Free Markets and Social Regulation: A Reform Agenda of the Global Trading System

by Sungjoon Cho

KLUWER LAW INTERNATIONAL

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Preface

This book seeks to diagnose challenges and to prescribe solutions for reconciling the clash between free markets and state regulation in international economic law. Against the backdrop of a transformation in the *telos* of the global trading system, from the narrow 'anti-protectionist' emphasis of GATT 1947 toward the much broader vision of the WTO, with its focus on 'integration,' 'anti-unilateralism' and 'sustainable development,' the book identifies a strong 'pro-trade' bias in the line of GATT jurisprudence and problematizes such bias in terms of a 'dual crisis' involving both regulatory and trade failure. As a solution to this crisis, the book introduces a new line of jurisprudence under the WTO system—principally, the so-called 'chapeau' test highlighting the *manner* in which a domestic regulation is adopted or applied rather than the *substance* of the regulation itself—which offers considerable promise as a means for achieving the dual goals of free trade and regulatory autonomy.

Yet, despite the potential benefits of this new jurisprudence, the book points out that the pro-trade bias still remains due to a structural 'dichotomy' between general obligations such as National Treatment, and exceptions under Article XX, to which the chapeau belongs. To bridge this dichotomy, the book demonstrates that the pursuit of the dual ideal of free trade and autonomous state regulation is treated in a more intellectually sophisticated and balanced fashion under the side agreements (SPS and TBT) than under the GATT. The book then deals with the 'domestic' issue of compliance and implementation under which the detailed behavioral changes must take place in order to execute those prescriptions to the dual crisis that the GATT/WTO jurisprudence and agreements offer.

Finally, the book surveys the phenomenon of convergence between the WTO and other representative polities and institutions, which may be observed to the extent that the management of the interface between free markets and state regulation is sought through treaties, jurisprudence and implementation of rules and regulation. In the context of such convergence, the book proposes a '*jus gentium* of international trade on domestic regulations' as a common legal precept that is capable of guiding, in a coherent and integrative way, the reconciliation of the clash between free markets and state regulations within the far-reaching field of international economic law, a precept that encompasses not only the WTO, but also other polities and institutions, such as the EU, the US and NAFTA.

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Finally, I dedicate this book to my late brother-in-law, Seokyun, who died young, but who will live long in our memories, for he taught us what life is.

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Introduction

In recent years the world has witnessed an unprecedented degree—both in speed and scope—of economic integration geared by the expansion of international trade. Often cited as an icon of globalization, the volume of world trade now measures fourteen times what it did just fifty years ago. Money flowing through the international financial market in a given day amounts to one trillion dollars. As the former WTO[1] Director-General Renato Ruggiero once said, 'the global market is becoming an internal market—and *vice versa*.'[2] Many factors, ranging from technological innovation to the fall of the Berlin wall, help to explain this dramatic phenomenon. Yet of practical significance for the present discussion is the fact that, thanks to this expansion of international trade, many countries including newly industrialized economies (NIEs) such as Korea, have been able to escape from the misery of poverty and dramatically raise their standards of living.[3]

Nevertheless, the effects of trade expansion and consequent economic integration have not been uniformly positive. In many situations they have constrained the free exercise of regulatory power in non-trade matters by sovereign states. For example, orthodox conceptions of free trade are viewed as incompatible with domestic bans on the importation of hormone-treated beef or genetically modified foods because such measures have the potential to hinder or impede global trade in agricultural products. On the other hand, critics of such perspectives would argue that free trade should not necessarily be allowed to force a reluctant citizenry to tolerate a lower level of regulatory protection. That is, if the people of a nation abhor exposure to asbestos and therefore choose a zero tolerance policy, free trade in asbestos-based products must yield under certain conditions. Yet, it is also problematic and undesirable if such regulatory considerations result in an inundation of regulatory unilateralism fatal to international trade. In fact, regulatory heterogeneity itself is a serous trade barrier whether or not it originates from protectionist intent. Global free trade is hard to

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1. Marrakech Agreement Establishing the World Trade Organization, April 15, 1994, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations [hereinafter WTO Agreement], LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND [hereinafter RESULTS OF THE URUGUAY ROUND], 6, 6–18; 33 I.L.M. 1140, 1144–1153 (1994).
2. Renato Ruggiero, A Borderless World, Address to the OECD Ministerial Conference (Ottawa, Oct. 7, 1998), *available at* <http://www.wto.org/english/news_e/sprr_e/ott_e.htm> (last visited on Sep. 27, 2001).
3. Regarding the role of trade in the economic development of Korea, *see e.g.*, THE MULTILATERAL TRADING SYSTEM IN A GLOBALIZING WORLD (Lee-Jay Cho & Yoon Hyung Kim eds. 2000); TUN-JEN CHENG ET AL., INSTITUTIONS, ECONOMIC POLICY AND GROWTH IN THE REPUBLIC OF KOREA AND TAIWAN PROVINCE OF CHINA (1996); DAVID C. COLE ET AL., THE KOREAN ECONOMY: ISSUES OF DEVELOPMENT (1980).

imagine under circumstances in which each country seeks to regulate domestic social affairs in its own way, without regard to international norms.

This tension between free markets and state regulation, which is often termed 'interface,' 'linkage,' or 'trade and . . .,' inevitably leads to a dual crisis—trade failure *and* regulatory failure. In other words, the relationship between free trade and state regulations tends to be a zero sum game: if one is pushed too far, a benefit for one is likely to come at a cost to the other. Therefore, an essential mission of the global trading system is to reconcile clashes between these two paramount values. Against this backdrop, this book considers how this mission has been pursued in the field of international economic law, identifies problems with these existing approaches and, finally, attempts to offer a more compelling solution. Importantly, the book addresses the 'legitimacy' of the global trading system. It is suggested herein that a proper reconciliation of the clash will tend to make the system operate more smoothly and thus enhance its acceptability among governments, traders and other stakeholders alike.

The dawn of the modern global trading system dates back to 1947 when the General Agreement on Tariffs and Trade (GATT)[4] was launched as a pillar of the Bretton Woods system, which represented a new postwar international economic order. The framers of GATT realized the vital importance of a global free market after the painful and costly lessons of economic Balkanization, which had been pandemic during the interwar period and which eventually led to the outbreak of the Second World War. What the framers of the system sought to accomplish through GATT was to foster free trade by tariff reduction and to police self-defeating mercantilist protection. This *telos* of anti-protection or anti-mercantilism, which echoed the ideas of Lochnerism, was also backed by an economic philosophy rooted in Ricardian comparative advantage as well as in the economic liberalism of James Madison, who cautioned against heeding the egocentric voices of domestic interest groups. Moreover, as seen in the name 'General Agreement on Tariffs and Trade,' tariffs were at the heart of international trade when GATT was born. One of the main objectives of GATT was to provide contracting parties with a forum for continuous rounds of tariff reduction negotiations. Therefore, even the legal mechanisms of GATT, such as the National Treatment obligation, were originally meant to preserve the balance of tariff concessions, rather than to establish an independent set of norms.

This anti-protectionist *telos* and tariff-oriented structure eventually led to a built-in *pro*-trade bias in GATT itself. Non-trade social concerns, such as human health and environmental protection, have been treated as mere exceptions to general obligations, such as National Treatment or Prohibition of Quantitative Restriction. In other words, non-trade policy objectives have typically been taken into account only *after* general obligations are found to be violated, and not at the initial stage when general obligations are examined. This pro-trade bias, which stems from the textual dichotomy between general obligations and exceptions, was aggravated by another form of pro-trade bias embedded in the interpretive practice of GATT panels. Under the old GATT dispute settlement system, exceptions were interpreted

4. General Agreement on Tariffs and Trade, October 30, 1947, T.I.A.S. No. 1700, 55 U.N.T.S. 187 [hereinafter GATT 1947].

narrowly and underwent stringent tests, such as the 'least trade-restrictive means' test. Therefore, under the old GATT regime, social values tended to receive inferior consideration vis-à-vis the liberal, free market ideology enshrined in general obligations, a phenomenon which John Gerard Ruggie described as 'embedded liberalism.'[5] Surprisingly, not a single domestic regulation was justified under GATT Article XX (General Exception) before the WTO was launched.

In addition, the legacy of tariff negotiation and its item-by-item style led general jurisprudence under the old GATT to what may be termed a *product*-oriented approach, which was symbolized by the 'like product' test. This product-oriented jurisprudence tended to deflect interpretive attention from *measures*, which are nothing but domestic regulations for protecting certain social values. For instance, panels confronting GATT Article III:4 (National Treatment in Domestic Regulation) spent most of their interpretive energy in determining whether two products in question—domestic and imported—were alike. By contrast, interpretation of another important requirement, that is 'less favorable treatment,' was relatively marginalized and thus the scrutiny of measures suffered. Indeed, if GATT panels had consistently developed a jurisprudence anchored by measures, not products, then domestic regulations could potentially have been redeemed as non-discriminatory at the stage of Article III before going to the exception clause for justification.

Nevertheless, this pro-trade bias could not be sustained when the winds of change began to blow in the late eighties and early nineties. First, domestic regulations received greater attention than before. More domestic regulations have been issued in response to the popular demands of the welfare state as well as to novel risks associated with the creation of modern technology. Second, traditional trade policy measures, such as tariffs and quotas, have begun to vanish partly because tariffs were lowered dramatically and partly because governments realized that protection of certain domestic industries tended to be very costly, often harming the economic interests of their own citizens. Under these new circumstances, the original pro-trade bias, coupled with a tariff-oriented approach, if left unchanged, would have failed to properly address the new status quo, thereby de-legitimizing the global trading system.

Notwithstanding the potential value of domestic regulation for addressing certain legitimate social policy objectives, the repudiation of GATT's pro-trade bias need not result in the rejection of free trade as a basic value. In fact the proliferation of non-protectionist and legitimate domestic regulations has resulted in regulatory heterogeneity. This functions as a serious non-tariff barrier to the achievement of free trade. Moreover, the trade-restrictive nature of domestic regulations has only intensified as national economies have become more interdependent.

Consequently, the global trading system has come to require a new *telos*, capable of transcending the narrow purpose of anti-protection while at the same time connoting a much broader ideal of 'integration' that ensures that trade values and social values can be upheld not in a competing, but in a coherent and synergistic fashion. The foremost initiative for accommodating this new *telos* has appeared in the form of a new treaty-making process, namely the launch of the WTO Charter

5. John Gerard Ruggie, *International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order*, 36 INT. ORG. 379, 415 (1982).

and its side agreements, after several years of the Uruguay Round negotiations. The Preamble of the WTO Charter expresses the ideal of 'integration' and 'sustainable development,' which certainly goes beyond the narrow anti-protectionist motto embedded in the old GATT. Furthermore, a more concrete and positive attempt to address the clash between free trade and state regulation was conducted through independent agreements, such as the Agreement on Sanitary and Phytosanitary Measures (SPS)[6] and the Agreement on Technical Barriers to Trade (TBT).[7] The SPS Agreement, for instance, handles sophisticated regulatory issues such as harmonization and risk assessment in order to preserve the Members' regulatory autonomy while avoiding a negative impact on trade flows.

The new *telos* embedded in the WTO Charter was also reflected in the interpretive attitude of the Appellate Body, created as part of the new WTO dispute settlement mechanism. Facing typical cases concerning discriminatory domestic regulations or import bans, the Appellate Body has tackled the traditional pro-trade bias through a reinterpretation of GATT Article XX (General Exceptions). Under the old GATT, panels focused on the 'content' of a given domestic regulation itself in interpreting Article XX, which often resulted in a presumptive conclusion that such regulation was not 'necessary' or even rationally 'unrelated' to the furtherance of social values of the regulating state. This 'second-guessing' or negation of legitimate policy objectives often infuriated domestic policy-makers and thus diminished the perception of GATT's legitimacy.

However, the Appellate Body directed its interpretive focus to the 'manner' in which a certain domestic regulation is adopted or applied, and not to the regulation itself. In its jurisprudence, the Appellate Body has emphasized the function of the 'chapeau,' or preambular language in Article XX that prohibits arbitrary or unjustifiable discrimination, as well as other disguised restrictions to trade. Through the interpretation of the chapeau, the Appellate Body has decided on a case by case basis whether a given domestic regulation was applied consistently or whether it respected due process, rather than reinvestigating, on its accord, whether the substance of the regulation itself is necessary or related to the furtherance of the regulating states' social policy goals. The result of the chapeau test was to safeguard the Members' regulatory autonomy in that it acknowledged the legitimacy—namely, the necessity or relatedness—of a given domestic regulation to its policy goals. Even if the measure turned out to be a violation, the outcome would not be catastrophic but merely suspensive, demanding only a change of application, rather than a repeal of the regulation itself. In sum, the focus on the manner of application in the Appellate Body's jurisprudence tends to mitigate the pro-trade bias, because it guarantees free movement of goods as long as the Members exercise their regulatory autonomy in good faith, by consistently following their own internal administrative processes.

Importantly, one finds in the chapeau test implications that run much deeper than a mere interpretive change. First, the principle of good faith inherent in the chapeau,

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6. Agreement on Sanitary and Phytosanitary Measures, Annex 1 A, the WTO Agreement, *supra* note 1 [hereinafter SPS Agreement].
7. Agreement on Technical Barriers to Trade, Annex 1 A, the WTO Agreement, *supra* note 1 [hereinafter TBT Agreement].

which prevents Members' abuse of regulatory competence, represents 'general principles of law,' which are most often associated with the principles of equity, estoppel or consistency. Accordingly, the chapeau can rely on general principles of law as an interpretive guidepost, which tends to bestow greater legitimacy on the adjudicated outcome. Secondly, the chapeau test enables the Appellate Body to conduct a 'teleological' interpretation, transcending narrow textualism and reflects the emerging *telos* of the global trading system. In its interpretation of the very abstract language of the chapeau, the Appellate Body managed to imbue the new *telos*, such as 'integration' or 'sustainable development,' to its interpretation of the chapeau, leaving such important questions as 'duty to cooperate' or 'due process' to domestic administrative processes. Last, but not least, the chapeau test is linked to trade governance by virtue of its federalistic emphasis on establishing an integrated global marketplace while guaranteeing the regulatory autonomy of each Member.

Despite the foregoing jurisprudential evolution, the pro-trade bias resulting from the dichotomy still remains in the context of GATT 1994 because such dichotomy is textually structured in GATT Articles III:4 (National Treatment) and XX (General Exceptions). No matter how legitimate a domestic regulation may be, it is condemned as a violation of general obligations in the first place before it is eventually justified under the exception clause. This lingering pro-trade bias is addressed fundamentally under the side agreements, such as the SPS and the TBT. In pre-emptive fashion, the Preambles to both the SPS and the TBT emphasize that no country should be prevented from taking measures for the protection of human health or the environment. Moreover, legitimate regulatory concerns are no longer marginalized as mere 'exceptions,' but redefined as 'rights.' For instance, SPS Article 2.1 specifies that 'Members have the right to take sanitary and phytosanitary measures necessary for the protection of human, animal or plant life or health ....' At the same time, such autonomous rights are juxtaposed with various 'obligations,' such as SPS Articles 3.3 (scientific justification requirement) and 5.1 (risk assessment requirement), which mirror the chapeau test in focusing on the *manner* in which a domestic regulation is adopted and applied. Three cases, *Hormones* (1997),[8] *Australian Salmon* (1998)[9] and *Japanese Agricultural Products* (1999)[10] under the WTO dispute settlement mechanism, which concerned human, animal and plant health, respectively, have resulted in the development of a representative jurisprudence involving the SPS Agreement, and contributed to a sophisticated coherence and reconciliation between trade and regulatory values.

So far, we have found that the clash between the free market ideology and state regulation under the WTO system has been addressed through the jurisprudential

8. European Communities—Measures Affecting Meat and Meat Products (Hormones), WT/DS26, Appellate Body and the Panel Report, as modified, adopted on Feb. 13 1998, *available at* <http://www.wto.org/english/tratop_e/dispu_e/distab_e.htm> (last visited on Sep. 27, 2001) [hereinafter *Hormones* (1997)].
9. Australia—Measures Affecting Importation of Salmon, WT/DS18, Appellate Body and Panel Report, as modified, adopted on Nov. 6, 1998, *available at* <http://www.wto.org/english/tratop_e/dispu_e/distab_e.htm> (last visited on Sep. 27, 2001) [hereinafter *Australian Salmon* (1998)].
10. Japan—Measures Affecting Agricultural Products, WT/DS 76, Appellate Body and Panel Report, as modified, adopted on Mar. 19, 1999, *available at* <http://www.wto.org/english/tratop_e/dispu_e/distab_e.htm> (last visited on Sep. 27, 2001) [hereinafter *Japanese Agricultural Products* (1999)].