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NOTES FOR AN ADDRESS BY

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"TRADE RULES OR POWER POLITICS?

REGULATING INTERNATIONAL TRADE CURRENTS"

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Thomas Jefferson observed that "it is the trade of lawyers to question everything, yield nothing, and to talk by the hour." Although we Cambridge alumni share some of the same basic training, having been taught to question the status quo and not to yield in debate, you will be relieved to know that I do not intend to talk by the hour. Instead, I would like to discuss briefly the remarkable reform in international trade relations that is unfolding before us.

Permit me to state three propositions. First, international trade *rules* are more than ever replacing power politics. Rules are providing transparency and predictability so essential to business in a global economy. Second, the way we enforce these rules is changing. Governments are being forced to come to grips with the limits on their sovereign authority to shape domestic policy. Third, the legal community has a special role to play in helping this new rules-based system to respond to the evolving needs of global traders and investors.

To begin, let's go back a little in time. The 1948 General Agreement on Tariffs and Trade, the GATT, was designed to address high tariffs, discriminatory quotas, and other measures employed by Messrs. Smoot, Hawley and their brethren in the U.S. Congress to "beggar-thy-neighbour" at the border. The GATT's rules did not reach, for the most part, beyond national frontiers and measures directly targeting imports and exports. Rather, they called for the reduction of tariffs and national treatment. They allowed countries to adjust prices at the border in various ways, for example, through temporary surcharges to protect domestic industry from import surges, or through antidumping or countervailing duties.

GATT rules served as a transformer, a mechanism for reconciling the trade currents of exporting nations with those of importing nations. This role can be seen in the concept of "nullification and impairment," and the maintenance of a balance of advantages, which is at the root of the GATT dispute settlement procedure. Rather than emphasizing harmonization or addressing domestic policies, they ensured communication and conversion from one national electrical current to another, thereby making economic co-operation that much more efficient, avoiding blow-outs and black-outs due to incompatible power grids. But they most emphatically did not reach into the domestic sphere to change the current in the belief that by regulating what happened at the border alone, trade could be increased.

Through successive rounds of GATT tariff reduction negotiations since 1947, these rules have proven to be remarkably successful. Although some peaks remain, particularly in the agricultural sector, industrial tariffs in most sectors are now low. And as a result, trade has grown at a rate nearly double that of the growth in production.

But through the 1980s, several things changed. First, trade ministers, ingenious bureaucrats and domestic regulators, who no longer had the tariff at their disposal, devised increasingly disguised non-tariff barriers in their stead. Powerful industries in powerful countries demanded new ways to prevent competing products from crossing the border. And once again, the international community faced the prospect that economic leverage, rather than the rule of law, would govern trade relations.

Second, something fundamental changed in the international trading system. Technological innovations, such as semiconductors, fibre optics and satellite communications, increasingly fuelled the globalization of business by facilitating the globalization of production – one in which firms are increasingly free to assemble inputs from around the world and to service an equally global marketplace. This in turn has accelerated the globalization of investment, as firms learned that the best way to achieve a comparative advantage in production, in sourcing and in technology was to establish a direct presence in foreign markets. Trade became much more about the movement of components, services and technology within global firms operating in global markets.

Where once foreign investment was seen as a way of substituting for trade – a way of jumping over national barriers – it is now seen by many firms as a necessary precondition for trade, to the point where trade and investment have become virtually indistinguishable. In fact, production by foreign affiliates has now overtaken exports as the primary means for delivery of goods and services to foreign markets.

And third, as the recent automotive dispute between the United States and Japan illustrated, differences in national approaches to trade policy making have become apparent. The differences during the Uruguay Round in the United States, Japan and Europe have been described as the diffusion of power and private sector activism in the United States, the bureaucratic balancing of member-state interests in the European Union and the bureaucratic balancing among several government departments in Japan. Differences in how governments approach regulating competition, the environment, or technical standards, although not necessarily intended to impede trade, may be discriminatory in their effect or provide an unfair advantage not apparent before the retreat of the tariff. These differences all contribute to "system friction."

These developments over the past decade or so drew together countries of the world in a concerted effort to update the rules, and thereby to check the unilateral exercise of power. The seven-year trade negotiation marathon known as the Uruguay Round of the GATT proved arduous. Issues previously viewed as relating solely to the domestic sphere had been raised to the international level. No longer were countries only concerned about measures imposed at

the border. Now domestic measures affecting competition were also on the table.

Under Peter Sutherland's wonderful leadership, the member countries of the GATT responded admirably to these challenges in the Uruguay Round. The Uruguay Round Agreement demonstrates a qualitatively different and novel role for the institutions it has created and the sub-agreements it incorporates. This is evident when one compares the new World Trade Organization [WTO] with the limited and passive list of tasks assigned in 1948 to the proposed International Trade Organization and subsequently to the GATT.

Trade lawyers have moved from dealing with a 70-page GATT Agreement to a 560-page World Trade Organization Agreement. Although Sir Winston Churchill once said that "if you have ten thousand regulations, you destroy all respect for the law," our expectations remain nevertheless high. We are calling on the World Trade Organization to resolve far more complex issues. Over the coming months, early panels may involve examinations of the extent to which a country may regulate internal competition and involve itself in a domestic market. We now accept this as a matter for international scrutiny. The rules of the WTO represent a paradigm shift, a far cry from the transformer and shock absorber of yesterday. Today, the WTO's rules have become a regulator, increasingly dictating the permissible power currents in trade.

These international trade rules, like all forms of regulation, are not static in nature; rather they foster progress and direct the course it may follow. They provide an orderly means for peaceful, and profitable, change. Trade rules therefore serve a dual function. On the one hand, they bring order to chaos. They are like traffic lights, creating transparency and predictability, allowing economic actors to maximize their benefits without harming others. On the other hand, however, they also create the conditions for channelling the raw, untapped energy of trade flows. Trade rules encourage some trade patterns over others and contribute to efficiency in a given economy. Trade rules therefore both regulate and improve. And rules prevent the larger powers from unilaterally, and without warning, imposing their will on lesser economic actors. Although power can never be ignored, its nefarious effects are at least mitigated.

Trade rules will also serve as a benchmark – the WTO as regulator must also have a performance meter. Through devices such as the new Trade Policy Review Mechanism, we can observe how far each of us has come and what work remains to be done. We need to measure our performance, just as we measure trade flows themselves.

As governments have increasingly demonstrated their willingness to accept the disciplines of agreed trade rules, so have these rules become more precise, covering more areas of activity. The zone of government action free from international disciplines is

increasingly circumscribed. We have designed an international institution which can regulate these issues, rather than serve more passively as a transformer that merely explains and absorbs the differences between trading partners.

As examples, let us look at two WTO agreements on non-tariff barriers: "technical barriers to trade" and "sanitary and phytosanitary measures," or SPS. In dealing with matters traditionally within the zone of domestic regulation, both agreements seek to strike a careful and appropriate balance between the right of every government to regulate in the name of safety, health, consumer protection, and the environment, on the one hand, and on the other hand the need to ensure that such regulation does not become an unnecessary obstacle to trade. The technical barriers agreement sets out specific rights and obligations regarding such government technical regulations and industry standards as labelling and packaging, terminology and symbols, and regarding testing, inspection and approval procedures. The SPS agreement deals specifically with measures to protect human, animal and plant life and health, for example, regarding pesticide residues in food, plant and animal diseases, food additives and toxins.

The agreements make clear that governments remain free to pursue legitimate regulatory objectives, such as consumer safety and health protection. Every government may establish the levels of protection that it considers appropriate. In other words, nothing in either the North American Free Trade Agreement [NAFTA] or the World Trade Organization Agreement constrains a government from determining the degree of tolerance or protection it wishes.

The technical barriers agreement says, in effect, that technical regulations must not discriminate between foreign and domestic products, and must not create unnecessary obstacles to trade. Special rules ensure that, where testing and approval procedures, or "risk assessments," are required, they are administered in a manner that treats foreign and domestic goods on an equal footing. The SPS agreement takes a somewhat different approach: governments must base their SPS measures on scientific principles and on a risk assessment. In effect, this requires a government to ensure that there is a reasonable relation between its measure and the underlying objective it is designed to meet.

Both agreements use internationally agreed standards as a benchmark, but generally allow governments to impose higher standards where the international standard is ineffective or inappropriate to meeting legitimate objectives.

In recognition of the fact that trade is made easier where domestic regulations in different countries are compatible, both agreements promote "equivalence" of standards and technical regulations. However, the notion of "mutual recognition" can be just as

effective, and less of an interference in domestic rule-making, in ensuring that regulators accept the domestic regulations of other countries as equivalent in a manner that ensures enhanced safety and consumer protection.

And in the spirit of avoiding disputes through early warning, both agreements require "transparency."

In sum, the new agreements on technical barriers to trade, or standards-related measures, and on sanitary and phytosanitary measures seek to provide a framework within which government, industry and consumers can address legitimate consumer health and safety and environmental measures in a manner that facilitates international trade.

At the recent G-7 Summit in Halifax, leaders of the major industrialized nations confirmed their commitment to implement the Uruguay Round Agreements, to consolidate the WTO as an effective institution, to ensure a well-functioning and respected dispute settlement mechanism, and to ensure that participation in regional trade initiatives continues to be a positive force for the multilateral system. As we stand at the summit's peak, we can survey with some pride the WTO Agreement and all that we have already accomplished in various regions. The successful conclusion of the Uruguay Round, thanks in large measure to Peter Sutherland's energy, intelligence and, in the end, sheer obstinacy, is surely one of the great achievements of the latter part of the 20th century, crowning almost eight years of negotiations, and signalling the fundamental changes occurring within the international trading system. We are right to regard this achievement with satisfaction.

It is tempting at this juncture to avoid climbing other peaks and take the easy path downwards towards gentler pastures. But attractive as a gentle stroll from the summit down to tranquil meadows might be, we cannot afford complacency. Why must we turn away from such pleasant prospects so soon after such a rigorous ascent? Because the signing of a trade agreement is but one peak among many to be crested. The conclusion of any trade agreement, even one of the sheer volume of the Uruguay Round for example, is only a beginning, and not the mere conclusion of a round of negotiations, difficult as they may have been. The G-7 leaders at their recent summit in Halifax said:

> We are committed to the successful completion of current negotiations in services sectors and, in particular, significant liberalization in financial and telecommunications services.... We encourage work in areas such as technical standards, intellectual property and government procurement; an immediate priority is the negotiation in the OECD of a high-standard multilateral agreement on investment.

Governments are not leading the charge; we are simply trying to keep up with global trade patterns. We cannot achieve this without trade rules to back us. We need the rule of law, as embodied in the WTO, to serve as regulator and transformer all at once.

The new, far-reaching and prescriptive rules of which I have been speaking have bred new challenges. These rules demand streamlined and effective dispute settlement to equip us with expeditious, timely and responsive procedures to enforce the rules and to prevent all-out trade wars – a sort of essential containment function.

As I have noted, until the World Trade Organization came into being, dispute settlement within the GATT, as transformer, was concerned primarily with the maintenance of a balance of reciprocal rights and obligations, rather than illegality or breaches of treaty obligations. This mechanism was a strange and unwieldy beast for trade lawyers, very different from the legal systems in which they had received their initial training. As an illustration, no consensus ever emerged on the nature of a GATT Panel ruling – whether or not it was binding on the parties to the dispute and whether or not it created legally binding interpretations of GATT rules for future disputes.

Within this difficult framework, there developed additional problems over the years. Delays of up to two years occurred between initial requests for consultations and circulation of a panel report. The quality of panel reports, while generally good, could vary. There were even, on occasion, shortages of qualified, available panelists. Moreover, the adoption of panel reports could be blocked by one of the parties to the dispute if it found it convenient to do so. Even if adopted, implementation of recommendations by the offending party could be delayed.

Now, with the creation of the World Trade Organization, a new era in dispute settlement has dawned. Practical and positive changes are being wrought. The creation of a Dispute Settlement Body which will manage all disputes, improved time limits, automatic establishment of panels, the creation of an Appellate Body and improvements in implementation and compliance procedures all mean that the new World Trade Organization, the regulator, has been given some bite.

Building on the impressive achievements of the North American Free Trade Agreement, the WTO now recognizes the importance of effective institutional arrangements for conducting trade on a non-discriminatory basis. It recognizes that the best form of dispute settlement is dispute avoidance. The best way to avoid disputes is to let others know what you are planning to do, to hear the views of others, and to correct small mistakes before they fester and become political issues. Hence the emphasis on transparency. The WTO also points towards more permanence in institutions.

However, these developments fall short of the revolution that is required. Although we have made such tremendous progress on the substance of the rules, some are now questioning the way in which these rules should be enforced.

Take the area of trade remedies. Under both the Canada-U.S. Free Trade Agreement and later the NAFTA, we created a unique system for binational panels to carry out judicial review of domestic antidumping and countervailing duty determinations. Although only an interim solution which, while responding to the problem of harassment by special interests, has no permanent place in a free trade area, this system has worked remarkably well. Over 50 cases have been heard; decisions have been well-reasoned and of a uniformly high quality and have been implemented by domestic authorities in the majority of cases without criticism or complaint. But now, the same special interests in the United States that used and abused trade remedy laws before are claiming that international judicial review raises constitutional problems.

The recent automotive dispute between the United States and Japan is again instructive. Faced with a range of domestic regulations that prohibited foreign firms from selling into the Japanese automotive market, the United States' knee-jerk reaction was to threaten unilaterally to impose sanctions first, and only later to accept begrudgingly that the WTO dispute settlement procedures might provide an avenue for achieving greater market access – for enforcing the rules.

Now it may be true that the differences between the United States and Japan were in part about matters on which we do not yet have rules, such as competition and concentration in domestic markets. And that is why, as I mentioned, governments are committed to building on the results of the Uruguay Round to broaden and deepen the coverage of international trade rules. But several aspects of the dispute are about things that the WTO does address: import procedures, technical standards, and other market access issues.

The knot of the problem is the question of sovereignty and national prerogatives. Canada's implementing legislation for the WTO Agreement involves amendments to 29 federal statutes, on matters ranging from banking licenses to entry visas for business people, and from trademarks, copyrights and patents to pest control products. The result is an ever-increasing interplay between domestic and international rules. As noted GATT scholar John Jackson has observed, this necessarily affects the decisions policy leaders make about when and how to intervene in their national economies.

We know that governments will intervene in their national economies when faced with "market failure" or when seeking to achieve "non-economic goals." They will have at their disposal such varied tools as taxation, regulation, subsidies and the manipulation of

incentives. But when does such intervention become an international issue? At what point should international rules step in? Within what decision-making framework will it choose to do so?

To the south of the 49th parallel, some are cringing at the expanded reach of the rules of NAFTA and the WTO. For example, Senator Dole has proposed a WTO Dispute Settlement Review Commission, with a mandate to review whether WTO panel decisions should be accepted by the United States. Americans seem to be contemplating the establishment of their own transformer, to shield themselves from WTO currents should they become "tyrannical and abusive." And I have already mentioned that arguments have been raised which query the constitutionality of giving antidumping and countervailing duty panel decisions binding effect in United States domestic law. Although the United States can rightfully claim to be a staunch defender of the international rule of law through such central institutions as the International Court of Justice and other United Nations bodies, there are those in the United States who appear unwilling to accept such an international rule of law for international trade. Section 301 still looms large on the horizon, despite the panoply of international rules now at the United States' disposal.

These new rules will become useless pronouncements without the backing of the proper incentives to ensure their enforcement. As we witness the growth pains of a new and more muscular institution, we must nourish it by making strengthened dispute settlement a high priority. Indeed, the credibility of the WTO will hang on the success of its dispute settlement mechanism.

Some day in the not-too-distant future, we may have to consider whether the WTO dispute settlement system, even with all the improvements over the GATT regime that preceded it, is up to the task of guaranteeing respect for the rule of international trade law. In Europe, the architects of what has become the European Union recognized that significant economic integration had to be accompanied by a system through which rules could be enforced effectively. And they concluded that only by creating a European Court of Justice with supranational authority, and by giving its rulings direct effect in the domestic law of its member states, could respect for an open trade and investment environment be assured.

Some have said that such supranationalism is antithetical to the democratic traditions which have shaped the American, Canadian and British political systems, that direct effect of international law cannot be reconciled with representational government and public accountability. Senator Dole refers to "unelected bureaucrats" with "an agenda of their own to modify existing international trade amendments, abuse their role, and reach inappropriate results." But the very source of our democratic traditions, Great Britain itself, yields ample proof that democracy and an international rule

of trade law can co-exist. In 1970, the British Parliament passed the European Communities Act and, although the relationship between Great Britain and its European partners has on occasion been rocky, British lawyers and judges have reconciled parliamentary sovereignty with the regulation of trade by the European Union. Through a wise, practical and jurisprudential approach, the British have demonstrated that Western democratic traditions are fully consistent with supranational regulation of trade.

Canada is taking some steps toward strengthening the rule of international trade law ourselves. For example, the NAFTA provides for investor-state dispute settlement, under which a foreign investor may itself invoke international arbitration directly against its host government to enforce the rules of the treaty. Final awards in such matters are given direct application in domestic law. And the pending negotiations concerning the OECD's proposed Multilateral Agreement on Investment may well draw on this example, providing as it does a powerful counterweight to special interest lobbying by obviating the need for companies to politicize disputes.

Another step in strengthening the enforcement of rules has been increasing the role of domestic authorities in enforcement. With more and more areas of domestic economic regulation now disciplined to some extent by international rules, so too more and more provisions of domestic statutes have their genesis in an international treaty. And both the NAFTA and the WTO set out a range of enforcement procedures to be implemented domestically: bid challenge review procedures for procurement; civil remedies for trade-related intellectual property matters; procedural requirements for the conduct of trade remedy proceedings, to name just a few. Domestic fora are, in effect, being asked to act as agents to enforce the international rules.

I have talked about creating a "WTO Plus" – a framework for liberalized trade among countries willing to go farther than all have been able to go to date, to go farther in regional groupings such as Asia-Pacific or the Western Hemisphere pending additional global rules. But the WTO Plus is also about controlling the incredible power surge created by trade flows and plugging it into the multilateral generator. Proper enforcement of international trade rules therefore serves the best interests of all trading nations. And, with many of the rules already agreed to, the step towards effective enforcement need not be as traumatic as many would make out. Indeed, it flows naturally from all that we have accomplished to date. Both domestic and international rules and rule-makers can work together, can learn from each other and reap the benefits of trade. As Canadians, we are particularly well placed to assist in the construction of a new WTO Plus architecture. We have always been committed to the overarching ideal of the rule of law, both within and among nations. And, as a small country open to the world through the tremendous percentage

of our economy given over to trade, we are quite comfortable with interdependence and international regulation.

As it unfolds, this growing interplay between the domestic and the international must have a significant impact on your daily lives as legal professionals. It imposes a professional responsibility to stay current with international legal developments. The practice of law has traditionally been viewed as a field that was jurisdiction-specific. Lawyers were rarely allowed to move beyond the confines of the law of their jurisdictions. But decisions about mobility rights in the European Union and under the Charter of Rights in Canada blazed a new trail. So too, in the new world trade order, things are different. If the statute that you interpret or apply flows from international considerations or has international consequences, you must be aware of this international dimension. If enforcement of global trade rules in part takes place at the domestic level and is not limited to the government-to-government arena, your advice must include continuing analysis of these rules. If domestic courts and tribunals are becoming local agents for the enforcement of international rules, then the relationship between domestic law and international law must be recognized explicitly. The practice of law is thus at the epicentre of a developing rule of international trade law.

But even the best-designed dispute settlement system, supranational or domestic, can only work if the rules themselves respond to business imperatives. And, as I mentioned, G-7 leaders at Halifax affirmed their commitment to addressing areas where the rules still fall short. However, we in government work from our remote capitals. Accordingly, we are dependent on you, on the front lines, to inform us of what is actually happening and what response is required. The legal community plays an essential role, not only in helping to write and to enforce the rules, but also in thinking strategically about where we are headed and to keep pace with developments as they unfold. New issues, including trade and environment, trade and competition, employment and labour standards, will increasingly require our attention, whether in the World Trade Organization or in the various regional groupings.

An ongoing dialogue among the legal community, business and government is essential to the development of an intelligent response to economic trends. I look forward to the next Cambridge Lectures to ensure that our lines of communication remain open.

Thank you.