SCHOOL OF LAW
UNIVERSITY of CALIFORNIA • IRVINE

Legal Studies Research Paper Series No. 2018-51

Bargaining Over Policy Space in Trade Negotiations

(Chapter In: Globalization Reimagined: A Progressive Agenda for World Trade and Investment Law, eds. David Trubek, David Kennedy, Alvaro Santos, and Chantal Thomas. Forthcoming 2019)

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Bargaining over Policy Space in Trade Negotiations

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In *Globalization Reimagined: A Progressive Agenda for World Trade and Investment Law, eds. David Trubek, David Kennedy, Alvaro Santos, and Chantal Thomas. Forthcoming 2019*

The international trade law regime overseen by the World Trade Organization (WTO) faces two significant issues from the perspective of policy space: (a) its failure to deal with imports produced under conditions that violate international labor norms and (b) the restrictions it imposes on development strategies that deter legitimate experimentation. This essay proposes two reforms in trade law to address these two issues: (1) a hybrid antidumping/safeguard regime that would authorize increased tariffs when imported goods are produced under substandard labor conditions; and (2) exceptions to the law on subsidies for legitimate industrial policy for development purposes. While there will be opposition to these measures since the "North" has an interest in the first and the "South" in the second, it may be possible to negotiate such a reform package with appropriate safeguards against abuse if political will can be mustered. Otherwise, countries may push the interpretation of existing WTO law to accommodate these policies, placing greater pressure on the WTO's judicial bodies.

Trade negotiations traditionally involve reciprocal bargaining to increase market access. In this way, they ratchet up trade liberalization over time. Yet, democratic governments are interested in more than just one-way trade liberalization. They also are concerned about policy space, and thus negotiations can and should involve reciprocal bargains over it to ensure democratic legitimacy and responsiveness. One can envisage parallel trade negotiations over policy space between developed and developing countries. The negotiations could involve the provision of greater policy space for developed countries to uphold the domestic social contract by protecting labor against social dumping, on the one hand, and greater policy space for developing countries to adopt experimental industrial policies to move up the value-added production chain, on the other hand. In this way, they can address both (a) the trade-labor problem involving the export of goods produced under working conditions that violate international norms, and (b) the trade-development problem involving WTO restrictions on industrial policies for development.

The challenge with these proposals is that they can impose significant externalities on outsiders. These externalities, however, can be subject to bargaining, as is the case with any rule. The challenge is to operationalize the concept of negotiating over policy space through new legal provisions while limiting the risks of protectionist abuse. Dani Rodrik has advocated the need for

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these policies to address distributional and development concerns.[2] What we need is complementary legal analysis regarding how they can be designed and operationalized. This essay sets forth a proposal.

1. Protection against social dumping. Claims of unfair trade proliferated following the election of neo-nationalist United States (U.S.) President Donald Trump. The underlying problem from a social policy perspective, however, is not "unfair trade" as viewed through the traditional WTO lens of product dumping because antidumping procedures tend to involve accounting ploys to show differences in pricing that may be economically justifiable and thus not "unfair."[3] The real underlying concern should be social dumping of products—that is, products produced under exploitative labor conditions—that sell for less than domestically produced products, and that thus lead to concerns over wage suppression and reductions of labor protections in the "North." These policies can undermine the domestic social contract and trigger political contestation against trade. A number of bilateral and plurilateral agreements include labor clauses pursuant to which countries agree not to obtain a trade advantage by failing to uphold national labor laws or (in some cases) minimum labor standards. These provisions, however, have proved insufficient in ways that this proposal aims to remedy.[4]

If provisions to safeguard against social dumping are incorporated into trade agreements, they should be subject to strict procedural, substantive, and injury requirements to combat abuse. Many of the provisions could take from the current WTO antidumping regime. The procedural criteria could mirror or build on Articles 5 (Initiation and Subsequent Investigation), 6 (Evidence), 11 (Duration), 12 (Public Notice and Explanation of Determinations), and 13 (Judicial Review) of the WTO Antidumping Agreement. Most importantly, due process rights would be provided to affected parties, including exporters, importers, organized labor, and other social groups, including consumer organizations. Similarly, injury criteria could reflect those set forth in Articles 3 and 4 of the WTO Antidumping Agreement, which require the showing of a "material injury," or threat thereof, to a "domestic industry." WTO jurisprudence provides significant guidance regarding these provisions' application.

The first challenge with implementing this proposal is to specify when violations of labor rights occur so that a country may impose increased tariffs. The criteria chosen would build from

[2] *See* DANI RODRIK, HAS GLOBALIZATION GONE TOO FAR (1997); DANI RODRIK, THE GLOBALIZATION PARADOX: DEMOCRACY AND THE FUTURE OF THE WORLD ECONOMY (2011); DANI RODRIK, STRAIGHT TALK ON TRADE: IDEAS FOR A SANE WORLD ECONOMY (2017).

[3] The issue of subsidies, such as from China, is more complicated. On the one hand, traditional economic analysis contends that foreign subsidies of traded goods benefit importing countries and their consumers. In particular, they increase a country's terms of trade because foreign governments make their subsidized exports cheaper for an importing country's consumers while that country's exports sell at the same price, bringing in the same amount of revenue. Nonetheless, there is significant evidence that subsidized Chinese products have harmed some U.S. workers and communities. Existing WTO rules permit governments to countervail and directly challenge these subsidies. However, the WTO Appellate Body has been criticized for placing undue constraints on governments' ability to countervail and challenge them.

[4] See Kerry Rittick, this volume.

experience with existing labor chapters in trade agreements, including the original Transpacific Partnership (TPP). The norms would address labor rights violations, and thus not undercut developing countries' comparative advantage in producing goods with lower skilled labor in reflection of differences in productivity. The list of labor norms would include rights against forced labor, child labor, hazardous work, and discrimination, establishment of maximum working hours and a minimum wage, and most fundamentally, rights to freedom of association and collective bargaining.[5] A country deciding to impose duties would need to show sustained violations.

A second challenge is obtaining evidence establishing labor rights violations. This can and has been done.[6] Indeed, the U.S. prevailed on this issue in its challenge of Guatemala's labor practices under the U.S.-Central America Free Trade Agreement (CAFTA).[7] To gather evidence of labor rights violations, governments can work with labor and civil society organizations, and recognize and incorporate evidence from reports of the International Labour Organization (ILO) on country practices, as the U.S. did in the Guatemala case.

A third challenge is to determine the amount of tariffs that may be imposed on the imports in response to the labor rights violations. The WTO Antidumping Agreement provides detailed provisions for the calculation of antidumping duties based on a comparison of product prices in the country of production and the importing country to determine dumping margins. The result is high transaction costs for all sides, including for the administrative authority. Accounting for the price differential caused by social dumping, in contrast, would not be necessary. In the case of social dumping, duties could be limited to the amount that would offset the injury that the increased imports from the country in question cause or threaten to cause to the domestic industry. Calculating such amount would be more transparent and not involve the manipulation of pricing data, thus reducing administrative costs for firms and administrative agencies. It would be analogous to the calculations made in safeguard procedures conducted under the WTO Agreement on Safeguards.

There are two key differences between this proposal and trade agreements such as CAFTA. First, under this proposal, a country can take direct action against imports produced under non-conforming labor standards. This proposal would shift leverage to the importing state to protect its social contract. No longer would it have to bring an international claim against the party violating the agreement. Rather, subject to procedural, substantive, and injury requirements, the importing country could impose a social dumping duty, just as it currently can apply a traditional antidumping duty under existing antidumping law.

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[5] See e.g. MARK BARENBERG, SUSTAINING WORKERS' BARGAINING POWER IN AN AGE OF GLOBALIZATION (2009). The minimum wage would have to be set near the market clearing rate, which will vary not only by country, but also within countries. Countries should thus have discretion in setting a minimum wage, which may vary within them in light of differing labor market conditions.

[6] Discussion with former official at USTR who worked on the case where the U.S. challenged Guatemala under the U.S.-Central America Free Trade Agreement (CAFTA), March 1, 2018.

[7] *See* In the Matter of Guatemala – Issues Relating to Obligations under Article 16.2.1(a) of CAFTA-DR (Final Panel Report, 2017).

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Second, the petitioner bringing the domestic social dumping action need not prove a causal link between the labor rights violations and increased imports. Rather, a petitioner would only need to show a correlation between (a) the violation of the specified labor rights, and (b) an increase of imports of the products from the country in question that causes or threatens to cause material injury to a domestic industry. The analysis would be simplified. The focus would be on the existence of sustained labor rights violations, in combination with a percentage rise in imports relative to domestic production that causes or threatens to cause material injury to a domestic industry.

This proposal is a hybrid that combines antidumping procedures with a safeguard remedy—that is, it combines a substantive law trigger based on labor rights violations and a safeguard remedy based on increased imports of products causing or threatening to cause material injury to a domestic industry. The rationale for this hybrid is at least two- (and for many) three-fold. First, it is notoriously difficult to prove causation and such difficulty should not work to the advantage of a producer that violates labor rights in a sustained manner. Second, a country should be able to safeguard its social contract by providing a remedy against products produced in such a manner. Third, for many people, sustained violations of international labor rights raise moral concerns and a country should not be forced to open its market to products produced in violation of them.

In practice, as under the current antidumping regime, the initiation of the investigation would trigger negotiations with the party subject to the investigation. As under Article 15 of the Antidumping Agreement, "constructive remedies" could be explored. In this case, however, negotiations triggered by a threat of tariffs would focus on measures to enhance compliance with labor rights. Labor and civil society organizations would be granted access to the process. This proposal would thus more directly benefit the exporting country's workers.

Such a social dumping agreement can be subject to abuse and thus must be subject to legal discipline. To counter abuse, an analogue to NAFTA Chapter 19 could be incorporated so that an exporter could request the establishment of a binational panel to review the final determination issued by the relevant authority.[8] In addition, or alternatively, the targeted country could bring a claim of non-compliance before the WTO dispute settlement system, just as under the existing WTO antidumping regime. Finally, as with all WTO agreements, compliance would be overseen by a WTO committee. In this case, however, representatives of the ILO could be granted official or observer status within it, leading to greater coordination of international labor rights policies.[9]

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[8] North American Free Trade Agreement, Dec. 17, 1992, 32 I.L.M. 289, at art. 1904.5. *See also* David A. Gantz, *Resolution of Trade Disputes Under NAFTA 's Chapter 19: The Lessons of Extending the Binational Panel Process to Mexico*, 29 LAW & POL'Y INT'L BUS. 297, 298 (1998).

[9] For example, the ILO has official status regarding the implementation and supervision of the Bangladesh accord that followed in the wake of the Rana Factory fire. *See* Larry Catá Backer, *Are Supply Chains Transnational Legal Orders? What We Can Learn from the Rana Plaza Factory Building Collapse*, 1 UC IRVINE JOURNAL OF INTERNATIONAL, TRANSNATIONAL, AND COMPARATIVE LAW 11, 13 (2016). In the WTO context, the International Monetary Fund (IMF) is granted official status within the WTO Committee on Balance of Payments Restrictions. *See* Gregory Shaffer & Michael Waibel, *The (Mis)alignment of the Trade and Monetary Legal Orders*, *in* TRANSNATIONAL LEGAL ORDERS,

If current antidumping law remains a parallel procedure (which would likely be the case given the political economy of trade negotiations and the need for a political safety valve), then there would be rules against "double counting," just as there are when antidumping and countervailing duty investigations are currently conducted.

If countries fail to agree to such provisions, countries could attempt to apply them under existing WTO law by claiming a general exception under GATT Article XX(a), which permits countries to restrict imports where "necessary to protect public morals" so long as the measures do not "constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction of international trade."[10] Article XX(a), however, lacks this proposals' procedural, substantive, and injury criteria and thus would be more subject to abuse. Moreover, the rationale for its use would have to be on moral grounds over the treatment of *foreign* workers, rather than economic and distributional grounds regarding protection of *domestic* workers and the domestic social contract. Thus, it should be much more difficult for a neo-nationalist government—such as that currently in power in the United States—to prevail compared to one whose policies are expressly outward-looking.

2. Industrial policy space for developing countries. Considerable policy experimentation is needed to catalyze economic development since no one knows in advance what works. This is particularly the case given the vastly differing contexts that countries face. Rodrik and others critique WTO rules for taking industrial policy options off the table for developing countries.[11] Industrial policy experimentation for development could be expressly authorized by amending existing WTO agreements, which already provide a framework. Developing countries could demand enhanced policy space for their development initiatives in return for provisions authorizing social dumping measures, again subject to legal discipline.

Since industrial policy of one country will have externalities on others, criteria need to be specified as part of a bargain. In the case of industrial policy, rules could be set forth in a separate agreement or in a revision of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). They would include general principles, substantive criteria, time limits, and reporting and transparency obligations. The general principle would be that the plans must aim to increase

187, 195, 198-201 (Terence Halliday & Gregory Shaffer eds., 2015) (formal analysis required from IMF before the WTO committee). In contrast, WIPO is granted observer status in the WTO Council for Trade-related Aspects of Intellectual Property Rights and the United Nations Environmental Programme holds such status in the WTO Committee on Trade and Environment. *See* World Trade Organization, *International intergovernmental organizations granted observer status to WTO bodies*, https://www.wto.org/english/thewto_e/igo_obs_e.htm (last visited Feb. 26, 2018).

[10] The WTO Appellate Body recognized the application of this defense for an E.U. ban on the importation of seal products in response to and in reflection of public morals regarding animal welfare. Restrictions on imports of goods produced in violation of human rights should also be permitted on "public morals" grounds.

[11] *See* RODRIK, THE GLOBALIZATION PARADOX, *supra* note…; RODRIK, STRAIGHT TALK ON TRADE, *supra* note…

productivity and set forth clear criteria for success so that they can be evaluated.[12] The substantive criteria would aim to constrain potential abuse.

The WTO SCM Agreement initially provided exceptions pursuant to which three types of subsidies would not be actionable: subsidies for research; subsidies providing assistance to disadvantaged regions; and subsidies for adaptation of facilities to meet environmental requirements, provided in each case they met specified criteria.[13] Those provisions lapsed, but they could be revamped and updated to include development-related industrial policies. For example, they could cover experimentalist policies to develop infant industries, which were initially permitted under GATT Article XVI (on Subsidies) and Article XVIII (on Governmental Assistance to Economic Development), but which are now subject to challenge under the SCM Agreement.

Under a revamped SCM Agreement, special authorization for industrial policy experimentation for development could be made available under agreed terms. For example, it could be limited to developing countries that meet defined World Bank criteria in terms of per capita income, and it could be further subject to industry competitiveness criteria. The criteria could build from national programs under the existing "Generalized System of Preferences" (GSP) that provide for preferential tariff treatment of developing country imports, subject to the denial of benefits once an industry becomes competitive.[14] Under the E.U.'s GSP program, for example, once countries become listed as high- or upper-middle-income economies (using World Bank criteria based on per capita income) for three consecutive years, they cease to benefit from the program.[15] Similarly, countries lose GSP preferences for their highly competitive export sectors. Analogous criteria could define beneficiary countries and sectors entitled to benefit from preferential treatment for industrial policy experimentation for development. In this way, countries like China would graduate from the system. Under the proposed system, the criteria for graduation would be agreed multilaterally, and thus not left to countries' discretion.

Time limits would be agreed so that ineffective programs are abandoned. The WTO Agreement on Safeguards provides an example of imposing time limits. Under it, a safeguard measure may be maintained without being subject to a withdrawal of concessions for three years.[16] Similarly, an industrial policy measure could be limited to a set number of years without being

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[12] Ricardo Haussman, Dani Rodrik, & Charles Sabel, *Reconfiguring Industrial Policy: A Framework with an Application to South Africa* (HKS Working Paper No. RWP08-031, 2008); Dani Rodrik, *Industrial Policy for the Twenty-First Century*, UNIDO (2004), http://www.vedegylet.hu/fejkrit/szvggyujt/rodrik_industrial_policy.pdf.

[13] Agreement on Subsidies and Countervailing Measures, art. 8.2, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 14.

[14] The provisions also could build on the concept of "export competitiveness" under Article 27.6 of the SCM Agreement (3.25% share of world trade for a product for two consecutive years) and the carve-out for export subsidies provided under Annex VII of the SCM Agreement (for least-developed countries and a list of developing countries until they reach a per capita GNP of $1,000).

[15] See GSP Handbook on the Scheme of the European Union. UNCTAD/ITCD/TSB/MISC.25/Rev.4 (2016), http://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1470.

[16] Agreement on Safeguards, art. 8, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 154.

subject to retaliation, provided it met the agreed criteria and the country complied with the other obligations relating to it.

The country adopting such a measure would have to report its program. The SCM Agreement already requires that members notify their subsidies each year to the WTO Committee on Subsidies and Countervailing Measures. However, the record of industrial subsidies notification is poor, with over half of WTO members not notifying them.[17] China's failures have particularly irked the United States, which has proposed sanctions against countries that fail to notify, such as a suspension of certain WTO benefits.[18] Under this proposal, a country's failure to report its obligations could trigger a suspension of the ability to use the policy until compliance occurs. Such a sanction would incentivize reporting in ways that the current SCM Agreement does not.

Transparency and reporting are public goods. They are important not only for trade relations, but also for domestic governance to limit rent-seeking. They reduce information asymmetries, enabling firms, citizens, and trading partners alike to know what governments are doing. Even if an industrial policy measure is legitimate, the public has a right to know, and other governments must be assured that it is not abused. In particular, domestic stakeholders must be able to monitor and hold experimental industrial policy programs accountable. Otherwise the results of experiments would not be known, and the risks of cronyism would increase. In the process, governments can learn from each other's experiences.

This proposal too would be subject to risk of abuse. To counter abuse, just as under WTO agreements generally, policies that fail to meet the criteria would be subject to traditional trade dispute settlement. In addition, to the extent that such policies cause material injury to a domestic industry in an importing country, that country could still impose countervailing duties, as under the current SCM Agreement. The ability to bring countervailing duties against such policies would, of course, limit the impact of industrial policies. Yet, such provisions would be required to address potential externalities on producers in third countries. This proposal would represent a return to the trade policies under the GATT where developing countries could subsidize infant industries, but their products could be countervailed when imported into a developed country where the subsidies caused or threatened to cause significant injury to a domestic industry.

Once again, if no agreement is reached, developing countries could initiate them and claim that they are not prohibited "specific subsidies" under the SCM Agreement and are thus permissible. This proposal, however, provides criteria that would help combat abuse in ways that are important both for trading partners and for domestic stakeholders.

3. Feasibility. Negotiation of these provisions would not be easy. Developing countries are wary of granting authorization to developed countries to block imports on social dumping grounds and developed countries are suspicious of emerging economy industrial policies. Emerging economies would demand some benefit from the negotiations to the extent that they could be

[17] Gregory Shaffer, Robert Wolfe & Vinhcent Le, *Can Informal Law Discipline Subsidies*, 18 J. INT. ECON. L. 711 (2015).

[18] Communication from the United States, *Procedures to Enhance Transparency and Strengthen Notification Requirements Under WTO Agreements*, World Trade Organization JOB/GC/148, 30 Oct. 2017.

excluded from the industrial policy exceptions and be a target of social dumping measures. Similarly, to the extent that many developing countries do not feel constrained by the SCM Agreement, they may find that they have less to gain from these negotiations than developed countries.

Here is where bargaining comes in. Subject to bargaining, provisions can be structured to combat abuse so that they would be subject to no more (and arguably much less) abuse than current WTO rules on "unfair" trade, such as antidumping and countervailing duty rules. For example, developing countries could be granted compensation when prevailing in a WTO challenge against a social dumping measure. In addition, bargaining could incorporate other issues of interest to countries, whether involving market access or other forms of policy space. Finally, the difficulties faced should be compared with the real-life alternative of existing challenges to the trading system. These issues should be frontally discussed so that the underlying social and development issues are addressed transparently. A multilateral institution such as the WTO provides an important forum for doing so. Negotiations can advance in parallel in plurilateral and bilateral fora. The conceptualization of trade negotiations in all fora should explicitly address policy space concerns.

4. Conclusion. These are politically challenging times. They present severe risks as well as opportunities. It is time to put forward proposals that retool trade agreements so that they directly address the challenges of social dumping and industrial policy experimentation for development. To address these issues, this essay proposes the creation of an antidumping system that directly addresses labor exploitation and new rules that permit industrial policy experimentation for development, in each case subject to defined criteria.

Lawyers and economists provided the intellectual constructs and designs for the existing trade legal order. John Maynard Keynes, for example, called lawyers the "poets" at Bretton Woods for their imagination in helping to craft the agreements.[19] Now economists and lawyers must do the same for the regime's redesign so as to save it from imploding.

[19] 26 JOHN MAYNARD KEYNES, THE COLLECTED WRITINGS OF JOHN MAYNARD KEYNES 102 (Donald Moggridge ed., 1980).