the dramatic rise of newly industrializing nations has created an intensely competitive international trading system."⁹ These phenomena are leading to two contra-

⁶ See Richard G. Harris, *Globalization, trade and income*, 26:4 CAN. J. OF ECON., 755-776 (1993) for a good discussion of these factors. In considering these developments and their impact on trade and social policy issues, it is important to distinguish between the ebb and flow in the fortunes of individual companies, cyclical forces, and the more fundamental structural changes taking place. In this paper, it is the latter that is the focus of attention.

⁶ See, e.g., ADRIAN WOOD, *NORTH-SOUTH TRADE, EMPLOYMENT AND INEQUALITY: CHANGING FORTUNES IN A SKILL-DRIVEN WORLD* (Oxford: Clarendon Press, 1994).

⁷ See, e.g., CHRISTOPHER FREEMAN & LUC SOETE, *INFORMATION TECHNOLOGY AND EMPLOYMENT* (IBM Europe, Bussels 1994).

⁸ Studying the phenomenon of globalization has blurred the lines between various economic subfields; labor, public finance, industrial organization, monetary and trade all need to be considered to gain a coherent understanding. Social scientists have been slow to respond, reeling under the mass of new information undermining the comfortable assumptions that underpinned older theories. Part of the problem in trying to get a handle on the issue of trade and social policy is that much of the analysis is taking place from within a paradigm that just does not reflect reality. Formal trade statistics, for example, no longer capture the reality of the range and depth of international transactions taking place within firms and within networks of firms. The transmission of ideas about design, engineering, advertising and sales through sophisticated computer networks represent international transactions, but are not fully reflected in the trade figures. As a result, there is a great deal of confusion or what Richard Harris calls "unconstrained theorizing." For the policy makers, this creates a double bind. There are so many conflicting theories offered by the experts that it is difficult to know which way to turn while virtually any possible policy choice can be theoretically justified. See Harris, *supra* note 5.

⁹ Keith Banting, 13:2 *Neoconservatism in an Open Economy: The Social Role of the Canadian State*, INT'L POL. SCI. REV. 152 (1992).

dictory pressures: a pressure to redistribute income to reduce the adjustment costs borne by economically weak but politically strong members of society and a need to reconfigure the social welfare system and bring it more into line with fiscal reality. In effect, the globalization of production is adding to the cost of government social programs while simultaneously curbing government's ability to generate revenues. Cost-conscious firms are successfully pursuing location and investment strategies that minimize their tax exposure at the same time as displaced workers are calling for more retraining and income-support programs. In virtually every OECD country, the share of government revenue derived from the corporate sector is declining while the share of government expenditure devoted to social programs is rising.¹⁰

II. GLOBALIZATION AND THE END OF THE KEYNESIAN CONSENSUS

The recession of the early 1990s has exacerbated the structural problems already evident in the 1980s and has added to growing anxiety about the impact of globalization on individuals and firms and the capacity of the state to pursue and protect national priorities, values and welfare. During the two decades after the second world war, largely in response to the crises of depression and war, governments in the OECD countries forged a series of interlocking policies and programs that provided the basis for a rising living standard for all segments of society. This so-called Keynesian consensus, based on large national firms, unions, and activist governments, created national economies that delivered high productivity, consumerism and social welfare. This consensus has now begun to fray under the onslaught of globalization. Union power has declined and social safety nets are being challenged under the pressures of cost competitiveness and fiscal restraint. Not only are the programs being questioned, but so are many of the intellectual and policy assumptions that went with that consensus. Keynesian demand management was critically dependent on the maintenance of a largely self-contained national economy. Interdependence has now changed the rules of the game, and labor, for example, now faces the unpalatable requirement of having to compete on a broad scale across frontiers. The desire is to avoid this choice through managed trade, i.e., to rediscover a way to take wage structures out of competition. It is a choice that governments cannot make but that poses a genuine dilemma.¹¹

As we saw above, the fundamental structural changes undermin-

¹⁰ See OECD OBSERVER, various issues, which tracks these numbers on a regular basis.

¹¹ See Ray Marshall, *Labor in a Global Economy*, in *LABOR IN A GLOBAL ECONOMY: PERSPECTIVES FROM THE U.S. AND CANADA* (Steven Hecker & Margaret Hallock, eds., University of Oregon, 1991) for an excellent discussion of the problems faced by labor in the new circumstances of a globalizing economy.

ing the Keynesian consensus can be traced to changes in the technology and organization of production. The dominant business strategy of the Keynesian era was mass production, achieved through the specialization not only of labor but even more of resources, management and machines. The extent to which this strategy could be implemented was dependent on final demand which is why demand management was key to the Keynesian consensus. The cost of specialization requires very high levels of production. "Mass production as a business strategy is thus typically accompanied by organizational approaches and marketing techniques designed to stabilize the business environment and maintain large, growing, and predictable markets for standardized goods."¹² The main variable for management is the length of the production run, so that it is possible to accept a labor market that takes wages out of competition. In fact, high wages have the desirable aggregate effect of increasing demand and thus the length of production runs. It also puts a high premium on stability. Unions may be a nuisance but high wages and fringe benefits keep workers on the job and high wages in turn stimulate high demand for the products of mass production.

This stable business strategy has been shattered by new information processing technologies and the consequent disaggregation of production and fragmentation of markets. Rather than productivity improvements flowing from access to natural resources and economies of scale, they now come from improvements in human resources and more effective ways to organize production. More fundamentally, national governments can no longer exercise their traditional control over the national economy and use domestic levers to promote high wages and full employment. The role of government remains important, but the old levers are no longer available and new ones remain to be devised.

The past two decades have thus seen the unraveling of the old strategies based on Keynesian macro-economics and Galbraithian industrial planning. Peter Dorman complains that "in practical terms, the consequences of the new global economy are continuing wage erosion, the deterioration of working conditions and social benefits, the loss of millions of jobs, particularly in manufacturing, the increasing difficulty in expanding or even maintaining levels of unionization, and the emergence of new pools of low-wage labor in secondary markets — the first world's Third World."¹³ These changed conditions fundamentally alter the structures and policies necessary for welfare and prosperity. They now require that societies make more effective use of the new

¹² Michael Piore, *Labor Standards and Business Strategies*, in S. HERZENBERG & J. F. PEREZ-LOPEZ, U.S. DEP'T OF LABOR, *LABOR STANDARDS AND DEVELOPMENT IN THE GLOBAL ECONOMY* 40 (1990).

¹³ Peter Dorman, *Trade, Competition, and Jobs: An Internationalist Strategy*, in *LABOR IN A GLOBAL ECONOMY* 64 (Hecker & Hallock, eds., 1991).

factors: quality, productivity and flexibility. The latter, especially in the use of workers and machines, is critical to future productivity growth and to competitiveness, more so than lower costs. Ray Marshall notes, "technology makes new organizations of production possible, but competition makes them necessary."¹⁴ Firms can compete in the global economy either by reducing costs or by becoming more productive or a combination thereof. Increasingly, they are re-organizing production in order to achieve quality, productivity and flexibility, all of which mutually reinforce each other. The role of workers in these re-organized facilities is very different. They need to be more flexible and knowledgeable, participate in many more decisions and contribute to the design of products and processes alike, based on their knowledge and experience.

The structural changes taking place in response to these demands have exerted considerable pressures on government social programs and on governments' capacity to continue to shoulder the fiscal burden of the welfare state. Thus, while the problems being experienced in virtually all OECD economies derive from a complex array of factors, they are being transmitted more rapidly throughout the OECD as a result of the increasing ease of transnational economic transactions. To people disadvantaged by these structural changes, the solution is simple: slow down and manage the transmission of these pressures through international transactions. The inability of the intellectual community to come up with politically more attractive policies has added to the political credibility of these simple answers.

III. LEFT AND RIGHT SQUARE OFF

Globalization has thus fundamentally altered the context within which governments and other social institutions must function. Analysis of the challenges posed for governments and society by globalization falls broadly into two competing perspectives. On one side stand those who fear that global competition threatens a race to the bottom as unprincipled and unbridled competition erodes labor and other national standards. In their view, this threat must be met with a concerted effort to maintain standards that will promote economic and social development, nationally and internationally. On the other side stand those who insist that excessive standards create distortions that undermine the capacity of firms in one jurisdiction to compete with others in the global market. In their view, governments should act to reduce or eliminate unnecessary regulations, including those of labor markets. These two schools represent the classical divide between emphasis on allocative efficiency and distributive fairness. The efficiency school contends that unless market forces are allowed to operate relatively freely, distortions

¹⁴ Ray Marshall, *Labor in a Global Economy*, in *LABOR IN A GLOBAL ECONOMY*, *supra* note 11, at 14.

will reduce efficiency, growth and prosperity for all; the equity school champions the synergistic effect of various distributive strategies on the modes of production and the scale of consumption.¹⁵

These two perspectives can be characterized in a variety of ways: left versus right, libertarian versus socialist, equality of opportunity versus equality of result, populist versus corporate or efficiency versus equity. Within the social sciences, economists tend to cluster at the efficiency end of the spectrum while sociologists are usually to be found at the equity end with political scientists somewhere in between. Of course, there are economists who emphasize equity considerations in their analysis and sociologists who are aware of the need for efficiency, but the subject matter of each discipline disposes where its practitioners are likely to find themselves on the ideological spectrum. Economists emphasize the benefits of markets, sociologists see reality in terms of class struggle, while political scientists concentrate on institutions and political structures. For a cross-cutting issue such as the interface between trade and social policy, these competing analytical systems tend to color much of the analysis and search for solutions. In terms of influence on public policy, the views of economists have long been dominant in the area of international trade while the sociologists have been the analysts of choice in the design of many social programs. In the new circumstances of a globalized economy both may need to learn from each other in devising solutions that last.¹⁶

¹⁵ For a discussion of these two perspectives in the context of labor standards, see Stephen A. Herzenberg, Jorge F. Perez-Lopez & Stuart K. Tucker, *Introduction*, in *LABOR STANDARDS AND DEVELOPMENT IN THE GLOBAL ECONOMY* (1990).

¹⁶ We live in an age of specialization, including in the academic community. Specialists, expert in increasingly small slices of reality, rule the day. Not only do we have robust departments of economics, political science and sociology, but within these disciplines, sub-fields have become as isolated from each other as the main disciplines have from other intellectual pursuits. Cross-disciplinary studies, much in vogue a few years ago, are now dismissed as the work of dilettantes. As a result, the academic community is filled with erudite tree inspectors lost in the forest of reality. Borrowing from literary criticism, social scientists have learned to deconstruct society into its most minute aspects, but like English professors, they similarly fail to appreciate that the whole is more than the sum of its parts. With a few notable exceptions, most of the social scientists who write about economic policy issues, the functioning of the economy and the role of government know little about business and government. A great many economists, for example, write about the way the economy functions on the basis of statistics rather than an intimate knowledge of the firm and how it operates. Many political scientists write about government decision-making without ever having read a cabinet memo or talked to a civil servant. This characteristic of academic analysis is particularly true of those on the ideological extremes where well-developed theoretical frameworks do not leave much room for the shades of gray that would enter with real-world observation and knowledge. Even centrist analysts, however, when they stray from their little slice of specialized knowledge, are most comfortable fitting the rest of their analysis within the confines of well-trodden academic paradigms rather than pursuing the common sense observations that rule the rest of their lives. When it comes to their academic work, they reason that common sense is a most unreliable guide because it is so common. An interesting description of the shortcomings of mainstream economic analysis can be found in WILLIAM LAZONICK, *BUSINESS*

The efficiency school, which places its faith in markets and individualism and which provided the intellectual underpinning for the GATT and other postwar international economic institutions, sees the extension of the market model as critical to future global economic growth, providing an ever-expanding pie through specialization and the international division of labor. The equity school, on the other hand, looks to the establishment of a global economy that in many ways replicates internationally the success of the national Keynesian economy of the 1950s and 1960s. It would require the establishment of institutional and regulatory structures internationally to guide the harmonious development of mutually reinforcing social and economic goals at a global level.

A major difference between the efficiency and equity schools is their view of the role of the state. The efficiency school concedes an important place to government in the establishment and maintenance of standards — whether for health care, education, housing or urban planning — but believes that the private sector is best placed to provide these societal services on a competitive basis. Governments should be involved in their delivery only in cases of market failure. For the equity school, governments should be involved not only in the design of standards, but also in the delivery of programs on the basis of both monopoly and universal access, with payment coming through a progressive tax system, thus reserving to the state two sometimes conflicting responsibilities. To the efficiency school, government should be involved in establishing an appropriate framework through both macro and regulatory policies within which the private sector can function effectively and efficiently (i.e., concentrate on the supply side of the economy and on promoting allocative efficiency) while the equity school is more interested in government using its powers to manage demand (i.e., the promotion of distributive justice).

A second strand is a moral one: free-market forces, while highly suited to the creation of wealth, are less well suited to addressing the question of its equitable distribution. Government policies, therefore, are directed to responding to the demands for equity, based on a democratic consensus on what that might be at any one time. There is always a delicate trade-off between the search for efficiency and equity. Too much of one will tend to harm the other. Finding the balance between equity and efficiency is made immensely more complicated in an integrated global economy where the coincidence of boundaries between political and economic markets has broken down.

Much of the debate between left and right is thus whether the economic or political market will be the ultimate determinant of social choices. To libertarians, only by letting consumers have choice can we

preserve freedom; the path of governments deciding who will produce what and who will consume it not only robs the consumer of choice, but ultimately threatens political liberties as well. Thus to neo-conservatives like David Frum, George Gilder and Michael Novak, traditional political rights should not be diluted by the acceptance of new economic and social rights.¹⁷ Political liberty can only be preserved on the basis of governments that recognize both their limits and their duties. The main function of government is to preserve the rule of law, guarantee the protection of private property and underwrite social order and security. To them, the Keynesian consensus contained the seeds of its own demise. Rather than realizing its goal of socializing the means of production, it succeeded in socializing the means of consumption. In Canada, for example, the state considerably expanded its role from that of promoting economic development to that of guarantor of a rising level of social security and an amenable lifestyle through an increasing array of programs. As a result, political rather than economic factors govern levels of consumption, a situation that is ultimately not sustainable.

To analysts like Frum, Gilder and Novak, the difference between the economic and political market is that in the economic market, prices bear a relationship to cost and therefore exert a discipline on consumer choice that is absent in the political market; indeed, in the political market, many have become convinced that there is no price tag; someone else will pay for the goodies distributed by a benevolent government. The crisis of the industrialized democracies today is that the profligacy of Keynesian demand management has come home to roost. There are not enough plutocrats to pay for the benefits voted by the proletariat. Social activists continue to believe there is unlimited wealth to tap in the corporate sector but to the previous limits imposed by falling returns to entrepreneurship must now be added the ability of most entrepreneurs to escape to a less constraining environment to pursue their interests. Neo-conservative thinkers like Gilder further suggest that, ironically, the strongest support for the welfare state comes not from the working classes and the poor, many of whom have visions of making it in the market economy, but from the media-bureaucratic university community, i.e., from those with secure salaried positions who are dependent on providing many of the services and programs of the welfare state.

Their view is not shared by all economists and is hotly contested

¹⁷ See, e.g., DAVID FRUM, *DEAD RIGHT* (Basic Books, 1994); GEORGE GILDER, *RECAPTURING THE SPIRIT OF ENTERPRISE* (ICS Press, 1992); and MICHAEL NOVAK, *THE SPIRIT OF DEMOCRATIC CAPITALISM* (Simon and Schuster, 1982). The thinking of Gilder, Novak and other leading members of the neo-conservative movement is well-captured by GARY DORRIEN, *THE NEOCONSERVATIVE MIND: POLITICS, CULTURE AND THE WAR OF IDEOLOGY* (Temple University Press, 1993).

by many political scientists and most sociologists. Neo-institutional economists, for example, insist that properly conceived and applied international and domestic labor standards can be important tools for ensuring that economic and social development are mutually reinforcing and harmonious. Scholars like Michael Piore, Ray Marshall and Patricia Marchak believe that the neoclassical market model distorts the reality of national markets and how they interact internationally. In reality, national economies consist of a set of institutional arrangements that simultaneously perform political, social and economic functions. In their view, efficiency is a dynamic rather than static concept and is influenced by institutional factors such as business organization and the regulatory framework. Piore argues, for example, that labor standards can force business to turn to productivity and quality-based strategies rather than the low-cost competition that flows from unfettered market forces.¹⁸

For neo-institutionalists, it is the proper role of government to devise a regulatory framework which will allow both social and economic goals to be achieved in a synergistic manner and to block undesirable business strategies. They argue that the broader institutions of society, including government, provide the context within which industrialization takes place. In the post-war period, national systems of interlocking macro and micro policies and other aspects of governance created unique patterns of national economic development. They argue that in most OECD countries, high standards and wages increased aggregate demand and induced higher employment. As a result, they take comfort from the lessons of the so-called Golden Age of industrialization in the OECD countries — the period of the Keynesian consensus — when high standards and wages prevented a second outbreak of the underconsumption and depression that had characterized the 1930s. The trick now is to replicate these conditions at a global level or protect national economies from the inroads of globalism.

An important determinant of one's analysis of these issues is one's view of the role and influence of government policies in determining international trade and investment flows and the success or failure of firms and industries. This in turn leads to different views of the desirability of international negotiations to reduce the policy differences between governments. There are various interventionist schools who are convinced that the role of government is determinative and can be deployed strategically to provide nations with competitive advantages increasing national rents from trade; there are others who are willing to concede an important influence to government policies but argue that

¹⁸ See, e.g., RAY MARSHALL, *UNHEARD VOICES: LABOR AND ECONOMIC POLICY IN A COMPETITIVE WORLD* (Basic Books, 1987); MICHAEL PIORE & CHARLES SABEL, *THE SECOND INDUSTRIAL DIVIDE* (New York: Basic Books, 1984); or PATRICIA MARCHAK, *THE INTEGRATED CIRCUS: THE NEW RIGHT AND THE RESTRUCTURING OF GLOBAL MARKETS* (McGill-Queen's Press, 1991).

the effect is rarely the same as the desire. The world of international trade and investment would probably be better off with less rather than more government intervention. Finally, there are those who believe that government regulatory activity provides influence only at the margin.

One of the problems with issues of this kind, of course, is that the theorists tend to pose the problems and solutions in black and white terms, whereas reality involves many shades of gray. A lot of the problems of strategic trade theory, for example, flow from the tyranny of trying to find an explanation that can be modeled. Theoretical analysis may help us to understand reality better, but it rarely provides a satisfactory basis for designing practical solutions. In an imperfect world of human institutions requiring compromise, the challenge is to find approaches that reflect a reasonable degree of reality. The 1947 GATT, as conceived and as it grew, represented such a solution, but no longer reflects reality nor a sufficient solution to the problems of the day.

Today's political reality is that while there is wide global convergence around macro-economic neo-classical prescriptions because it was learned, often painfully, that the Keynesian consensus had limited application in an open economy, there continues to be broad support for many of the components of the welfare state. Therein lies part of the challenge faced by the trade policy community. The trade and payments system conceived in the 1940s exercised neo-classical disciplines on its members' macro-economic and border policies but left room for Keynesian experimentation within their respective domestic economies. Now that national economies have become much more integrated into a single global economy, the contradiction between the two regimes has become painfully apparent. The crisis in the advanced industrial economies, therefore, is how long the welfare state can remain intact in an open global economy. The efficiency school insists that it is not sustainable, while those espousing equity maintain that it must and it can be sustained through a variety of active labor and adjustment policies and other forms of government intervention and planning.

It is thus not difficult to appreciate why the forces of globalization have now disposed both left and right to consider the need for rules about social issues in international trade agreements, although for very different reasons and for achieving very different goals. The focus today is on the two squeaky wheels of environmental and labor issues, but it will enlarge to a broader range of social policy issues as awareness of the reality of a global economy grows. For the right, international rules can be used to create a level playing field, disciplining governments from capriciously interfering in the efficient operation of the market. For the left, the ideal line of defense is to isolate national economies from the rigors of competing in the international economy so that governments remain free to maintain their own social programs; that is

why populist, left-wing groups mounted such a virulent attack on the Canada-US FTA in Canada and on the NAFTA in the United States; both agreements threaten a potential loss of control. Having conceded, however, that the clock is unlikely to be turned back, they now see the next challenge to be the negotiation of international agreements that can be used as instruments to create a universal Keynesian welfare state, guaranteed by international treaty. Their revised preference can be seen in the call for agreements enforcing environmental protection and international fair labor standards. Like conservatives, they can appreciate the utility of international rule-making to reinforce their goals domestically.

The task will not be easy. If any of the various analytical models of economic growth and development were fully persuasive, then it would be a relatively simple task to make policy that would ensure desirable ends and a better future. But we cannot even agree about the past, let alone predict the future. Each model provides insight into an aspect of the human condition, some doing a better or more convincing job than others. Because reality is constantly changing, is infinitely complex and involves many variables, we never quite capture the whole. The task of devising policy is made even more complicated by the fact that we constantly confuse the positive and normative dimensions of the various slices of reality under scrutiny. As Arthur Okun has argued:

A democratic capitalist society will keep searching for better ways of drawing the boundary lines between the domain of rights and the domain of dollars. And it can make progress. To be sure, it will never solve the problem, for the conflict between equality and economic efficiency is inescapable. In that sense, capitalism and democracy are really a most improbable mixture. Maybe that is why they need each other — to put some rationality into equality and some humanity into efficiency.¹⁹

IV. IS THERE AN ECONOMIC CASE?

Given the cacophony of conflicting voices in the academy, is it possible to construct an economically convincing case for integrating social policy disciplines into trade agreements? From the perspective of neo-classical economics, the answer would appear to be a resounding no.²⁰ Neo-institutionalists, on the other hand, are ready to tackle the project, even if it places in jeopardy the open, multilateral trade regime so care-

¹⁹ ARTHUR OKUN, *EQUALITY AND EFFICIENCY: THE BIG TRADEOFF*, 120 (The Brookings Institution 1975).

²⁰ See, e.g., William Watson, *A Skeptical View of the Social Charter*, in *TIES BEYOND TRADE: LABOR AND ENVIRONMENTAL ISSUES UNDER THE NAFTA* (Jonathan Lemco & William B.P. Robson, eds., C.D. Howe, 1993).

fully built up over the past fifty years. Other analysts, not convinced that either of these schools of thought represents a wholly satisfactory explanation, are reconsidering the theoretical underpinnings of mainstream economics in an effort to gain a better understanding of the nature of global commerce and its role in economic growth and development.

Ever since the days of Alfred Marshall, economic analysis has been dominated by those trying to perfect a general theory that assumes a highly stylized world of perfect competition among individual producers and consumers. The objective is to understand the forces that keep the economy in equilibrium. Mainstream economics has managed to accommodate some of the insights of dissenters like Schumpeter and Keynes, but the core of the faith has remained rigorously neo-classical, even in the face of a growing gap between theory and reality. The areas of change that are critical to understanding the globalization of the economy — changes in the technology and organization of production and in the institutional and governmental setting — are all areas that mainstream economic analysis has had difficulty integrating into its theoretical framework. As noted by William Lazonick, "Mainstream economics contains no theory of innovation and no theory of competitive advantage . . . [while] history shows that the driving force of successful capitalist development is not the perfection of the market mechanism but the building of organizational capabilities."²¹ Thus it is analysts who are skeptical of the claims of neo-classicism who are at the forefront of those trying to understand the momentous changes taking place around us, including important work on growth theory, trade, industrial organization, technology and more. The result is an exciting period of debate in the academy but confusion in governments and elsewhere as various new schools of thought offer often conflicting policy advice.²²

What is missing is a satisfactory general theory that builds on the

²¹ WILLIAM LAZONICK, *supra* note 16, at 7-8.

²² Stimulating analysis of the transformation taking place and its implications for both theoretical work and policy development can be found in the work of a group of scholars interested in understanding the role of technology in economic growth and development. Building on the ideas of earlier economists like Schumpeter and Kondratieff, people like Christopher Freeman, Luc Soete, Keith Pavitt, Carlotta Perez, Richard Nelson, Nathan Rosenberg, David Mowery and others are developing new insights into the nature of growth and economic development. The phrase techno-economic paradigm shift to describe this transformation was first used by Carlotta Perez and is described by her and Christopher Freeman in *Structural crises of adjustment: business cycles and investment behaviour*, in *TECHNICAL CHANGE AND ECONOMIC THEORY* (Soete et al., eds., Pinter, 1988). See also *LONG WAVES IN THE WORLD ECONOMY* (Freeman, ed., Pinter, 1984). For a Canadian perspective, see Richard G. Lipsey, *Notes on the Changing Technoeconomic Paradigm and Some Implications for Economic Policy*, Mimeo, Canadian Institute for Advanced Research, Program in Economic Growth and Policy, Simon Fraser University (1993) and Richard G. Harris, *Trade, Money, and Wealth in the Canadian Economy*, Benefactors Lecture, C. D. Howe Institute, Toronto (September 14, 1993).

central role of the market but accounts for the influence of technology, organizations and institutions and deals with the economy in its global setting. Unfortunately, none of the other schools of economic analysis provides a satisfactory alternative. Marxism is even more stylized and removed from reality than neo-classicism while neo-institutionalism, the French modes-of-regulation school and new theories on technology and dynamic growth are as yet incomplete. What is needed is someone of the stature of a Marshall or Keynes to devise a new general theory that combines the insights of these various schools and applies them to the new reality of a global economy.²³ Until then, we will have to limp along on the basis of the current state of highly debatable analysis.

Most theories of international trade, for example, assume that trade takes place between unrelated firms located in different countries, i.e., a product is exported by a willing seller located in one country to a willing buyer located in another. More and more, however, trade takes place within the firm or within strategic alliances, i.e., between branches of a single corporation or within networks of strategically allied firms, and decisions about what to invest and where are dictated by a broad range of factors. Neither existing trade theory nor current theories about the firm deal adequately with the complexities of a world dominated by large global corporations trading and investing relatively freely throughout the globe and increasingly able to evade unwelcome forms of government regulation and taxation.

It is within this new and more complex set of circumstances that we must consider whether there is now a stronger economic case for tying social policy more clearly into the disciplines of international trade agreements, with the particular case of labor standards providing the most urgent example. Consideration starts with the problems raised by the secular decline in manufacturing employment in virtually every OECD country. In terms of output, manufacturing's share of GNP has remained fairly steady over the past fifty years, but its share of employment has steadily declined. Technological developments and productivity improvements have steadily lowered the relative costs of goods and reduced the value-added that labor provides. At the same time, relatively lower productivity improvements in the service sector have led to relatively higher costs and higher requirements for labor. These two secular movements have steadily increased the share of GNP and em-

²³ To be fair, that is exactly what Richard Lipsey and his colleagues are working towards at the Canadian Institute for Advanced Research. See, e.g., RICHARD LIPSEY, CANADIAN INSTITUTE FOR ADVANCED RESEARCH, *ECONOMIC GROWTH: SCIENCE AND TECHNOLOGY AND INSTITUTIONAL CHANGE IN A GLOBAL ECONOMY* (Toronto, study number 4, June, 1991). Lipsey presents a devastating analysis of the shortcomings of neoclassical theory and the promise of the new growth theory. Unlike many critics of neoclassicism, however, Lipsey does not make the mistake of equating defense of the market with neoclassicism. The market, which has been the bedrock of Western economic development, rests on more secure foundations than neoclassical equilibrium theory.

ployment devoted to services.²⁴

The decline in demand for traditional jobs is, of course, typical of a period of major economic transformation. In the century since 1880, technological changes destroyed about two-thirds of the jobs then in existence but at the same tripled the number of people employed. Long-term aggregate patterns, however, contain within them a variety of less stable shorter-term and industry specific sub-patterns which give rise to the need for offsetting social policies. The social policy concern is thus not about absolute levels of employment in the long run, but the amount of churning and mismatch as some jobs disappear, others are created and people adjust to changing circumstances.²⁵

That churning has caused a lot of anger and frustration within the labor movement and that anger is creating pressure on governments to respond. Part of this anger, of course, is rooted in ideology. Many labor leaders and their intellectual advisors see the world in terms of class struggle. They identify organized labor as workers exploited by a capitalist class that seeks unfettered rights to profit and uses the state as one of its agents of coercion. In its more extreme views, existing international regimes are seen as advancing the exploitive role of the large firm, and now becoming stateless and even less responsible. Most of this line of reasoning is a populist version of Marxist economic determinism. It bears no more resemblance to the real world than the mechanistic analysis of neoclassical trade theory. Pursuing this ideological trail will do little in helping to confront the real issue of trying to find a balance in the pursuit of conflicting trade and social policy objectives.

But this anger is also rooted in the genuine hardships flowing from globalization. To get costs down, firms are lowering wage costs, changing the structure of work and work rules, closing down inefficient facilities, and raising productivity through capital improvements, technological innovations and relocation. The resulting labor relations atmosphere is chaotic and strained. Even more to the point, the labor movement is trying to come to grips with the fact that the wage gap is becoming increasingly real between high- and low-wage countries as modern technology and management techniques are wiping out the productivity gap and modern, low-cost transportation and communications technologies make location a less critical factor. Organized labor fears that

²⁴ See Paul Krugman, *Competitiveness: A Dangerous Delusion*, 73-2 FOREIGN AFF. (1994) and Paul Krugman and Robert Lawrence, *Trade, Jobs and Wages*, SCI. AM., April 1994 at 44-49.

²⁵ See Fred Wien, INSTITUTE FOR RESEARCH ON PUBLIC POLICY, *THE ROLE OF SOCIAL POLICY IN ECONOMIC RESTRUCTURING* (Halifax, 1991). There are, of course, other factors at play which affect aggregate levels of employment, including labor participation rates influenced by demographic patterns, women entering the work force, length of education, availability of alternate sources of income through various social programs, and more. For a good discussion of long-term trends in economic growth and development over the past century, see William J. Baumol, Sue Anne Batey Blackman and Edward N. Wolff, *PRODUCTIVITY AND AMERICAN LEADERSHIP: THE LONG VIEW* (The MIT Press, 1989).

based on current trends, it will not be long before most demand in OECD economies can be satisfied either by large, highly automated factories running 24 hours a day on the basis of a few managerial and maintenance workers, or by imports produced in low-cost labor countries. At the aggregate level, the introduction of labor-saving technology generates new kinds of labor requirements, productivity improvements and cost reductions, but such changes also have effects on distributional and employment patterns which cannot be ignored by governments.²⁶

Within organized labor and among analysts who share their concerns, there is a clear split between those who believe that the difference in wage structures is the crux of the matter and those who recognize that differences in wage structures are a normal reflection of different national and regional endowments. To these more moderate analysts, different wage levels are acceptable as long as they are freely arrived at and are not the product of coercive institutional and governmental factors. In OECD economies, well developed labor and other laws ensure that wages reflect a non-coercive labor market; such is not always the case in developing or low-wage economies.²⁷

For more militant members of organized labor, the preferred strategy is to continue to isolate national economies from low-wage international competition so that wage and related labor-market issues can be addressed within the limits of a single national economy. To ensure compliance, trade would only take place among economies at similar levels of development and be managed on an agreed basis among those countries. For more moderate analysts, however, a more practical approach is seen to lie in the promotion of workers' rights at a global level and their enforcement through trade agreements. Five workers' rights, recognized as such by the International Labor Organization (ILO), are considered central to the development of proper international stan-

²⁶ See Wien, *THE ROLE OF SOCIAL POLICY*, *supra* note 25, for a more detailed discussion of this problem.

²⁷ Of course, if the object of the game is to raise standards in those countries, the evidence suggests that the best way is to trade with them and let economic development lead to internal pressures for higher standards. Gary Fields indicates that the evidence in a range of LDCs suggests that the imposition of labor standards, particularly relating to minimum wages and working conditions, leads to higher labor costs and lower employment. The Far East experience is that workers benefit most from government efforts that encourage investment in labor-intensive activities within a framework that lets markets dictate outcomes. The data is compelling. Since the 1960s, when full employment was reached in economies such as Singapore, Korea, Taiwan and Hong Kong, the mix of jobs improved; real wages rose, by as much as a factor of four; and high work-place standards and income inequality remained at low to moderate levels. In short, workers in these economies were not impoverished by economic growth, but benefited from it. Little of this was achieved, however, with the help of labor unions and formal labor standards. In other words, the four tigers have proven deficient in process but outstanding in outcome. See *Labor Standards, Economic Development, and International Trade*, in *LABOR STANDARDS AND DEVELOPMENT IN THE GLOBAL ECONOMY* (1990).

dards: the right of association, the right to organize and bargain collectively, the prohibition of forced labor, a minimum age for the employment of children, and minimum conditions of work including wages, hours and occupational health and safety.²⁸

For analysts like Ray Marshall, effective labor movements must thus also have global strategies that are designed to support high-wage, full employment, equity policies that match the strategies of the firm. In his view, markets work within a framework of rules that promote a range of non-economic or market-supporting policies. In this context, governments routinely act to force companies to compete on the basis of quality, productivity and efficiency, not low wages. "In a global economy, however, labor standards must now be part of international trade rules." Such rules would establish fair labor standards and practices, including rules that would prevent wage suppression in order to attract investment. In his view, international labor standards would promote equitable economic development in the third world and prevent a destructive downward spiral of deregulation among OECD countries.²⁹

These arguments, however, are largely political. The economic basis for them remains weak. The pure wage argument, of course, seeks to deny the very basis for international trade. Policies, domestic or international, that would take wages out of international competition would in effect close down a substantial portion of international trade. The regulatory argument, however, is more subtle. It can be summarized as follows: footloose firms use the promise of new investment or the threat of disinvestment to convince governments to relax regulatory requirements and tax burdens; the resulting erosion of the tax base reduces the capacity of governments to maintain a viable social safety net to the detriment of society as a whole; and the capacity of firms to disaggregate the production process and locate slices of it in different areas of the globe has led to the equalization of wage levels. High-skilled labor is in high demand and relatively scarce and is thus highly rewarded while low-skill labor is relatively abundant and in declining demand, thus depressing wages. The reinforcing interrelationship between these three factors suggests to proponents of this view, that governments need to find ways to regulate the capacity of private capital to move between and within jurisdictions in an effort to find the most congenial regulatory and fiscal locations. Given the interdependence of modern economies, no government can afford to act alone. Only by acting collectively can regulations thwarting the irresponsible behavior of private capital be implemented. In the absence of such regulations, la-

²⁸ Peter Dorman, *Trade, Competition, and Jobs: An Internationalist Strategy*, in *LABOR IN A GLOBAL ECONOMY*, *supra* note 13, at 66.

²⁹ Ray Marshall, *Labor in a Global Economy*, in *LABOR IN A GLOBAL ECONOMY*, *supra* note 11, at 21.

bor will continue to bear the brunt of adjustment to globalization.

The argument has a surface plausibility. Empirical research, however, suggests that while environment, labor and other social policies have some effect on investment decisions, that effect is quite small and certainly much smaller than critics of trade liberalization imagine it to be. The question is whether businesses will relocate because of lower regulatory costs or whether they will simply take advantage of lower regulatory costs once relocated. The incentive to take advantage of lower requirements once in a location, e.g., to factor in lower regulatory costs when contemplating a new investment or a decision to relocate, and the decision to relocate because of such factors are quite different. For global enterprises, locational decisions are influenced by a variety of factors, including access to materials, energy resources and markets, labor supply and costs, infrastructure availability and costs (such as transportation, electricity, water and waste disposal), capital availability and costs, the potential for economies of scale and scope, governmental measures (such as taxes, regulations and incentives), and site costs. Additionally, there are less tangible influences such as the site preferences of managers influenced by the availability of suitable schooling, housing and other amenities, as well as familiarity with the available options. Finally, historical investment patterns suggest a strong bias toward clustering, i.e., a bias to locate close to other firms involved in similar activity. Carpet makers, for example, are concentrated around Dalton, Georgia while computer firms have clustered in Silicon Valley south of San Francisco, along route 128 near Boston and in the Ottawa valley. The weighting to be assigned to these various factors can vary widely from industry to industry and firm to firm. In most industries, regulatory costs are but a small fraction of total costs and are thus unlikely to weigh very heavily in such decisions. Studies of environmental costs, for example, indicate that they typically involve less than 1%, with only a few industries reaching 2 to 3%.³⁰

Most of the cases of relocation to take advantage of lower social costs rests on anecdotal evidence, rather than systematic investigation. During the NAFTA debate, for example, most of the anecdotal evidence revolved around Los Angeles wood products manufacturers. All efforts at systematic investigation have tended to debunk the claim that firms will move to avoid regulatory requirements. In most cases, the

³⁰ See Frederick W. Mayer, *The NAFTA, Multinationals and Social Policy*, in *MULTINATIONALS IN NORTH AMERICA* (Lorraine Eden, ed., University of Calgary Press, 1994) for a discussion of the intricacies of locational decisions. Patrick Low indicates that for the United States, the weighted average cost to output of pollution abatement and control equipment was 0.54 percent, with the highest ratio, for the cement industry, being just over three percent. See *World Bank, Trade Measures and Environmental Quality: Implications for Mexico's Exports*, 159 *INTERNATIONAL TRADE AND THE ENVIRONMENT*, WORLD BANK DISCUSSION PAPER 107 (Patrick Low, ed., 1992).

important factor was not regulatory costs but labor costs and involved only partial relocations of labor-intensive slices of production. The NAFTA debate focused on the appalling social and environmental conditions in the maquiladora border regions of Mexico. There are many horror stories, but the debate unfairly tarred all plants with the same brush; many of the newer investments, particularly by multinational firms, do not exhibit the same problems and generally have their own global standards. Finally, the NAFTA experience also suggested that the problem is less due to a lack of labor standards and other laws, and more due to a lack of economic capacity and political will to enforce them. With further economic development, in part spurred by more open international trade and investment conditions, the economic capacity should improve while international agreements can act to increase political will.³¹

The only conclusion we can draw is that while the ethical case for worker rights may be strong, the economic case remains problematic. It needs evidence based on reputable studies to determine the relationship between workers' rights, wage levels, competitiveness and investment patterns. To date, most of the evidence is based on deductive reasoning and anecdotal examples.

As with the particular case of labor regulations, the more general social policy case rests on similarly tenuous economic arguments. There is no denial that the modern welfare state is expensive and thus requires a high level of taxation; most OECD governments have learned over the past decade that their capacity to raise revenue has fallen far short of their requirements as the cost of maintaining the welfare state continues to grow. Not only have cost projections proven unrealistic, but behavioral changes flowing from the welfare state have driven up demand for services beyond the state's capacity to pay. At the same time, the institutional and other benefits that flow from a well-ordered modern society continue to make investment location (except for the most routine tasks) more attractive in high-cost economies than in low-cost economies. The unprecedented surge in foreign direct investment in the 1980s was almost exclusively an intra-OECD phenomenon. The problems of the welfare state, real as they may be, do not appear to be a major factor in international investment decisions and need to be addressed on a basis other than trade agreements.

Additionally, the need for governments to pay for the fiscal burden of the welfare state through international borrowing is leading to a discipline of its own. Such disciplines should not be confused with the kind of disciplines that can be exercised through trade agreements. The ability of governments to borrow from domestic and international lenders is

³¹ See Mayer, *The NAFTA, Multinationals and Social Policy*, in *MULTINATIONALS IN NORTH AMERICA*, *supra* note 30, at 514-15.

directly related to the confidence such lenders have in the fiscal and monetary probity of the borrowing state and is expressed in exchange and interest rates. Again, these are self-regulating levers for national participation in a global economy. They function at the aggregate, macro-economic level and do not need trade agreements to make them work.

V. IF NOT AN ECONOMIC CASE, HOW ABOUT A POLITICAL CASE?

If the economic case for integrating social issues more coherently and systematically into trade agreements is weak or premature, why then continue the discussion? The reason is that feeble as the economic case may be, the political case is very potent. As has been demonstrated countless times before, governments, particularly of large, powerful states, will respond when there is a strong political case, even in the face of their own skepticism about the economic case. The economic case for antidumping and countervailing duties, for example, has never been very strong. If anything, the steady reduction in other trade barriers and the globalization of production have further undermined the economic rationale. Nevertheless, the proliferation of antidumping regimes continues and new antidumping and countervailing duty cases are initiated daily. Deeply entrenched domestic interests continue to convince governments to impose such duties and provide domestic producers an advantage over foreign producers, even as the distinction between foreign and domestic producers becomes ever more artificial.

The political case for negotiating international rules to govern the interrelationship between trade and social issues is thus relatively straightforward. It rests on the larger risk posed by the willingness of large and powerful countries to act unilaterally in response to domestic political pressures arising from perceptions of fairness. Such a development could lead to a significant erosion in the gains from fixed-rule, non-discriminatory, liberalizing trade agreements. As noted by GATT Director General, Peter Sutherland: "The use of [unilateral] trade restrictions to spur nations to raise standards and to penalize those lagging behind can be a powerful political club but it is unlikely to achieve the objective. Like all clubs it is most available to the strong for use on the weak. And introducing this weapon into the world trading system would put it at immediate risk of collapse."³²

Sutherland is both right and wrong. Unilateralism does breed contempt and cynicism and can lead to an erosion of the rule of law. Nevertheless, such sentiments, when properly channeled, can also lead to cooperative solutions that in the end may prove beneficial. Such cooperative international solutions can help both strong and weak deal with the need to find delicate compromises among competing domestic polit-

³² TORONTO GLOBE AND MAIL, May 16, 1994, at B10.

ical interests. This is not a new development, of course. The history of international trade negotiation reflects the continuing dominance of political considerations over economic ones. The GATT, for example, has always been a disappointment to mainstream economists. It is based on too many compromises. Its rules permit governments to impose a variety of trade-restricting measures, such as tariffs, quantitative restrictions, discriminatory government procurement provisions, and anti-dumping and countervailing duties. Nevertheless, the cumulative effect of GATT's rules and procedures has been to impose an upper limit on resort to such measures while its periodic negotiating conferences have succeeded both in reducing barriers and strengthening the rule of law. Perversely, therefore, a set of rules and procedures that may be economically irrational can result in an economically desirable result, i.e., a more efficient allocation of global resources leading to steady increases in global, and national, economic welfare.

Globalization suggests that we now take another step in the same direction. The arguments that made the international regulation of border and related measures desirable and effective over the past fifty years should now be applied to the kinds of domestic policy instruments governments use to pursue social objectives. The conflict created by differing regulatory regimes can be ameliorated by negotiating rules that place a limit on the degree of divergence that participating governments will tolerate and at the same time constrain governments from taking unilateral action to offset perceived negative effects. In short, negotiations about rules are likely to accelerate efforts to reduce regulatory differences while their absence is unlikely to slow ongoing silent integration and the resultant scope for conflict and unilateralism.³³

The real issue, therefore, is not whether governments will negotiate about these issues, but where and to what purpose. The pressure to act is already there. Effective lobbying by a broad coalition of environmental, labor, human rights, religious and citizens groups concerned about job loss and erosion of regulatory standards has already made the political case that there is a relationship between trade liberalizing, fixed-rule agreements and social and environmental degradation. Part of the case, of course, is pure strategic opportunism: interest groups are able to hold a politically important trade issue (e.g., passage of NAFTA or the Uruguay Round results) ransom to demands to meet their own agenda (e.g., tougher environmental and labor regulation and

³³ The relationships, however, are complex and can be easily exaggerated in political dialogue. Frederick Mayer notes, "The relationship between government regulatory regimes and private investment locational decisions demonstrates that causality can run in both directions. Differences in costs imposed by differences in political regimes can affect private location decisions. Conversely, the possibility of such private relocations can trigger a political response that limits the incentives to flee." Mayer, *The NAFTA, Multinationals and Social Policy, in MULTINATIONALS IN NORTH AMERICA*, *supra* note 30, at 521.

enforcement). Additionally, however, symbolic politics is involved. To many political activists, GATT, NAFTA and other trade agreements have come to symbolize environmental rape, corporate exploitation, a social race to the bottom and other broad social problems flowing from a much more complex set of factors.³⁴ Governments will respond to such claims, either unilaterally or cooperatively.

The question, therefore, is the extent to which governments, and the people they represent, are prepared to tolerate differences in regulatory standards, values and national priorities within a more open global economy. John Jackson has argued that dumping and countervailing duties and safeguard measures were necessary to lubricate the tensions that arise from such systems friction.³⁵ As the scope of systems friction widens, the need to enlarge the role of these lubricating measures similarly needs to expand.

Negotiating about these issues need not be an economically negative experience. Business leaders and neoclassical economists are concerned that such politically motivated agreements will reduce the scope for economically rational decisions, at a cost to individual businesses as well as the economy as a whole. The evidence to support this fear is not robust. Not all regulation, domestic or international, need have a negative economic impact. The international experience in setting product standards has generally been positive. The standards have been high and industry compliance has been good. Rather than leading to losses in competitiveness, it has led to the development of higher product and process standards. More generally, there is sufficient evidence to suggest that stronger rules, domestic or international, often lead to higher and more uniform standards and enforcement practices in the jurisdictions involved which in turn lead to stronger competitors. Generally, consumers will pay a premium for quality. Efforts by quality-conscious firms to deliver quality and reduce the premium usually pay dividends.

Michael Porter has argued that tough regulatory standards breed strong competitors. The history of Japanese industrial development provides suggestive evidence. In the 1950s and 1960s, Japanese products were cheap, generally of low quality, and created little fear among European or American competitors. By the 1980s, exactly the opposite held true. Spurred on in part by tough regulatory requirements, Japanese products were expensive, reflecting very high quality standards, while Japanese-based firms were among those most feared by European

³⁴ This aspect of the debate has its corrosive aspect, feeding xenophobic and even racist prejudices. The argument suggests that third-world citizens are not like us and should not be admitted to the club. It is ironic that the churches have been so strongly associated with these symbolic politics. See Mayer, *The NAFTA, Multinationals and Social Policy*, in *MULTINATIONALS IN NORTH AMERICA*, *supra* note 30, at 518-19.

³⁵ John Jackson, *Achieving a Balance in International Trade*, 2 INT'L BUS. LAW. 123-28 (1986).

and American competitors. GATT's own history also reflects the insight of this observation. More stringent obligations have been imposed on the wealthier members while more permissive rules have governed the trade regimes of the poorer members. Perversely, the obligation to live up to tougher requirements has helped to strengthen the economies of the wealthy members while the weaker obligations assumed by developing countries hindered their economic development.

Thus, while the economic case may be weak and the political case strong, pursuit of political objectives may, in the end, lead to desirable economic consequences, i.e., the development of global firms and industries able to meet stringent global regulatory requirements and capable of delivering quality products at competitive prices.

VI. SOVEREIGNTY, EXTRA-TERRITORIALITY AND UNILATERALISM

While conceding the political case, some will still object, concerned that the development of international rules governing social policy issues will lead to a serious erosion of national sovereignty. Such sentiments display a lack of historical perspective and appreciation of current reality. The concept of sovereignty as currently conceived is of rather recent vintage, the result of an historical evolution of no more than a few centuries, largely confined to Western Europe and more recently North America. Based on this evolution, the term conveys not only ideas about territorial and national integrity, but also about the conduct of relations between states and their role in the establishment and management of international regimes.

It was not until the sixteenth century that the royal territorial state began to take discernible shape, replacing the flexible concepts of personal fealty that had governed social arrangements in the middle ages. There was gradual recognition that the sovereign exercised control over a defined geographic area, i.e., was able to exercise sovereignty over that territory. For this concept to work, it required not only that people resident in the territory accept the king's suzerainty, but that one monarch recognize the territorial sovereignty of another. To this end, European courts developed rules of behavior to govern relations between them. The first mature expression of such rules is usually identified with the Peace of Westphalia in 1648. Concomitant with the development of the territorial state came theories not only of the duty of its residents to the sovereign, but also of the duty of the sovereign to those living within his territory. Thus both the concepts and practice of governance and sovereignty developed in tandem.

By the nineteenth century, the territorial state had acquired national characteristics, i.e., government and territory were presumed to be synonymous with a people with a shared language and other cultural attributes. By this time, the functions of government had also grown to include not only defense of the state's territorial integrity, but also of

its national identity. Concurrently, the rules of inter-state behavior had also become more sophisticated, particularly during the long Pax Britannia. Sovereign governments now entered into an increasing range of treaty obligations and established international regimes to ensure the smooth operation of such international functions as the delivery of the mail and the regulation of issues ranging from copyright to tariffs. In effect, these rules were based on a shared acceptance that sovereigns could cede some of their ability to act independently in return for the benefits that were presumed to come from cooperative joint action.

Over the course of the twentieth century, the attributes of the nation-state grew further to embrace the social welfare state. By the middle of the century, attributes of the nation-state included not only territorial and national integrity, but also the capacity to promote the economic and social well-being of its citizens. At the same time, the post-war system of multilateral rules and organizations became the latest expression of rules to govern inter-state relations. As with the expansion in the attributes of the nation-state, the range of issues addressed by the rules of inter-state relations had similarly expanded.

Today we face a new reality. Advances in transportation and communications technology have made it possible to breach the territorial, social and cultural integrity of the nation-state on a daily basis. The convergence of popular cultures and the crisis of the welfare state all point to the need to develop a new definition of sovereignty as well as a new set of norms and rules for inter-state relations. In short, we need a new set of rules that recognizes that the realm of goods, services, capital and technology has largely escaped from the effective regulation of the territorial nation-state, while its people remain largely attached to it.³⁶

In effect, such a regime may end up recapturing political authority that has been lost as a result of the silent integration flowing from the forces of globalization.³⁷ Even more to the point, cooperative, jointly agreed international rules may provide an effective antidote to the tyranny of unilateralism by the powerful. The most potent threat to the sovereignty of most nation-states today comes not from the fruits of

³⁶ As Robert Reich has noted, only a small elite can as yet escape the bonds of the territorial nation-state — those he characterizes as symbolic analysts. *See THE WORK OF NATIONS: PREPARING OURSELVES FOR 21ST CENTURY CAPITALISM* (Alfred A. Knopf, 1991).

³⁷ Notes Frederick Mayer:

Rather than contributing to the further empowerment of private actors [NAFTA] may, in fact, be the beginnings of a recapture of power by states, either by facilitating greater cooperation among them or by creating supranational institutions capable of addressing social issues on a regional basis. To the extent that economic activity — trade and investment — becomes increasingly regional, rather than either national or global, what may be developing is a political architecture more coincident with the economic landscape.

Mayer, *The NAFTA, Multinationals and Social Policy*, in *MULTINATIONALS IN NORTH AMERICA*, *supra* note 30, at 522.

cooperative action but from the extra-territorial application of unilateral definitions of appropriate standards by the United States.³⁸

The United States is the only country that has a strongly developed body of doctrine and practice favoring the extra-territorial application of its laws, based on its strong sense of mission and manifest destiny. In some cases, the United States proceeds extra-territorially in order to pursue clearly established U.S. interests or defend U.S. citizens. In others, extra-territoriality involves the simple extension of U.S. values and other political priorities to other jurisdictions. Traditionally, U.S. extra-territoriality involved matters related to antitrust cases, national security (export controls) and the compulsion of foreign disclosure in the context of U.S. litigation. Additionally, however, it can also be used to pursue human rights issues, environmental protection, labor matters, securities, drug and racketeering enforcement and intellectual property protection. The U.S. legal doctrine of extra-territoriality thus means that as the global economy becomes more integrated and the U.S. economy becomes more globalized, the potential for more adventures in this area is very real.³⁹

U.S. willingness to apply its laws beyond its frontiers thus poses a serious threat to global commerce and the development of appropriate global rules and institutions. In effect, the U.S. authorities appear prepared to determine who are "outlaw" nations and what are "outlaw" values and act accordingly. Outside of the United States, there is broad acceptance of three basic principles that would seem to place the unilateral reach for jurisdiction outside a nation's territory beyond the pale: acceptance of the sovereign equality of states; agreement that one government cannot frustrate or undermine the law or policy of another; and the maxim that national laws must reflect self-limitation that respects the sovereignty of other nations (comity). For more than 300 years, international law has recognized these principles except where states have voluntarily ceded authority to another or to an international organization or regime. The United States, however, has never accepted them.⁴⁰

Even in the absence of a U.S. doctrine of extra-territoriality, the size and dominance of the United States market in the global economy

³⁸ I am indebted for the ideas and analysis in this section to a paper prepared by Doug Rosenthal, *The Greening of Extraterritorial Jurisdiction in U.S. Law* (to be published).

³⁹ In recent years, the U.S. Congress and the courts have begun to assert a "universal" jurisdiction over such issues as human rights and the environment. They have also indicated a willingness to challenge the application of another country's law in its own territory, as they did during the infamous uranium cartel case and in the kidnapping by U.S. law enforcement officers of alleged criminals in Canada and Mexico. Congress has even shown it is prepared to pass legislation to punish behavior in one jurisdiction compelled by the government of that jurisdiction, even when such action is at odds with US interests or standards. *Id.*

⁴⁰ See *id.* for a fuller discussion of these principles and the extent to which the United States stands outside them.

have in the past created a strong disposition for U.S. legislative and legal action to be determinative in the making of international rules. This was a natural by-product of the hegemony enjoyed by the United States during the post-war years.⁴¹ As a result, American negotiators were conditioned to assume not only that their objectives were in the interest of the United States, but were morally superior to all others. There simply was no other point of view that needed to be taken seriously. For the United States, rule-based international regimes have thus often meant the extension of U.S. rules and procedures to the rest of the world. The GATT, for example, bears a remarkable resemblance to many of the provisions of the *Tariff Act* of 1930. Section 301 of the *Trade Act* of 1974, which provides for unilateral police action in the trade and economic sphere, is often used to condition others to conform to U.S. norms. In a regime where the norm is often American, it is not unnatural for the United States to arrogate to itself the right to act as its arbiter. While annoying, this exercise of hegemony has not been without benefit. It created an ordered world and it committed the United States to a set of rules that had the virtue of stability. Those rules could not be changed without the consent of other participants.

However, in a world where power is much more widely dispersed and the sources of legitimacy are more widespread, unilateralism, particularly by the major player, breeds anarchy and contempt. Even where an individual instance of U.S. unilateralism may have beneficial effects for many of the participants in the system, the broader implications are such as to bring the whole system into question. Too often, it also smacks of protectionism and displays an arrogance that has no place in a well-functioning global trading system. The rule of law no longer applies. In its place, power rules the day and, in the absence of a hegemon, even the more powerful players will suffer the results of this lawlessness.

U.S.-based firms have begun to appreciate this shift in reality. Gone are the days when the U.S. economy did not need the global economy but the rest of the world needed the U.S. market. The United States now relies on the rest of the world for a growing share of its goods, services, capital and technology. U.S.-based actors now have significant stakes beyond the shores of the United States and non-U.S.-based firms have important stakes in the U.S. market. In such circumstances, determining 'national' interests becomes increasingly strained; one soon comes to the inevitable conclusion that rules-based internationalism is the only game worth the candle.

Economic internationalism today means the development of a global regime consonant with the new reality of a global economy.

⁴¹ See ROBERT GILPIN, *THE POLITICAL ECONOMY OF INTERNATIONAL RELATIONS* 72-80 (Princeton University Press, 1987), for a discussion of the theory of hegemonic stability.

American commentators are beginning to get their minds around the concepts involved and the radically different ways in which the United States must pursue its interests in a post-hegemonic world. They are learning that while the United States may still be critical to the functioning of the global economy, it can no longer insist on its views as to how that economy should operate. It may be the biggest and most influential player, but it is no longer the hegemon.

Most American opinion and decision-makers, however, still have a long way to go. The practical result is that the world will have to suffer the fallout from this learning experience, whether it involves Japan-bashing, wars of words across the Atlantic, or skirmishes against Canadian wheat and other products. Eventually, however, even Americans will come to see the logic of the global economy and the benefits of rules-based internationalism. It is now in the interest of the United States to cooperate and accommodate the needs and views of others.

WHY TRADE AGREEMENTS?

If we accept that political considerations will drive governments of major nations to continue to press for accommodation on such issues as fair labor standards and environmental protection, we must then ask whether trade agreements are the appropriate vehicle to address these issues. In an ideal world, the answer should properly be no. Trade bureaucrats are not the best officials to address the complexities of fair labor standards or other social issues, nor are trade agreements necessarily the best instruments for addressing them. Steve Charnovitz argues that GATT, for example, is not a good vehicle for dealing with environmental or labor issues. It is not geared to separating "good" from "bad" trade; rather, it establishes rules about trade restrictions. GATT article XX(b), for example, does not forbid trade in dangerous products; it permits governments to restrict imports of such products. He notes that "at present, the GATT is a long way from even acknowledging a fundamental question: Are international rules needed so that countries will not suffer a comparative disadvantage from protecting the environment and providing basic safeguards for workers?"⁴²

Charnovitz is right. In a well structured world of international rules and institutions, the ILO, for example, would set labor-market rules and manage procedures for review, compliance and enforcement. The ILO, however, has no credible record in the establishment of enforceable rules and in supervisory and compliance procedures.⁴³ Other

⁴² Steve Charnovitz, *Environmental and Labour Standards in Trade*, 15-3 THE WORLD ECONOMY, 353 (May 1992).

⁴³ The ILO International Labour Code, for example, provides a poor model for the future. Part of the reason lies in the failure of the ILO to distinguish between conventions, recommendations and model codes of practice, guides, manuals and safety regulations, including a host of

international agreements and organizations in the social field have similar shortcomings. As a result, trade agreements will continue to be the focus for addressing these domestic policy issues internationally. Galling as this may be to some, it makes political sense because the problems and challenges such policies pose in intergovernmental relations frequently first manifest themselves in the context of international trade. Until governments are prepared to enter into self-executing international agreements enforced by domestic courts, trade agreements may thus provide the most effective way of enforcing international rules governing such policies and resolving international conflicts — intergovernmental or intercorporate — that may arise as a result of them.

There is, of course, a middle ground. It is possible to negotiate the substantive issues in separate labor, environmental and other agreements but include provisions for enforcement through trade measures. To avoid any significant erosion of the benefits of an open international economy, however, the application of such sanctions would need to be consistent with the rules of the trade regime and be supervised by it. The objective would be to ensure that trade sanctions would only be used as a last resort, after more positive measures to achieve the desired result had been exhausted. To achieve this objective would require the negotiation of appropriate cross-walks between trade and other agreements, similar to the cross-walks originally negotiated between the International Monetary Fund (IMF) and the GATT to deal with trade measures for balance-of-payments reasons or between the Customs Cooperation Council and GATT on customs issues. It should be possible to negotiate provisions in the World Trade Organization (WTO) on how and under what circumstances trade measures are to be applied to enforce substantive obligations adopted in other agreements, e.g., environmental or labor standards.

Nevertheless, while the forum would be more appropriate, the issues would be the same: the negotiation of substantive rules and their

sector-specific standards. The result is a massive and confusing code that is at least ten times as detailed as the densest national regulations. By mid-1992, the ILO had 160 members who had adopted 173 conventions (162 in force) and 180 recommendations for a total of more than 4,600 provisions. Each member state has ratified an average of 33 conventions for a total of 5,500 ratifications, creating an immense supervisory task. It is no wonder that over the years the supervisory function has been scaled down and become increasingly perfunctory. The existence of an overabundance of instruments also devalues the half dozen or so that are of qualitative importance. Additionally, the much ballyhooed tripartite nature of the organization is not reflected in practice. Many of the member states' employers' and workers' representatives participate only sporadically and most member states discharge their reporting obligations less than enthusiastically. The United States, which is actively seeking to strengthen international fair labor standards through the GATT, has a less than exemplary record of ratifications — only 11 — although its record of compliance is good. See Efrén Córdova, *Some Reflections on the Overproduction of International Labour Standards*, 14 COMP. LAB. L.J., 138-162.

enforcement, under specified circumstances, by trade sanctions. One way or another, therefore, the interface between trade and social policy will have to be confronted and it is more likely to arise in the context of trade negotiations than elsewhere. It is necessary, therefore, to develop a clear understanding of the nature of international trade agreements before we get into a discussion of whether or not they can serve as useful vehicles for addressing the new range of issues.

All trade agreements today can be characterized as forming part of the GATT-based trade relations system, i.e., they are all broadly consistent with the rules and procedures set out in the GATT. When first negotiated, GATT was conceived as an intergovernmental agreement that regulated what governments could and could not do to influence the flow of goods across their frontiers. In 1947, such measures were largely confined to border measures, particularly tariffs and quantitative restrictions. The resulting rules were held together by the principle of non-discrimination. Members had to treat goods crossing the border without regard to their origin and, once goods had satisfied the GATT-sanctioned frontier requirements, members could not discriminate between domestic and foreign goods.

By the 1980s, however, GATT had evolved into a much more complex arrangement. Rather than relying on a traditional diplomatic approach to resolving disputes, its members had gradually pioneered the development of judicial-like international procedures. Rather than maintaining a code of broad principles, GATT's members had developed a construction of detailed rules and procedures. By the 1990s, GATT's rules covered not only goods, but also services, investment and technology. In the original GATT regime, member countries had traded access in one market for access to another market. The new WTO, on the other hand, will deal with the terms of trade at a global level. In a global economy, the terms of trade should involve not only negative prescriptions about what governments may do at the border, but also positive norms about their approach to environmental protection, their regulation of labor markets and other social issues. The GATT experience thus suggests the extent to which member governments have been prepared gradually to enlarge the scope for internationally regulating government behavior and extending international regulatory authority.

The negotiation of a code governing the protection of intellectual property during the Uruguay Round of GATT negotiations provides a case in point. Governments agreed that they would extend a specified level of protection to the owners of intellectual property and use trade sanctions to enforce them. Such protection will be provided by all GATT members to all owners of intellectual property rights, regardless of their residence or place of business. In effect, governments have now agreed that among the terms of trade that will apply in the global

economy is a guarantee of the property rights of owners of intellectual property. It is not difficult to conceive how that same pattern of rule-making can be applied to other kinds of rights and conditions.

At the same time, it is important to keep in mind that the GATT regime does not regulate production, trade or investment *per se*. It does not say what may be produced where, what may be traded and how that trade is to be conducted. Rather, it provides a set of rules about how member governments can regulate trade and investment between them. The parties that are regulated are not private parties but national states. The system does not confer rights and obligations on individuals, but on member states.

Populist critics of the current trade regime argue that it is based on the neo-classical market model and aims at providing free rein to market forces by constraining the capacity of governments to regulate. Its main beneficiaries are perceived to be internationally competitive firms. They argue that the GATT rules involve a capitulation by democratic governments to global firms and institutions that are not responsible to any electorate.

International trade agreements, of course, can be constructed to serve a wide variety of ends. To date, however, experience contradicts the charge that they foster such an irresponsible regime. Rather, the GATT rules provide a framework within which governments establish their own priorities and schemes of regulation. Product standards provide a good example. Governments are not prevented from setting product standards, but they are constrained from using them as overt barriers to trade. With the exception of removing highly inefficient border barriers such as tariffs and quotas, trade agreements rarely establish free trade. Rather, they reflect an international consensus on an appropriate regulatory regime based on the virtue of non-discrimination. Individual countries retain tremendous scope for intervention, which is why both left and right remain unhappy: these agreements represent compromises between competing values and priorities rather than ideological straitjackets.

Thus, while the trade regime may not be the ideal place to resolve intergovernmental and interfirm conflict about social issues, they provide an adequate, second-best framework. What will be required is the development of appropriate working relationships between trade officials and those responsible for social issues. For trade negotiators, working with other subject specialists is nothing new. Fifty years ago, trade negotiations dealt largely with tariffs and quotas, i.e., government policy measures applied at the border. Trade negotiators, therefore, were usually drawn from among those people who had some experience in dealing with these matters. But as the boundaries of trade negotiations have expanded, trade negotiators have of necessity learned to deal with a much wider range of issues. Doing so required that they learn to

"share" their file. Over the past few years, they have learned to work with industrial policy specialists, government procurement experts, competition lawyers, service industry regulators, product health and safety inspectors and more. Each of these fields has its own assumptions, goals and sensitivities. As a result, relations have not always been easy, but both sides have adjusted, made the necessary compromises and managed to serve the national interest as defined by the government of the day.

WHAT WOULD BE INVOLVED?

Having established that there is a good political case for addressing social policy issues in the trade negotiations of the future, what exactly would such negotiations involve? Moving from trade agreements that address how societies regulate commerce (the exchange of goods, services, capital and technology) to agreements that regulate how societies govern themselves (their social arrangements, the protection of the environment, the regulation of competition and the protection of private property) involves more than a simple extension of the existing trade regime. The historical, cultural, social and political forces that have shaped how societies have arranged such matters cannot be ignored. Negotiating international standards on such emotive issues thus presents a formidable challenge, spurred on by the threat that in the absence of multilateral rules, the vacuum will be filled by unilateral action.

A good place to begin would be to determine the extent to which existing GATT principles and practices would apply. GATT negotiations have traditionally involved two reinforcing bargaining strategies. The first revolves around a set of negative prescriptions. The GATT rules respecting non-discrimination, tariffs, quantitative restrictions, balance-of-payments measures and trade remedies all involve self-denying ordinances: governments agree not to engage in certain policies and practices and thus let the market determine winners and losers. These negative prescriptions are susceptible to an exchange of concessions, i.e., each government can deny something in return for another government denying something of similar value. In this way, governments are able to exchange politically risky increases in import competition for politically rewarding increases in export opportunities within a fixed-rule order that guarantees stability.

The second strategy is grounded in the commitment to most-favored-nation treatment and the organization of negotiations around the principal-supplier rule. It means that bargaining about exchanges of concessions is based on market power, i.e., the largest economies exchange concessions among each other which are then multilateralized for the benefit of all the other participants. Smaller countries, having little to offer in terms of economically significant markets, are

marginalized both in terms of the concessions they can offer and the specific concessions they can seek. Nevertheless, they gain considerably from the concessions traded among the larger economies and the overall effect of the process is liberalizing. Following the lead of the major powers thus makes both political and economic sense for the smaller powers and ensures commitment to a regime dominated by a few major players.

These two fundamental characteristics of the GATT trade relations system of the 1950s through the 1970s, however, seem ill-suited to the development of rules about social issues. Substantive obligations in such areas as environmental protection and fair labor standards require governments to go beyond self-denying ordinances and enter into positive obligations, i.e., to conform to international standards. Bargaining about norms and standards is not as easily organized on the basis of market power. In most cases, the norms are those of the major powers who insist that they do not have to make major adjustments.⁴⁴ It is the smaller powers that will have to make the most significant concessions, but without the politically necessary counterweight of gaining additional access to the markets of the large powers. While there may be clear benefits to expanding the reach of a fixed-rule international economic order, such benefits are likely to be perceived more in economically than in politically persuasive terms.

Complicating matters even further, the number of countries actively participating in the negotiations has vastly increased. By the middle of 1994, more than 120 countries were members of the GATT. Many of these are small countries with a high stake in a successfully functioning multilateral trading order but with little to offer to make it work better or to unblock stalemate. Thus, in proceeding to the next stage of global rule-making, GATT's basic rules and procedures may need to adapt to a new range of issues.

GATT's basic principles can be divided into two sets: procedural and substantive. The first group involves such matters as due process, collective decision-making and transparency. There is little potential

⁴⁴ The complexity of the issues involved was well illustrated by the U.S.-Japan Structural Impediments Initiative (SII). Conflicting views of how to approach domestic and international economic issues were explored at a level of detail that at times bordered on the bizarre. Both sides complained about the different values and priorities of the other side with the United States strongly suggesting that if Japan were prepared to become more American, many of the trade frictions would disappear. Such discussions are difficult enough bilaterally; they would be even more difficult multilaterally and suggest the need for careful preparation regarding both substance and technique in future discussion of social policy issues. See Amelia Porges, *U.S.-Japan Trade Negotiations: Paradigms Lost*, TRADE WITH JAPAN: HAS THE DOOR OPENED WIDER? (Paul Krugman, ed., The University of Chicago Press, 1991) and Michael Mastanduno, *Framing the Japan problem: The Bush administration and the Structural Impediments Initiative*, XLVII INT'L J., 235-264 (Spring, 1992). Jagdish Bhagwati in *THE WORLD TRADING SYSTEM AT RISK* also explores some of the complexities of negotiating rules about the new issues.

for controversy here, although GATT's application of these principles may need some further refinement. For example, environmentalists criticize GATT's failure to live by its own precepts. In GATT, transparency means that the rules that govern trade should be widely available and that national tribunals should provide opportunity for all sides to be heard. GATT members, however, have been reluctant to open their deliberations in Geneva to greater public scrutiny. Those deliberations reflect GATT's diplomatic heritage and have not as yet caught up to its more modern quasi-judicial nature. If GATT's procedures are to achieve the legitimacy required to address such delicate social issues as labor standards, they will need to become more transparent and there will have to be wider participation in rule-making and dispute settlement.

More difficult issues are raised by the substantive principles that underpin GATT rules: national treatment and most-favored-nation treatment. As we have seen, these are concepts that lend themselves well to rules about exchanges of goods and have proven reasonably applicable to investment and services, but may not be wholly suitable to the development of substantive rules about social issues. In effect, rules governing such social issues as labor standards and environmental protection will require establishing process standards, i.e., setting rules not about products and their consumption but about the way products are made.

National treatment is the basic cornerstone of the GATT approach to the regulation of trade in goods. It means that in the home market, governments must not impose different requirements on foreign products than they impose on those of domestic origin. It does *not* mean that governments can expect that exported products will be treated everywhere the way the government of the exporting country treats those products.

It is difficult to use the national treatment standard, however, as the basis for process standards. To do so would amount to its perversion. The *product* standard basically aims at protecting consumption or use in the regulating government's market; a *process* standard basically aims at protecting production in the regulating government's territory. To extend that concept by insisting that the process by which a product is produced must meet a national treatment test is to establish extra-territoriality as a fundamental rule of international trade. That is a point of departure that only large countries can afford to take and, as we have seen, makes increasingly little sense even for them.

A few examples illustrate the problem. Muslim countries may decide that they will not allow the sale of products from factories that operate during Ramadan or on other high holidays. Saudi Arabia may prohibit the sale of products from establishments that employ women. South Africa may ban the sale of products from countries or factories

that do not maintain strict Sunday closing laws. Each of these instances may meet the national treatment rule, but they would each amount to an absurd intrusion by one country into the affairs of another.⁴⁵ To make the point even more sharply, should Canada decide that it will no longer trade with a country that still maintains the death penalty, the United States would rightly regard such a decision as either a mischievous effort to justify protectionism or an unwarranted and intolerable intrusion into its domestic affairs.

The simple solution, of course, is harmonization. The question then arises, harmonize to whose standard? The inevitable answer would be to the standards set in the large and powerful economies. While there may be instances where such an approach makes sense, in many other circumstances it would not. It is not reasonable to insist that all countries must conform to the social preferences of the powerful. There are perfectly rational reasons why various societies make divergent social choices. California's climactic and geographic circumstances might dispose its citizens to choose very stringent air pollution standards while the people of Saskatchewan could as rationally choose lower standards. Such social choices should not necessarily give rise to trade actions. Similarly, rules about maximum hours of work that make sense in a large metropolitan setting may make little sense in rural circumstances. The United States, which boasts a large but well integrated continental market, has not found it necessary for the fifty states to harmonize much of their social legislation. The same logic would seem to apply for an even more diverse global economy.

In the elaboration of a new GATT standards code, governments have gained some experience in developing rules based on the more sensible and less intrusive concept of mutual recognition, i.e., governments agreed that similar objectives can be met by a range of different standards and procedures. Rather than negotiating about detailed rules, they have limited negotiation to agreement about basic objectives and have let individual governments determine how those objectives are best met for their societies. Such an approach, with suitable adaptation, might be amenable to what is needed in the field of social policy.

Whatever approach is adopted, there will be a need to distinguish between standards or rights whose contravention is clearly an affront to human dignity and decency and those that should flow from market outcomes. In the area of labor standards, for example, it is necessary to distinguish between such basic rights as freedom of association, collective bargaining, exploitive child labor and deliberately unsafe and unhealthy working conditions and those which are the result of market outcomes such as wages, hours and conditions of work. Instituting a

⁴⁵ See Jackson, *World Trade Rules and Environmental Policies: Congruence or Conflict?*, 29-4 WASH. & LEE L. REV., 1227-1277 (Fall, 1992).

fair labor relations process, for example, will not lead automatically to rising and more equitably distributed wages when labor is in plentiful supply. Nor do higher wages necessarily require a particular labor relations process. In some countries, the best choice among a bad lot can still be very bad, no matter how fair the labor relations process. The real objective for most workers then, quite logically, is more good jobs. To insist on high labor standards — process and substantive — is often to deny progress toward that more fundamental goal.⁴⁶

Finally, considerable attention will need to be devoted to the development of appropriate enforcement procedures. For some, existing antidumping and countervailing duty proceedings offer a model. In effect, GATT rules would provide cover for unilateral action by member states based on domestic complaints procedures and domestically determined standards, rules and procedures. Given the rather checkered history of antidumping and countervailing duty procedures, this is not an approach that would seem to recommend itself to most members of the global community. They are particularly repugnant to those countries who are likely to be at the receiving end of such actions. Analysts committed to open markets find them similarly abhorrent. A more suitable approach would involve multilateral supervisory, compliance and enforcement procedures in an appropriate institutional setting, the main aim of which would be compliance rather than sanctions.

One practical way to proceed would be to negotiate international rules of fair competition that include basic labor standards, minimum levels of environmental protection and similar provisions, within the framework and enforcement mechanisms of international trade agreements. The basis for such standards can be found in the core standards elaborated by the ILO, UNEP and other international organizations. The effect of such a code would not be to reduce competition between high-wage and low-wage economies, but to ensure that an internationally agreed level of obligation governs the behavior of firms in the global economy. The quid pro quo would be that the establishment of such standards would outlaw their unilateral pursuit.

Other approaches can also be explored. What is no longer an acceptable option is to continue to insist that the world does not need international rules to govern the much more complex and intense level of integration that has developed over the last few decades. The reality is that the world of commerce has already made large strides in adapting to the transformation from an interlinked set of national economies to an integrated, denationalized global economy. What is missing is an appropriate set of rules to minimize intergovernmental and intercorporate conflict. In its absence, large powerful economies will set their own

⁴⁶ See Gary Fields, *Labor Standards, Economic Development, and International Trade*, in *LABOR STANDARDS AND DEVELOPMENT IN THE GLOBAL ECONOMY* (1990).

rules and impose them on the less powerful, ushering in an era of anarchy and lawlessness. No country can afford such a turn of events, including the United States and Canada.

CONCLUSIONS

As suggested by the range of issues that will need to be addressed, getting there will not be easy. Governments will need to develop consensus on a potentially difficult group of issues, many of which challenge traditional concepts of sovereignty. To achieve the necessary international consensus, governments will need to rely on a fresh supply of intellectual capital generated either internally or in universities and think tanks. New negotiating tools and techniques may be required as well as more robust institutions and approaches to the resolution of conflict. In effect, the next decade is likely to see a major reconsideration of the design, content and techniques of the international trade regime.

For Canadians, the need to be active in the forefront of these developments cannot be overemphasized. Canada's dependence on and benefits from an effectively functioning trade and payments system have been well established. Its ability to play a constructive role has been equally well documented. But an ability to ensure that Canadian values and priorities are reflected in the evolving new regime requires that Canadians think the issues through and make their contributions early in the process. As a relatively small player, that is where they are most likely to influence the content and course of a negotiation. In short, they need to be quick, early and creative.

For Americans, the challenge is to learn to play a diminished but still critical role. The United States can no longer forge consensus among its trading partners through the exercise of hegemonic authority, but it is still capable of blocking consensus. Achieving its goals, therefore, will require that it learn to exercise a new kind of leadership, one that is more prepared to compromise and accommodate the interest of others while not losing sight of the main goal. Too often in the near past, U.S. negotiators have failed to achieve a grand vision because of their inability to accommodate others on small matters. The goal is a better functioning global economy; the broad model is in many ways the successful American version of the Western economy; the details, however, need not be American. Indeed, the system is likely to be more effective the more it is able to incorporate some of the more successful aspects of other experiences. For Americans, psychologically conditioned to see all things American as by definition superior, this will be a hard lesson. It is a lesson that will need some deep reflection on the nature of sovereignty in a global economy. It will require that the

United States determine whether its sovereignty requires the continuing use of its coercive power or a greater willingness to pursue cooperative solutions and live with them.