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REFLECTIONS ON CONSTITUTIONAL CHANGES TO THE GLOBAL TRADING SYSTEM

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INTRODUCTION

My subject includes a “work in progress” of mine, which is designed to step up a level of generality and look at how these issues with which we have struggled, here in some detail, fit into a broader perspective. We have discussed competition policy, telecommunications, and certain other aspects of those; however, there are many subjects that one could think of along the same lines. There are, of course, the very pregnant areas of financial services, and some of the difficulties that have been going on this year, and certain peculiar features of them. In the financial services area, we have to worry much more about problems of fiduciary relationships, prudential protections of consumers, fraud—which bring to mind things such as the *BCCI* case, and so on. Then there is the environment; continuing work on agricultural trade, and the many of the intricacies there; product standards; consumer protection in its broader ramifications; and securities regulation, now moving into a twenty-four-hour market. Around the world there are securities, market operations, telecommunications, airline linkages, and so on. And, if you begin to push the frontier, you also have to think of such things as labor regulations, labor standards, human rights, and how those link. So, how can we begin to think about all this? What I want to do is relate this to the World Trade Organization (“WTO”), and to the broad subject that we are talking about, and ask whether there are some generalizable principles. The broad subject, I think, is the subject of the regulation of economic behavior that crosses borders—international economic regulation.

What I am going to do is present a sort of oversimplified template, or type of analysis, that one could walk through to look at this, basically in two parts. First, I will talk about the policy and economics of international regulation in the context of some of the traditional, almost doctrinal, economics learning about regulation relating to government intervention in the market. Second, I will look at the ques-

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tion of institutions, particularly international institutions, and that is where we move into the questions of some of the very important developments that are going on right now in the world, and in the WTO particularly.

I. MARKET-FAILURE ECONOMICS IN AN INTERDEPENDENT WORLD

The first of these subjects is policy and economics of international economic regulation. The traditional economic learning, the type of things that you get from undergraduate textbooks, tends to let the market work and keep the government out. Government ought not to intervene, it is felt, unless there is some particular reason for intervening.

Immediately, however, there is a reason for intervening sometimes—the so-called question of market failure: let the market work, but when the market fails to work, then there is justification for some kind of intervention. Usually that means government intervention. And so, the question is: when should governments regulate at all?

Now, notice what I am doing. I am moving in a more general way toward some of the issues that have been discussed already, because, I think, there is a tendency to jump immediately to the internationalization. What I am doing with this analysis is starting with the broader question: should you have any government intervention at all? And it is a question that we have faced consistently in domestic economics for many decades, perhaps this century. If the answer to that question is “yes,” then we need to ask, “what kind of intervention?”

One of the interesting facets about this is that, in most of the economic texts, these questions are considered in the context of a *domestic* economy. There is very little mention about what the indications of an international economy mean for these conditions. And, what do they tell us?

Regarding the first question and its relation to market failure, the most familiar and the most commonly reiterated in the economics literature are the problems of monopoly (competition policy); the problems of asymmetry of information (for instance, the consumer versus the expert sellers); and the problems of government distortions, for a variety of reasons (and those get very troublesome because there are a lot of different valid policy reasons why governments step in that do not have to do with the functioning of the market, and yet they cause distortions in the market). Also, there is the public goods problem, the problem of where the market cannot, or cannot adequately,

give incentive for the creation of something that the public needs, because there is the opportunity for the whole public to use it, or capture it (a subject, of course, that is very close to intellectual property questions). And there is a question which is related to some of the others that I have just mentioned—the question of distributive justice, or other alternative policies of governments.

Here is the point where I think our analysis begins to cut. Suppose you can do that analysis in the context of a domestic economy. Then ask: what difference does it make that we are in the kind of internationally-linked world that we are in? Look first at monopoly or competition policy. In some cases, you are really talking about a world economy; you are not talking about a national economy. And so, that may change entirely your first judgment as to whether government intervention is necessary. For example, perhaps there is a national monopoly but, over time, borders have been thrown open to the product in such a way that the national monopoly is really no longer a market failure, because it has to struggle against the rest of the world. But you can also see the opposite conclusion possible. It may be that things do not look like they are market failures domestically, when you look at a closed economy, or you hypothesize a closed economy. But when you move to the international system, because of various formal or informal linkages of various kinds, you may indeed find that there is market failure. Thus, the international dimension of this creates the potential for different judgments on the question of whether we have a particular market failure, monopoly, or competition policy question.

Asymmetries of information is another case very ripe for difficulties enhanced by the international market. First of all, we have language differences worldwide, which makes it much harder for many persons to be able to understand information. We have deep cultural differences where a “yes” means “no,” a “no” means “maybe,” etc. We have a whole variety of factors: distance, different legal systems, the ability to enforce contracts in different ways, and so on. So asymmetries of information can really give rise to a lot of different conclusions, based on international activities.

Government distortions, of course, provide many possibilities. Are we beginning to face international government distortions? Are we beginning to face the regulations, for instance, such as General Agreement on Tariffs and Trade’s (“GATT”) textile system, as an illustration of how the international regulatory system begins to create distortions?

Public goods provide another set of market-failure possibilities. There are a lot of public goods in the international landscape. One is peace and security, for instance, peacekeeping in the United Nations. Another is human rights. There are certain values there, certain broader values than just economic market-oriented values. Thus, again the international landscape leads us to a conclusion that the market is not able to cope the way that we think it ought to be able to.

Distributive justice suggests a variety of policies within the scope of domestic market concerns: progressive taxation, welfare, safety nets, and a social market economy. But, internationally, of course, the developing countries argue for certain preferences. They argue for an international financial safety net, almost the equivalent of international bankruptcy.

So the next question is what the government response to market failure should be. In the economic literature, there are generally several kinds of responses that have been suggested—ways that governments can intervene. The government can tax. The government can subsidize. The government can regulate and create penalties for deviant behavior of various kinds. The government can try to alter various market incentives, for example, by creating a system of permits that are purchased or bid for, to allow certain environmental degradation under certain systems.

What about the international system, then? Now, here is where we begin to see major problems, because the international system is relatively frail and undeveloped and it makes it very hard to take on this whole inventory of responses. It is very hard, or impossible, for the international system to tax, at least under current situations. It is quite hard for the international system to subsidize, because national sovereign governments are not prepared to give enough sums of money to an international body that would be doing the subsidizing, to make it really worthwhile. The focus internationally is really on *regulation*, partly, by second- or third-best-analyses in many cases, because the international system cannot tax very well, or subsidize. The fourth alternative I mentioned, incidentally—altering the market incentives of certain structures—is also difficult for the international system, e.g., to set up an apparatus for selling licenses or auctioning licenses. So, the focus is really on regulation, and in many cases, that seems to be the only available international government intervention.

In this two-part analysis, we look first at where there is a need for intervention and we see how the international system, market, and so

on, conditions that. Second, we examine the responses. It is not necessarily the case that, because the international landscape causes a different judgment on market failure, there needs to be an *international* response. It may be that the international landscape, which causes us to make a judgment of market failure and therefore a need for government intervention, could nevertheless lead us to decide that the kind of government intervention ought to be a *national* government intervention, and not necessarily an international one. So, that is part of the analysis also.

And, indeed, then you get into a cost-benefit analysis of choosing institutions to respond. You then have to ask whether it should be international, or whether it should be domestic, or what levels of government are the best for intervention: from the local neighborhood all the way up to global government entities.

In a number of cases, the optimum approach would be some kind of international or global response, but the institution concerned is so weak, or so fraught with the potential abuse that, on a cost-benefit analysis, you decide that you really cannot choose that. You have to fall back on national governments for intervention because of the dangers, or risks, of the international system. Sometimes, because the international system is too rigid—that it is so hard to renegotiate a treaty, for example—that once a measure is in place, it is virtually impossible to amend. We have seen elements of that in the GATT, and maybe now in the WTO. So when we look at the international intervention, let me just remind you that there are a series of different possibilities there. There are also unilateral possibilities in the nation/state acting through extraterritorial measures, or section 301-type measures, of threatened sanctions or threatened retaliation.

II. INSTITUTIONS

Now, let us turn to institutions, particularly international institutions. The first thing we have to ask is: What are some of the goals of the international institutions, or what are some of the goals of having international institutions intervene in markets?

Of course, the prime goal is to facilitate the cooperative mechanisms of many nations. This actually can take you into another kind of economic analysis, sometimes called the prisoner's dilemma, where you look at what governments might do independently, or unilaterally, and you discover that if they all act unilaterally in their own particular interest, the effect is a disaster multilaterally, or a disaster for

the world. One country can use tariff increases, for instance, in certain strategic ways to try to gain additional welfare for its population, until other countries start to do the same thing, possibly in retaliation, and then, very soon, you have a spiraling down of the welfare available in the world, even putting aside the question of distribution. The international institution really has to be first and foremost designed to facilitate the cooperative mechanisms that are called for in many cases.

I suggest as another goal that institutions act in a way that allows implementation of goals, which usually means a rule-oriented system because the rule-oriented system allows adequate predictability and becomes a basis of planning for non-governmental organizations ("NGOs"), corporations, private entrepreneurs, and so forth.

By that we mean a system that operates on rules which are negotiated and formulated through some kind of a rule-making process, but once in place, there is a structure to make those rules reasonably effective so that individual entrepreneurs can depend on it and use them for predictability and planning. A reason for this is our desire to have markets work. In other words, this is really tuned to market-oriented economies where you have decentralized decision-making. Millions of entrepreneurs, not the central state agency, are making decisions, and those millions of entrepreneurs need some kind of framework for planning.

For example, if an entrepreneur plans to invest in a shoe plant in Costa Rica, it needs to know several things. It needs to know that its property is reasonably protected. It needs to know something about the intellectual property being protected. It needs to know something about whether that plant will be able to sell across borders, because Costa Rica is arguably too small to support an efficient shoe factory. If it does not know these things, then it faces higher risks, and that means it needs a higher return, which in turn means that the lack of a rule orientation raises the "risk premium" of the allocation of capital in the world, and therefore reduces the welfare in the world.

How do you make the rules? Well, you need some kind of an institutional structure that will do that, because you need, first of all, to formulate the initial set of cooperative mechanisms. However, then you need somehow to make it keep up, and that is often the most difficult part of this international system. That is true in a lot of different areas, including arms control, the United Nations Charter, and the worry about the Security Council and its makeup. It is very hard to

change treaties, particularly when you have 130 to 180 countries involved with all sorts of constitutional processes. This you do not do lightly, and so the institutions have to be put in place with some of that in mind, and that leads to some subparts of this analysis under rule-making.

You have to figure out how decisions are going to be made. Will you have weighted voting? Will you have a Security Council, a small council-type system, or is it "one-nation, one-vote"? If so, what are the ramifications of that for large, powerful countries in the system, who, *de facto*, and empirically, are not going to submit to very important decisions on a "one-nation, one-vote" system. You also need the capability at various levels, but probably internationally, to study, gather information, research, analyze, and flag some of the issues coming down the track, so that the system will not be so surprised, as it was, for instance, in the Mexico Peso problem. And, you need legitimation. You need something that seems to be fair in the minds of the world's citizenship, if you will, the world's citizenry.

So that leads to a fourth goal—the goal of oversight and audit, as the way I have phrased this at the moment. You want to keep the institution responsive, moving with the times, but you want to keep it honest. Furthermore, you do not want it to be defrauded all the time, and you do not want special interests taking over portions of the decision-making apparatus. Finally, you want it to be viewed as legitimate, that is, you want, again, the citizens throughout the world to say "yes, they are doing the best they can in looking out for our interests, we know that human institutions are never perfect, but on balance, we need to have that." So what do you do for that?

One response is transparency. This has been an enormous weakness of international organizations and structures, partly from several centuries' history of diplomatic discourse, which has strongly stressed negotiation in a context of secrecy, and, in some cases, secrecy in order to prevent their home constituencies from learning what they are doing. That is not all bad because sometimes what they are doing requires certain compromises, and they do not want to telegraph those compromises too early in a process where there may be some education needed of the citizenry. If there is anything that the environmentalists have taught us in the last five years about international regulation, it is this issue of transparency. It is something, of course, we are struggling with in the context of the WTO.

Participation is important also. This again goes back to the question of international rule-making by elites. We have just begun to develop a worldwide system in some of our institutions where there is much broader public participation, quite often through the formula of NGOs, and certification of NGOs in a variety of contexts. That is something that the new WTO is struggling with right now.

Checks on power, or checks and balances, are necessary to keep the international system from misusing its power. Now, there are a number of interstitial ways that we do that, and some of those have been mentioned yesterday. One of them is limits on decision-making, where we limit the powers of the governing body. There is a lot of this in the WTO charter, and this was a matter of great concern to the U.S. Congress last year, for instance. My own perception and testimony was that the WTO Charter actually had better limits on decision-making, in the sense of checks and balances, than GATT. This raises a counter-problem: are there too many limits on the decision-making and rule-making in the institution? For example, are there too many limits on decisions that relate to voting structure and so forth? The nonself-executing nature of the international decisions and the international treaties are a form of check and balance against overreaching power.

There are limits in the dispute-settlement process also. How far can a panel go, what is its competence, and what should a tribunal do? There have been some specific areas that have been raised in the last few years about this, and we can recognize those as part of a pattern of checks and balances, even if we do not agree in all cases about them. For instance, what should be the standard of review by a panel which is examining a national government executive branch action? Can it review national actions *de novo*, or should it only look at the law and not the facts? If it looks at the law, is it only the international law, namely the treaty clauses, at which it looks? What are the grounds of interpreting the treaty clauses?

Of course, we have a very interesting clause in the antidumping text, Article 17.6, that in the closing minutes of the Uruguay Round proved to be a possible deal-breaker. The whole round could have collapsed on the basis of this arcane language that I do not think more than about three dozen people in the world understood.

Another example is the legal effect of the result of a panel, or tribunal ruling. Generally, under international law, it is not *stare decisis*. There is some precedential effect, but it is not *stare decisis*. That

is the approach of the World Court statute, and it is a pattern reaffirmed by some of the preeminent authors of international law. Again, in a sense, that is a form of check, because it is saying: "All right, panelists, you can solve this particular dispute between countries A and B, but you're not going to proclaim a rule that's going to bind the other 138 members of this organization, in all future cases."

Then there is something that distresses some people, what I would call "national oversight and audit" of what the international system is doing. In the United States, we have a lot of it, maybe, some would say, too much of it. We have the Congress holding hearings about the United Nations, refusing to pay its budgetary fees, etc. In the WTO context, we have, on the horizon, something called the "Dole Commission." It is still not legislation, but it tracks a compromise that Senator Dole had with the administration late in 1994, which was absolutely crucial to get approval of the Uruguay Round. The idea calls for a national commission that is supposed to review and advise the Congress on the legitimacy of what a panel does in a decision that relates to the United States. Is this bad? There are certain elements that are pretty benign, although there are one or two elements that are kind of borderline, but I think we could live with them without much trouble.

National constitutions and how they work are necessary to interface the international system with the domestic system. This is a potential check. The question of selecting the officers of the international system will be a check on power. Are there self-perpetuating officers in the system that seem to be able to prolong their tenures, even though there is considerable doubt about their effectiveness as leaders of some of these international organizations? Indeed, this relates even to some allegations of fraudulent behavior.

And then there is this pregnant word that was mentioned once or twice yesterday—"subsidiarity." And, that again, relates to the question of how far up or down the scale of governmental entities should decision-making of government intervention be placed, which is partly a checks-and-balances question, but partly an allocation-of-power question, which are two questions very closely related.

III. WTO

How does the WTO stack up against this? Is the WTO going to be the institution that many of us hope it will be, and will it be an improvement on this very messy, but joyously interesting institution,

the GATT of the past? Does it improve on the GATT? I am convinced it does. I think the WTO has many attributes that are far superior to the GATT, along the lines that I have mentioned. The rule-making is much better constrained and checked, for what that is worth. The new WTO dispute-settlement understanding applies a very elaborate set of texts for a dispute-settlement procedure that we all hope is going to work well and improve the system.

The WTO faced an enormous challenge by the United States in May and June in the disastrous Japan/United States auto situation, where I think the United States very shortsightedly thumbed its nose at the system. In the end, however, it appears that the United States backed down, so in doing that, it may have actually strengthened the system.

As indicated above, however, the other side for many of these questions is whether we have gone too far with the checks. Let me just give you several examples. First, in order to amend the dispute-settlement understanding, it takes full consensus. Now, consensus is a delicate word in GATT history and in the new WTO. It is not quite unanimity, but in certain situations, I think it can amount to unanimity, and it can cause a stalemate or the prevention of any progress in evolving the Dispute Settlement Understanding rules. We have to watch and see if we can make the system work nevertheless, using certain custom and practice to try to interpret some of the existing language in a way, for example, to provide for more opportunity for transparency and public citizen understanding.

Another example is whether there will be more opportunity for NGO participation in a way that will enhance the legitimacy of the process. Another example is Annex 4 of the WTO, which contains four international text agreements that are Pluralateral Agreements, which means optional. This is a slight departure from the single-package approach of the Uruguay Round negotiation. This could be a place where you could really make some progress for new upcoming issues. That could be a place, for instance, for competition-policy text, or an environment-policy text. But additions to Annex 4 require full consensus, and thus, can be blocked. We will have to see what the practice will be. That might be an area of dynamicism in which the organization can begin to face many of these new issues, some of them left over from the Uruguay Round and some of them to be faced in the future. On the other hand, it may be a place that will result in more stalemate.