

Adapting Trade Policy to Social, Environmental, and Development Goals

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International trade law has been oblivious to social inclusion. One of the results has been a rise in neo-nationalism and the threat of trade wars. This proposal addresses how international trade law can be retooled in order to: help combat harmful tax competition, avoidance, and evasion; aid domestic social security and job retraining; support labor protection; discourage social dumping; and enable industrial policy experimentation for development. The proposal involves: pursuing tax cooperation and linking trade agreements to tax agreements; incorporating adjustment policies into trade agreements and adding monitoring mechanisms; enlarging trade negotiations over policy space; setting up procedural and transparency safeguards to prevent abuses and hidden protectionism.

Challenge

Globalization intensified in the 2000s. The global value chain (GVC) revolution (trading tasks and parts rather than goods) has been welcomed as a new path of development for the developing world, and seen as making WTO rules obsolete. This triggered a web of new bilateral and plurilateral trade agreements that would facilitate more efficient GVC operation. The agreements were to include commitments to low and preferably zero percent tariffs; efficient, transparent, and low-cost customs administration to get parts quickly across borders; investment protection to facilitate the decentralization of production; enhanced intellectual property protection; liberalization of services (including visas for temporary entry of business persons); harmonization and mutual recognition of regulatory standards to eliminate non-tariff barriers to trade; and competition norms to address abuses where GVCs operate. Transnational companies wanted and obtained legal provisions enabling them to coordinate their global operations and enhance their global competitiveness. In this way, they could more efficiently combine their capital and know-how with developing country labor to maximize profits.

However, these new opportunities have their downsides. Being able to produce and trade more efficiently from abroad, businesses can threaten to offshore jobs if workers insist on higher wages and better working conditions. Similarly, they play governments off each other, threatening to invest abroad if taxes on capital are not reduced and if subsidies are not increased. Their increased leverage threatens to erode governments' ability to fund social protection and educational and employment policies, while undermining labor's ability to bargain collectively. Agreements like the TransPacific Partnership (TPP) further facilitate the offshoring of tasks, thereby further favoring businesses over labor regarding employment terms, and businesses over government regarding state taxation and subsidization.

With the rise of neo-nationalism around the world and the threat of trade wars, the new trade policy mantra is that trade must be made more inclusive. But there is limited guidance on how to achieve that goal. The traditional trade policy approach comprises two steps. In the first step, countries sign international trade agreements to combat protectionist pressures and thereby mutually enhance the size of the national economic pie. In the second step, recognizing that trade creates "losers" as well as "winners," affecting who gets what part of the pie, countries support those harmed through domestic social policy.

Our thesis is that the traditional approach of calling for complementary domestic policy in parallel to trade liberalization is no longer sufficient, and that trade agreements should themselves be designed, directly and indirectly, to enable domestic policy choices over social policy (Shaffer 2019). We need new thinking to retool trade agreements to address the social challenges of rising inequality, wage erosion, and job precariousness, on the one hand, and policy space for experimentalist development initiatives, on the other. It will not be an easy process to retool trade agreements to help ensure social inclusion through these means, but the current system otherwise could unravel.

The main challenges for the existing trade system in light of economic globalization are three-fold: challenges to the fiscal state and thus the state's capacity to implement social policy; concerns over social dumping; and the need for flexibility for experimentation in development policy. The first reflects changes in the relation between global business and the state, the second the relation between global business and labor, and the third the relation of international rules and national development policy.

Proposal

1. Reaffirm the purposes of trade agreements. Before addressing how trade agreements may be retooled, we need to clarify what are and should be the purposes of a multilateral organization for trade like the World Trade Organization (WTO). To characterize the purpose solely as the narrow goal of pursuing "free trade" is mistaken.

The core purposes of the WTO are four-fold. First, the WTO provides a *multilateral forum* for the creation, revision, and monitoring of compliance with rules for international trade. It is through a basic institutional framework of rules that social cooperation, economic coordination, and business planning take place. Second and more specifically, trade agreements create rules that can *increase standards of living*, as trade liberalization enables a more efficient use of domestic and global resources. Trade liberalization, however, is not an end in itself, but rather a means. Third, these rules and institutions help countries address the *externalities* of their behavior on each other. Each country's protectionist policies to address its view of its respective needs has impacts on others. Fourth, the WTO creates a mechanism for *institutionalized dispute settlement* so that political disputes over the implementation and interpretation of agreements are resolved through a neutral third-party legal institution. Opportunistic, self-serving interpretations of rules are thereby constrained, disagreements turned over to a third party, and uncertainties clarified. These goals are inter-related and should be advanced in a mutually supportive manner.

Overall, we need to rethink the organizing principle of trade agreements in relation to these purposes. That principle should be to enhance social and individual capacity in support of human flourishing. If this organizing principle is not advanced, then the overall system could be at risk.

2. Retooling trade agreements. Thus, in complement, trade agreements should be designed and conditioned upon tax and social policy to ensure that they are supportive of social inclusion. They should include, or be conditioned upon, agreements that (i) help combat harmful tax competition, avoidance, and evasion, thus in support of the financing of government programs; (ii) aid domestic social security and job retraining; (iii) support labor protection; (iv) disincentivize social dumping; and (v) enable industrial policy experimentation for development.

a. Pursue tax cooperation and link trade agreements to tax agreements. Tax policy becomes more directly linked with trade policy when globalization processes constrain governments' fiscal choices. To attract investment, governments have reduced taxes on corporate income earned within their borders. In parallel, investors and other high-net-worth individuals have taken advantage of tax arbitrage opportunities to allocate income to low-tax jurisdictions through creative lawyering, use of tax havens, and tax secrecy laws that prohibit cooperation with public authorities. This tax competition and use of tax havens undermines a main source of revenue for modern welfare states, so that the state is less able to provide social security and job retraining to benefit those adversely affected by economic globalization. This problem is particularly severe for developing countries.

Structurally, states must overcome collective action problems and coordinate if they are to effectively combat harmful tax competition and protect state tax sovereignty. Enhanced domestic labor and social welfare policies are not rendered impossible by globalization, but the current system supports the free flow of capital, goods, and services that make these policies more difficult to pursue. The policies will be facilitated if harmful tax competition is constrained and the tax base increased through inter-state coordination. Trade agreements could be conditioned on separately negotiated international tax agreements, which could be incorporated by reference to them.

b. Incorporate adjustment policies into trade agreements and add monitoring mechanisms. Adjustment policies are needed to offset the risks of economic globalization and rapid technological change. Since it is politically easier to blame trade involving foreigners than technology, these policies can help protect the international trade legal order itself.

Countries will vary in their preferences, but they need policy space to provide basic health care, some form of basic guaranteed income (including but not limited to retirement and disability income), housing, child support, public education, and job training. Long-term employment is increasingly vulnerable in a globalized world characterized by rapid technological change. Given the increased risks of employment shocks for an increasing number of workers, support for trade liberal policies should be conditioned on the development of job flexicurity policies. Flexicurity policies aim to combine labor market flexibility, lifelong learning, active labor market policy, and social security. Flexibility is required to ease economic adjustment and enhance labor accountability. Lifelong learning facilitates job transitions by enhancing individual capacity. Active labor market policies provide the unemployed with rights, complemented by duties.

Traditionally, trade adjustment policies have been a matter solely of domestic concern. The problem with these programs has been two-fold. First, the programs are narrow in their focus, and fail to address the interconnections of rapid technological change and trade. As a result, they have been far from sufficient to address the increased precariousness of work. Second, there is nothing that guarantees that a future legislature will not curtail or eliminate the benefits, and so they have often been cut back after a trade agreement enters into force.

To ensure ongoing domestic and international support for an open trading system, a commitment to redistribute the gains from trade could be incorporated into trade agreements themselves (Meyer 2017). In this way, governments would make commitments more credible not only to workers but also to their trading partners, which otherwise would be concerned about trade restrictions.

One can envisage different kinds of obligations in a trade agreement, such as:

- (i) a fiscal obligation on countries to enact substantive policies to redistribute the gains from trade domestically;
- (ii) an obligation to report to an Economic Development Committee of experts created under the agreement, which would independently gather data on the impacts of trade within the country; and
- (iii) a dispute settlement mechanism to enforce the commitment, which could lead to the suspension of trade concessions. Even if a sanctioning mechanism is not included or used, the mere creation of reporting requirements can spur the preparation of shadow reports by labor organizations and civil society organizations to keep governments accountable, which can play into domestic politics.
- (iv) In complement, a small financial transaction tax on the value of currency or securities sales (say less than 0.1 percent) to help fund such policies (Garcia & Meyer 2017).

c. Enlarge trade negotiations over policy space to prevent social dumping and enable development One can envisage a new form of bargaining in trade negotiations that involves negotiations over policy space as well as over market access. The negotiations could involve the provision of greater policy space for developed countries to uphold the 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. The problem with such policies, however, is that they can impose significant externalities on outsiders. These externalities can be subject to bargaining, as is the case with any rule. The challenge is to operationalize the concept of negotiating over policy space while limiting the risks of protectionist abuse.

(i) *Protection against social and environmental dumping* The much maligned TPP went further than previous agreements by creating minimum labor standards coupled with an agreement with Vietnam to condition the implementation of trade commitments on them. These provisions provide a baseline that can be adapted to protect against social dumping more broadly. However, if such provisions are to be incorporated into trade agreements, they must be subject to strict procedural, substantive, and injury requirements in order to combat abuse.

The first challenge with implementing this proposal is to specify when violations of labor norms occur so that a country may impose tariffs as a social safeguard. The criteria chosen would build from experience with existing labor chapters in trade agreements, including the TPP; one could also cite the language around women and trade in the Canada-Chile FTA as an example of how extant trade agreements can be revisited to incorporate social concerns. Environmental norms can also be incorporated similarly—for instance, the border tax adjustments for carbon are an example of the sort of initiative the G20 might put its weight behind (Paneza 2015). A country deciding to impose duties would need to show violations of agreed norms. The list of labor norms would include freedom of association and collective bargaining, elimination of discrimination, prohibition of forced labor, elimination of child labor, enforcement of occupational health and safety standards, and establishment of maximum working hours and a minimum wage.

A second challenge is obtaining evidence establishing labor rights violations. 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 its case against Guatemala case under the Central America Free Trade Agreement (CAFTA). A key difference between this proposal and the CAFTA text is that the petitioner bringing the domestic social safeguard action need not prove a causal link between the labor rights violations and increased imports, which is extremely difficult to show given the number of potential causal factors that can explain trade patterns. Rather, a petitioner only needs to show a correlation between the violation of the specified labor rights, and an increase of imports of the products from the country in question that causes or threatens to cause material injury to the domestic industry.

A third challenge is to determine the amount of duties that may be imposed. Duties could be limited to those needed to offset the amount of the injury to the domestic industry caused by the imports from the country in question.

Subject to these procedural, substantive, and injury requirements, a country could impose a social dumping duty. Such a system would shift leverage to the importing state to protect its social contract, in contrast to current trade agreements that only provide the ability to bring a claim against the party violating the labor clause. In practice, as under the antidumping regime, the initiation of the investigation would trigger negotiations between the party subject to the investigation and the investigating authority. In this case, however, the negotiations would transparently address the issue of labor rights violations, potentially leading to agreements to enhance labor protections and thus more directly benefit the exporting country's workers. Remedies could directly target the source of concern in the exporting country through measures to enhance labor protections and their enforcement. Compliance with the agreement could be overseen by a committee (as with all WTO agreements), and representatives of the ILO could be granted observer (or official) status within it.

(ii) *Industrial policy space for developing countries.* There is more than one way to catalyze economic development, and considerable pragmatic policy experimentation is needed since no one knows in advance what works. This is particularly the case given the vastly differing contexts that countries face. Developing countries could demand such enhanced policy space for development initiatives in return for provisions authorizing social safeguards measures. Since industrial policy of one country will have externalities on others, criteria need to be specified as part of a bargain. 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 productivity, and not to compensate for low productivity, and that they must set forth clear criteria for success so that they can be evaluated.

Special authorization for industrial policy experimentation could be limited to developing countries that meet defined World Bank criteria in terms of per capita income, subject to industrial 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. Time limits could be agreed so that ineffective programs are abandoned and replaced.

The country adopting such a measure would have to report its program. The failure to report could trigger a suspension of benefits, including use of the policy until compliance occurs. Such a sanction would incentivize reporting in ways that the current WTO agreements do 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 to know what governments are doing. 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.

3. Conclusion. International trade law traditionally was oblivious to social inclusion and environmental protection. There is growing recognition that this must change. Although international trade law is not primarily to blame for rising job insecurity and stagnant wages, it is not wholly innocent either. International trade law implicates social equality, solidarity, and inclusion.

It will not be easy to retool trade agreements for social inclusion, but 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 underlying social and development issues are addressed transparently and not glossed over. An implication of this analysis is that trade negotiators must be better connected with other Ministers in their home country than they currently are.

The old, ensconced idea to leave social and redistributive policy solely to the domestic level while liberalizing trade and constraining states' policy space through trade agreements threatens to undermine domestic social solidarity and, as a result, the international trading system itself. Under the current threats of trade wars, redesigning the international trading system is needed to save it.

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